Improving lives with **smart infrastructure solutions**

Costain Group PLC

Annual Report
and Accounts 2018

Costain is a smart infrastructure solutions company

Our people

This report features people from around our business as they help to deliver smart infrastructure solutions.

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

Highlights

Strong performance driven by smart solutions

Our successful performance in 2018 marks our step into a new era for Costain as we continue to differentiate ourselves as a smart infrastructure solutions company.

We achieved another strong performance with an increase in underlying operating profit, enhanced margins, a record order book and an 8% increase in dividend for 2018.

Underpinning our success is our strategy to position ourselves at the forefront of the revolution in technology impacting our markets. We expertly integrate consultancy, technology, asset optimisation and complex delivery services, building long-term strategic partnerships with our clients to deliver their increasingly large and complex infrastructure programmes.

Underlying[1] profit before tax

£49.7m

2018	**49.7**
2017	43.8*
2016	37.5

Reported
£40.2m

Underlying[1] operating profit

£52.5m

2018	**52.5**
2017	49.1*
2016	41.1

Reported
£43.1m

Revenue
(including share of joint ventures and associates)

£1,489.3m

2018	**1,489.3**
2017	1,728.9
2016	1,658.0

Reported
£1,463.7m

Underlying[1] basic earnings per share

38.2p

2018	**38.2**
2017	32.9*
2016	31.5

Reported
30.9p

Total dividend per share

15.15p

2018	**15.15**
2017	14.00
2016	12.70

Net cash balance[2]

£118.8m

2018	**118.8**
2017	177.7
2016	140.2

Positive outlook

- Record higher-quality order book of £4.2 billion, with over 90% repeat business.
- Continuing differentiation into the UK's leading smart infrastructure solutions company.
- Focus on long-term client relationships and integrated technology-enabled services.
- Proactive alignment with rapidly-changing market and increasing complexity of client demands.
- Continued involvement in major regulatory-driven procurement processes across our target markets.
- Robust and enhanced balance sheet enabling participation in longer-term and larger strategic contract relationships.

Order book

£4.2bn

2018	**4.2**
2017	3.9
2016	3.9

* 2017 has been restated in accordance with common practice to reflect the decision to change the accounting treatment of Research and Development Expenditure credits (RDEC) which is a reclassification between operating profit and taxation. The 2017 reported basic earnings per share of 31.1p remains unchanged as a result of the restatement.

1 Before other items; amortisation of acquired intangible assets, employment related deferred consideration, an exceptional one-off pension charge of £8.6 million in respect of the equalisation of Guaranteed Minimum Pensions (GMP) impacting UK companies with defined benefit pension schemes and a £2.6 million credit (2017: £2.5 million credit) for the reassessment of the accounting treatment of RDEC.

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

Company Overview

Our story

We improve lives with smart infrastructure solutions

What we do

We deliver integrated smart solutions to meet urgent infrastructure needs across the UK.

Why we do it

We help to safeguard the security, increase the capacity, improve customer service and drive efficiency in our clients' infrastructure programmes.

We power communities

ENERGY

Find out more on **page 08**

We keep the water flowing

WATER

Find out more on **page 10**

We keep the nation moving

TRANSPORTATION

Find out more on **page 12**

Our strategy

Our strategy is to focus on blue-chip clients whose major spending plans are underpinned by strategic national needs, regulatory commitments or essential maintenance requirements. Our five strategic priorities drive continued progress and differentiation.

Achieve sustainable growth in profit

Deliver value and innovation for our clients

Broaden our integrated service delivery

Operate responsibly and safely

Attract and develop new skills

→ see our strategic overview and performance on **page 26**

How we do it

Our expertise in the integration of technology, consultancy, asset optimisation and complex delivery positions us at the forefront of a rapidly-changing market environment.

Technology

Consultancy

Asset optimisation

Complex delivery

Our culture and values underpin everything we do.

→ see our business model on **page 24**

Our people

3,736

across the UK

BIM managers | Consultants | Project managers | Environmental scientists | Designers | Programme managers | Engineers | Technologists | Data analysts | Quantity surveyors

Why Invest in Costain?

Our expertise in technology integration, consultancy, asset optimisation and complex delivery positions us at the forefront of a rapidly-changing market environment

We have a track record of sustained growth in profit and shareholder returns. We develop strategic long-term relationships with blue-chip clients leading to over 90% repeat business.

Addressable market spend

£21bn pa

Focused strategy

- Focus on blue-chip client spend underpinned by regulation, legislation or strategic national needs.
- Revolution in technology is changing markets rapidly and presenting significant opportunity.
- Growing by broadening our integrated, technology-led service offering.

Find out more on **page 26**

Sustained underlying profit growth

8 years

Financial strength

- Track record of sustained underlying profit and margin growth.
- Strong balance sheet and positive net cash position.
- Sustained growth in returns to shareholders.

Find out more on **page 112**

Our people

- Highly skilled and experienced leadership team.
- Broadening mix of skills and diversity across our workforce.
- Attracting industry-leading talent and investing in development.

% of our people in consultancy and technology roles

34%

Line managers trained in mental health awareness

980+

Responsible business

- Committed to the highest Safety, Health and Environment (SHE) standards and to operating sustainably, ethically and inclusively.
- Robust corporate governance and risk management processes.
- Supporting local communities and providing a positive lasting legacy.

Find out more on **page 30**

Repeat business

90+%

Strategic client relationships

- Record £4.2 billion order book underpinning confidence in future performance.
- Over 85% client satisfaction.
- Trusted to deliver innovative solutions to complex infrastructure challenges.

Market Overview

Our markets are changing fast and creating new opportunities

The revolution in technology currently underway across infrastructure is fundamentally changing our markets. Client expenditure is moving away from the construction of new assets, with a greater proportion directed towards the optimisation of existing infrastructure, using technology to provide insight, step-change improvements and efficient delivery.

We estimate that our clients will spend around £91 billion per annum, of which approximately £21 billion per annum is on the technology-led services that we deliver. Our markets have common requirements, underpinned by strategic national needs, regulatory commitments or essential maintenance requirements, to safeguard the security, increase the capacity, improve customer service and drive efficiency across our clients' infrastructure assets.

ENERGY

WATER

TRANSPORTATION

REQUIREMENT

Ensure security of supply

Improve customer service

Increase capacity

Enhance efficiency

Total market spend

c £91bn pa

Addressable market spend

c £21bn

Energy market spend

c £47.9bn pa

Water market spend

c £10.5bn pa

Transportation market spend

c £32.8bn pa

GOVERNMENT AND REGULATOR ACTION

Tightening of legislation and raising the performance bar to improve the country's infrastructure and people's lives

CHALLENGES

- Optimisation of existing networks
- Legislation and regulation
- Value-for-money criteria
- Budget prioritisation

AREAS OF FOCUS

ENERGY
- Decarbonisation
- Decentralisation
- Digitisation

Find out more on **page 08**

WATER
- Reduced leakage
- Improved customer service
- Intelligent asset optimisation

Find out more on **page 10**

TRANSPORTATION
- Smart motorways
- Digital railway
- Smart mobility

Find out more on **page 12**

Clients are consolidating their supply chains and demanding technology-enabled smart infrastructure solutions

Market Overview

ENERGY

We power communities

Costain's nuclear team is at the heart of a number of nationally strategic programmes in nuclear new-build and generation; delivering energy security for the UK, decommissioning; dealing with the UK's nuclear legacy and defence; supporting the security of our nation.

Our oil and gas team is shaping the future of the UK's energy industry by helping our clients to optimise business value from their critical onshore and offshore assets, and taking a leading position in developing solutions to address the urgent UK decarbonisation imperative.

Our power team is ensuring the energy companies build greater resilience and transition from centralised to decentralised energy systems.

RIIO-1 (2013–2023) TOTEX of c £60 billion with emphasis on innovation to deliver a smarter, sustainable energy network for a low carbon future.

Market Overview

WATER

We keep the water flowing

Costain is supporting its water sector clients to improve and maintain water quality standards, enhance supply resilience and meet anticipated demographic shifts. This requires a step change in efficiency and will be delivered through innovative application, new technologies, intelligent asset optimisation, data analytics and increasing connectivity between assets and control.

Need for step change in customer service, cost efficiency and leakage reduction in AMP7 (2020–2025) with TOTEX of £50 billion (an increase from £44 billion in AMP6), with emphasis on asset optimisation and utilisation of technology.

Market Overview

TRANSPORTATION

We keep the nation moving

The UK Government's vision for the strategic road network is that it supports the economy, is safer and more reliable, greener, more integrated and smarter. More consistent and reliable journey times are demanded while reducing the number of people killed or seriously injured. This will mean a 'roads revolution' based on a range of new vehicle and infrastructure technologies which will transform the way our highways are used and maintained.

Costain continues to contribute to increasing the capacity, improving journey times and enhancing safety across the UK's strategic road network.

The Autumn 2018 budget confirmed c £25 billion investment in roads for the period from 2020–2025, with emphasis on modernisation and automation.

Market Overview

TRANSPORTATION

We keep the nation moving

The rail sector in the UK is changing rapidly. Network Rail is introducing new digital technologies to increase the capacity and performance of the network and to improve the experience of their customers.

Costain is delivering significant programmes to enhance and improve the nation's rail network.

Record £47 billion programme proposed for Control Period 6 (2019–2024) to reduce delays and improve infrastructure reliability, for transformation into a digital railway.

Chair's Statement

We have delivered growth in underlying profit, enhanced margins and a record order book.

Dr Paul Golby CBE
Chair

I am pleased to report that Costain has delivered another strong performance in the year, with continued growth in underlying profit, enhanced margins, and a record order book.

The Group has made significant progress on its transformation, developing a strong and increasingly differentiated position in a rapidly-evolving market environment by providing smart infrastructure solutions that expertly integrate consultancy, complex delivery, technology and asset optimisation services.

This is strategically positioning Costain at the forefront of the technology revolution underway across infrastructure and underpins our ambition for further growth.

Dividend

The Board recognises the importance of regular dividends to shareholders and, as announced in August, has reviewed its dividend policy following the Group's continued strong performance. Reflecting the historical and expected future pay-out ratio, going forward the Group will target dividend cover of around 2.5 times underlying earnings. The Board is committed to growing the dividend in line with earnings over the medium term.

Costain is strategically positioned at the forefront of the technology revolution underway across infrastructure

Our strong performance and confidence in the Group's future opportunities have resulted in the Board recommending a final dividend of 10.0 pence per share (2017: 9.25 pence) which, if approved, will be paid on 17 May 2019 to shareholders on the register as at the close of business on 12 April 2019. This represents an increase of 8% in the total dividend for the year to 15.15 pence per share (2017: 14.0 pence).

Governance

At Costain we have a Board committed to the highest standards of governance. Our annual report will set out and explain the processes we have in place to deliver long-term success while also ensuring that the Company complies with all applicable laws and regulations and meets the requirements of our stakeholders.

We measure the Board's effectiveness by holding an externally facilitated evaluation every three years, the most recent of which was in 2017, which found the Board to be well-functioning and effective. An internal evaluation was held during the year which reiterated that conclusion and monitored progress on actions to help ensure the speed of transformation and organisational development is maintained.

We welcome the changes to the Corporate Governance Code, which came into effect for reporting periods starting 1 January 2019 and as appropriate we are adapting to practices required by the code and will report on these in due course.

Board and people

We announced today that Andrew Wyllie CBE, after 14 years as chief executive of the Company, is retiring to pursue a non-executive career. He recently took up the presidency of the Institution of Civil Engineers and is a non-executive director of Yorkshire Water Services. Alex Vaughan, currently managing director of the Group's natural resources division, will be appointed as CEO with effect from the conclusion of the Company's Annual General Meeting (AGM) on 7 May 2019.

Find out more about Governance on **page 58**

I would like to thank Andrew for everything that he has done for the business and to wish him and his family well for the future. Andrew can feel extremely proud of what he has achieved at Costain. He leaves the Group in good health, the result of the growth strategy which he and his colleagues have been implementing for the last 14 years. We are delighted that Alex will be taking over. He has played a major role in the development of the Group and the implementation of its strategy and has the expertise and ambition to deliver the future growth of the business.

As previously announced, and as part of our planned Board succession, James Morley retired as a non-executive director of the Company, and as senior independent director, on 8 May 2018 after the conclusion of the Group's AGM. Jane Lodge was appointed to act as the Company's senior independent director with effect from the conclusion of the 2018 AGM. I would once again like to thank James for more than 10 years of dedicated service to Costain, during which time he has made a significant contribution, and wish him well for the future.

The success of any company is down to the quality of its leadership and the depth of talented and skilled people throughout the organisation. On behalf of the Board, I would also like to thank all of our people for their commitment, dedication and hard work. The strong results we have achieved over several years and the positive outlook for the future would not be possible without them.

Corporate citizenship

Driven by our values, we take seriously our wider corporate responsibility and the role the business plays in society. This corporate perspective is also integral to the development of long-term relationships with our blue-chip clients who increasingly place a demonstrable commitment to corporate responsibility high on their selection criteria for preferred suppliers.

Outlook

This has been a year of continued progress at Costain. The business has delivered another set of strong results with further growth in underlying profit at enhanced margins. We also ended the year with a record higher-quality order book of £4.2 billion.

This success has been driven by providing smart infrastructure solutions which expertly integrate consultancy, complex delivery, technology and asset optimisation services. Costain is at the forefront of the rapidly-evolving UK infrastructure market, working with its clients on a long-term, strategic basis to deliver their progressively large and more complex investment programmes. This increasingly differentiated strategic positioning underpins our ambition for continued growth.

With a clear purpose, strategy and record order book, I look forward to reporting on future progress.

Dr Paul Golby CBE
Chair

6 March 2019

Chief Executive's Statement

Fourth industrial revolution is defining a new era for Costain

I am pleased to report that we have delivered another strong performance and continued to progress as a business.

We are fulfilling our purpose by improving millions of people's lives across the UK through the deployment of technology-based engineering solutions to address urgent national infrastructure needs in transportation, water and energy.

Our strong trading performance is the consequence of the implementation of our focused and ambitious strategy, our enhanced market differentiation and robust financial management.

We are operating in a dynamic and rapidly-changing market environment influenced by major demographic, economic, social and technology trends which are creating a wide array of exciting new business opportunities for the Group.

Another strong trading performance

Results

The 'Costain Way' business management system ensures the rigorous application of policies and procedures across the Group governing a robust approach to opportunity assessment, continual monitoring of contract and operational performance and effective financial management.

The planned further improvement in operating margins ensured that underlying operating profit increased 7% to £52.5 million (2017: £49.1 million). The reported operating profit was £43.1 million (2017: £47.2 million).

The term 'underlying' throughout this document excludes the following items: amortisation of acquired intangible assets, employment related deferred consideration on acquisitions, an exceptional one-off pension charge of £8.6 million in respect of the equalisation of Guaranteed Minimum Pensions impacting UK companies with defined benefit pension schemes and a £2.6 million credit (2017: £2.5 million credit) for the reassessment of the accounting treatment of Research and Development Expenditure Credits (RDEC).

Revenue, including the Group's share of joint ventures and associates, for the year was £1,489.3 million (2017: £1,728.9 million) reflecting a lower level of capital project activity in the year, in line with our strategic change in mix of activities.

Underlying profit before tax increased to £49.7 million (2017: £43.8 million) and underlying basic earnings per share increased to 38.2 pence (2017: 32.9 pence). Reported profit before tax was £40.2million (2017: £41.8 million) and reported earnings per share were 30.9 pence (2017: 31.1 pence).

Our divisional target blended underlying operating profit margin range remains 4%–5%, and we expect to be operating towards the upper end of that range within the next three years. In 2019 we are targeting further increase in profit with an enhanced margin on a lower revenue profile, reflecting our changing mix of activities and the timing of major regulatory-driven investment programmes, with anticipated revenue growth in 2020.

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

Our record, higher-quality order book reflects the changing nature of client spend.

Andrew Wyllie CBE
Chief Executive

c 1,300 people in consultancy and technology roles, up 300% in three years

3,736 people

Chartered professionals across a wide range of disciplines

600+

22% of senior managers are female, up from 10% in 2014

22%

Chief Executive's Statement continued

Record order book

The Group ended the year with a record higher-quality order book of £4.2 billion, reflecting our differentiation and strong market positions. We secured over £1.8 billion of new contract awards and extensions to existing contracts during the year. The order book, which contains over 90% target cost, cost reimbursable contracts, continues to evolve, reflecting our strategic positioning in a rapidly-changing market environment.

In the second half of the year, the Group notably secured a leading place on a six-year framework contract by Highways England to deliver its Regional Investment Programme. One of the key reasons for our success was our ability to meet Highways England's required outcomes through the application of technology-led solutions; digital modelling, improved productivity through our smart delivery platform and data analytics for customer insights.

Technology contracts won in the year evidence the growing importance of technology integration in our markets, reflected in the changing nature of the requirements and spending profile of our clients.

As a consequence of our focus on developing long-term strategic relationships with blue-chip clients, over 90% of the order book comprises repeat business. In addition, the Group has an increased preferred bidder position of c £600 million (2017: £400 million).

As at 31 December 2018, the Group had secured c £0.9 billion of revenue for 2019 (31 December 2017: c £1.1 billion secured for 2018).

The order book provides good medium and long-term visibility and underpins our confidence in the Group's future performance.

Strong balance sheet and robust financial management

A strong balance sheet is paramount to the success of the Group. Evidence of financial strength and robust financial management are prerequisites for qualification with our major clients who are consolidating their supply chains and placing larger long-term contracts to undertake multi-billion pound, multi-year investment programmes.

Costain finished the year with a positive net cash balance of £118.8 million, in line with expectations (31 December 2017: £177.7 million), with the reduction from last year's exceptionally high level due to the timing of receipts in that period.

Throughout the year the Group had a positive net cash position with an average month-end net cash balance of £77.1 million (2017: £96.7 million). The period-end and month-end balances have reduced due to a lower level of revenue and therefore cash flow receipts and payments during the year. Going forward average month-end and period-end net cash positions are anticipated to trend closer to each other.

In December 2017, the Group successfully increased and extended its total banking debt facilities to £191.0 million, which now have a maturity date of June 2022.
The Group maintains a regular, constructive dialogue with its banking syndicate who remain highly supportive of the business and its significant opportunities. In addition, the Group has in place committed and uncommitted bonding facilities of £320.0 million.

The Board believes that the Group's balance sheet, banking and bonding facilities align the composition and structure of the Group's funding with its prevailing strategic, operational and investment priorities.

Training and development

103,500 hours

Order book

£4.2bn

Money raised for charitable causes

£199k

Dynamic and rapidly-changing market environment

We are entering a new era for Costain, an era defined by the start of the Fourth Industrial Revolution.

The Fourth Industrial Revolution is now having a global impact and is characterised by a fusion of technology breakthroughs that are blurring the lines between the physical, digital and biological spheres. These breakthroughs are occurring in a number of fields including artificial intelligence, robotics, nanotechnology, quantum computing and biotechnology.

These developments are creating a range of new possibilities, and consequently we are now seeing a stream of new policy announcements, product developments and service enhancements.

In highways for example, we have recently seen the introduction of a UK ban on the sale of petrol and diesel cars from 2040, accelerated in Scotland to 2032. In the year, we saw the introduction of the UK's first `Electric Streets' scheme, banning the use of petrol and diesel vehicles on nine roads in the City of London. During the year BMW also launched the trial of its ReachNow `mobility as a service' offering in Seattle to compete with Uber and Lyft. The foremost vehicle manufacturers have launched various new electric models in the last year.

All of these developments are having a profound impact on transport infrastructure, and the associated market participants, and are stimulating a fundamental re-think about how national infrastructure is provided. We are therefore seeing a rapid change in the spending patterns of our clients, with the deployment of emerging technology being core to their next generation of infrastructure solutions.

We are strategically positioning Costain at the forefront of this revolution, transforming the business into a leading smart infrastructure solutions company. This differentiation is allowing us to seize the wide array of exciting opportunities being created for our business. Our considerable expertise across the integration of technology, consultancy, asset optimisation and complex delivery services places Costain well in this rapidly-evolving market.

During the year, we have benefited from the start of a new generation of smart infrastructure contract awards, including delivering the first phase of the A2/M2 Connected Corridor, and participating in the Midlands Future Mobility testbed programme.

Helping the UK to achieve decarbonisation targets with hydrogen

We are working with SGN on the groundbreaking H100 project, which aims to demonstrate how hydrogen can be distributed in a safe, secure and reliable way. Our feasibility and front end design work will help to identify the optimum location for the construction of a hydrogen demonstration facility. The gas network supplies the energy to heat 82% of the UK's buildings, and so this can make a major contribution to meeting the UK's decarbonisation targets, by establishing the evidence base required to support the use of hydrogen for decarbonisation.

Chief Executive's Statement continued

To meet this ever-greater urgency and complexity in delivering the UK's infrastructure needs, our major clients are also consolidating their supply chains by investing in increasingly long-term, collaborative multi-billion-pound programmes and service enhancements, underpinned by redefined legislative and regulatory imperatives.

Costain is therefore actively involved in a number of major, regulatory-driven procurement processes including the c £25 billion Highways England's Road Period 2 (2020–2025), the AMP7 (2020–2025) programme in the water sector with an expected Totex of c £50 billion, the RIIO-1 c £60 billion (2013–2023) programme in the energy sector and the record £47 billion Control Period 6 (2019–2024) for Network Rail.

These changing client trends are why we are also continuing to invest in our skills, services and capabilities, both organically and by targeted acquisition.

We have continued to develop the strength and experience of our outstanding team with c 1,300 of our people working in consultancy or technology roles, representing over one third of our total headcount. We now have over 600 chartered professionals across a wide range of disciplines and also sponsor 25 PhD students who are undertaking leading-edge and targeted research at renowned universities including Cambridge, Imperial College and Edinburgh.

In line with society's rapidly-changing attitude toward equality, diversity and inclusion, I am delighted to advise that for the first time in Costain's history, more than half of our graduate intake in the year was female. We have also made significant progress at the senior level with one third of our Executive Board being female. We were delighted to receive for the first time in the year, The Times newspapers' Top 50 Employers for Women award.

To further support the development of our technology capability, we are relocating to an enlarged technology centre in Somerset where some 150 dedicated staff will develop cutting edge technology solutions for application across all our operations in water, transportation and energy.

While there remains uncertainty about the precise terms of Brexit, we have considered the impact on our business as part of our risk management. We believe that because of our long-term regulated contract relationships with our clients, and over 90% cost reimbursable contracts in our order book, our business model will remain resilient under the range of most likely scenarios.

This dynamic and rapidly-changing market environment is creating a huge and exciting opportunity for Costain, and with a focused strategy, outstanding team and strong balance sheet, we are well-placed to capitalise on the opportunities.

Costain Cares

The management of Safety, Health and Environment is a core value at Costain. Through the dedicated and diligent efforts of the whole team, the Group's Accident Frequency Rate (AFR) in the year was 0.03, which is our best-ever performance and places us at the leading edge of our industry peer group.

We have now launched our Wellbeing Safety Environment Strategy (WiiSE) and objectives for 2019. This strategy aims to further raise the bar in terms of our health and safety performance.

During the year, the Company was fined for a safety incident which occurred in 2015 while undertaking work on a waste water treatment plant. A full investigation was held following the incident and the lessons learnt implemented across the Group.

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

Throughout the year we continued to prioritise the health and wellbeing of the Costain team. Initiatives included recognising and supporting improved mental health, encouraging flexible working and fundamentally re-evaluating traditional working practices.

We are firmly committed to gender equality in the workplace. Across our business we are confident that men and women are paid equally for doing equivalent roles. Our gender pay gap has reduced to 24.25% but still reflects fewer women in senior leadership positions. We continue to work hard to address this and are confident of making further progress in the gender balance of the Group

Improving the safety and reliability of our strategic road network

We are providing the technology to power pioneering work led by Highways England to transform journeys by allowing connected and autonomous vehicles (CAVs) and roads to 'talk' to each other. This was tested for the first time on the live network on the high-tech corridor being created on the A2/M2 in Kent. We brought together industry leading technology partners from across Europe and delivered an integrated end-to-end system.

to reduce our gender pay gap. For more information please download the report from our website www.costain.com.

The Costain Charitable Foundation is the focus of the range of charitable and community work we undertake, both individually and as a Group. I am pleased to report that we raised nearly £200,000 for charitable causes in 2018.

Well-positioned for the future

This has been a year of further progress at Costain. The business has delivered another strong result with growth in underlying profit and an improved margin performance, as well as ending the year with a record higher-quality order book of £4.2 billion.

Costain is entering a new era, with the Group winning a growing number of technology-enabled contract awards, evidencing the changing nature of our clients' requirements. Our expertise across the integration of technology, consultancy, asset optimisation and complex delivery services positions us at the forefront of the rapidly-evolving UK infrastructure market, working with our clients on a long-term, strategic basis to deliver their increasingly large and complex investment programmes.

It has been a great privilege for me to be chief executive of Costain for the last 14 years. Much has been achieved over that time as a result of the combined efforts of an outstanding team and I would like to thank my colleagues for their support and commitment. With a clear strategy, strong balance sheet and record order book, the business is in an excellent position to deliver further growth in the future.

Andrew Wyllie CBE
Chief Executive

6 March 2019

Business Model

Focused markets and integrated, technology-enabled services

Our market sectors

Our integrated services

How we operate

Responsible working

We are focused on continuing to operate a sustainable business that creates economic, environmental and social value and delivers tangible benefits for our stakeholders.

Read more on **page 30**

Embedded values and culture

Our culture and values underpin everything we do.

www.costain.com/our-culture

Find out more about engaging with our stakeholders on pages 36 and 37

Sources of competitive advantage

Smart technology
We invest in research, innovation and technology to provide the smart infrastructure solutions our clients need.

Outstanding reputation
We are recognised in the industry for our outstanding delivery and technical excellence.

Financial strength
Our strong balance sheet, positive net cash and sustained profit growth provide the financial resources to invest in our business.

Skilled and experienced team
The expertise of our industry leading team enables us to deliver optimal solutions for our clients.

Strategic partnerships
We develop long-term relationships with our clients, collaborating strategically at all levels.

Proven track record
Our clients trust us to consistently deliver innovative solutions on time and on budget.

Engaging with our stakeholders

Shareholders

We deliver sustainable growth in profit and increasing returns for our shareholders.

Dividend growth	Total dividend for the year
8%	15.15p

Clients

Our strategic relationships enable a deeper understanding of our clients' needs, allowing us to identify, create and deliver the best solutions.

Repeat business	Client satisfaction
90+%	86%

Workforce

We value all of our people and provide a safe and rewarding environment.

Accident frequency rate	Training hours
0.03	103,500

Community

Our projects bring productivity benefits from enhanced infrastructure and employment opportunities.

Number of hours employees volunteered	Young people engaged in STEM
5,825	20,000+

Suppliers

We build partnerships with our suppliers and provide industry-leading training through our supply chain academy.

Number of SMEs graduated from supply chain academy	Percentage of total expenditure spent with SMEs (small, medium sized enterprises)
150	36%

Robust corporate governance
We have rigorous policies and procedures and mandatory training to ensure we do things right first time.

Read more on **page 58**

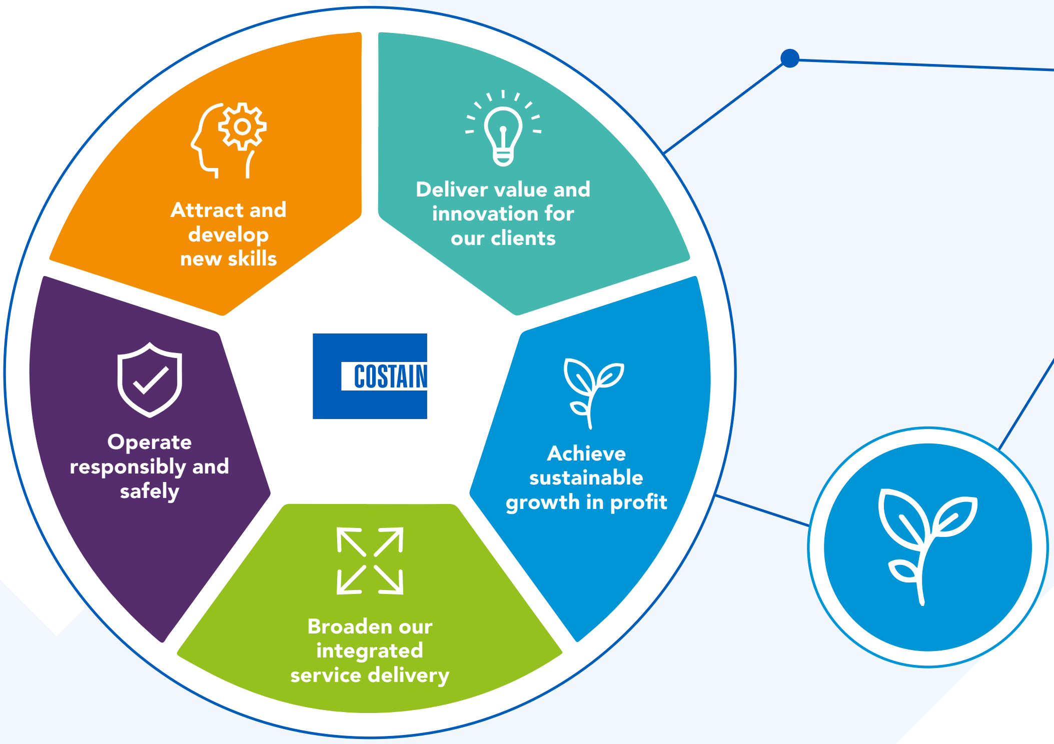
Effective risk management
We have robust risk management processes which identify, manage and mitigate potential risks to ensure the success of the Company.

Read more on **page 48**

Strategic Overview and Performance

Transforming Costain to deliver the next generation of infrastructure solutions

By positioning ourselves at the forefront of the revolution in technology we will differentiate our business, maximise our opportunities and increase value for our stakeholders



Achieve sustainable growth in profit

Deliver sustainable profitable growth by focusing on future market demands driven by regulation, technology innovation and client requirements for smart infrastructure solutions

2018 achievements

We have increased our underlying[1] profit for the eighth successive year and improved our underlying[1] operating profit margin from 2.8% in 2017 to 3.5% in 2018. We also ended the year with a record order book of £4.2 billion.

2019 focus

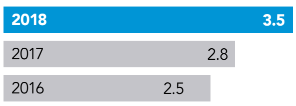
We will continue our focus on delivering further growth in the profit generated by the Group. We expect to be operating at the upper end of our divisional target blended margin of 4%–5% within the next three years.

Associated risks

- Failure to maintain a strong balance sheet.
- Failure to identify and secure new work.
- Failure to manage the legacy defined benefit pension scheme.

Underlying[1] operating margin %

3.5%



Underlying[1] operating profit £m

£52.5m

* 2017 has been restated in accordance with common practice to reflect the decision to change the accounting treatment of Research and Development Expenditure credits (RDEC) which is a reclassification between operating profit and taxation. The 2017 reported basic earnings per share of 31.1p remains unchanged as a result of the restatement.

1 Before other items; amortisation of acquired intangible assets, employment related deferred consideration, an exceptional one-off pension charge of £8.6 million in respect of the equalisation of Guaranteed Minimum Pensions (GMP) impacting UK companies with defined benefit pension schemes and a £2.6 million credit (2017: £2.5 million credit) for the reassessment of the accounting treatment of RDEC.

Deliver value and innovation for our clients

Add value to our clients through long-term strategic relationships, aligned objectives, a deep understanding of their needs and our ability to combine engineering and technical expertise to deliver integrated, technology-led services

2018 achievements

We have maintained our level of repeat business at over 90% by delivering outstanding service to our clients, as evidenced by our 86% customer satisfaction score.

2019 focus

We will leverage our relocation to an enlarged technology centre and enhance our development of cutting edge technology solutions for application across all our operations.

Associated risks

- Failure to manage projects effectively.
- Failure to anticipate and respond to changes in client circumstances.

Client satisfaction %

86%

2018	86
2017	85
2016	85

Repeat business %

90%+

2018	90+
2017	90+
2016	90+

Broaden our integrated service delivery

Continue to broaden our range of integrated, technology-led services meeting our clients' complex and evolving needs, building on our leading advisory and design expertise, established track record in delivery and proven skills in asset optimisation

2018 achievements

We have benefited from the start of a new generation of smart infrastructure contract awards including securing a market leading position in connected and autonomous vehicle (CAV) infrastructure through our roles on the A2/M2 Connected Corridor and Midlands Future Mobility.

2019 focus

We will continue our active involvement in major, regulatory-driven procurement processes including the £47 billion Control Period 6 for Network Rail, Highways England's c £25 billion Road Period 2 and the c £50 billion AMP7 programme in the water sector.

Associated risks

- Failure to deliver the business strategy.
- Failure to identify and secure new work.
- Failure to anticipate and respond to changes in client circumstances.

% of people working in technology and consultancy

34%

2018	34
2017	32
2016	29

Number of Costain sponsored PHDs

25

2018	25
2017	21
2016	13

Strategic Overview and Performance continued

Operate responsibly and safely

Build a long-term sustainable business that creates economic, environmental and social value for all our stakeholders, upholds the highest safety standards and drives inclusivity across all areas of the business

2018 achievements

We achieved our lowest ever accident frequency rate (AFR) of 0.03 and environmental incident frequency rate (EIFR) of 0.13. Mental health awareness training was completed by over 980 of our line managers and we increased awareness of LGBT+ inclusivity.

2019 focus

We will continue to implement our 2025 sustainability strategy based on the four pillars of responsible business: ensuring Costain is a safe and great place to work, creating a better environment, supporting our local communities and providing sustainable solutions for the marketplace.

Associated risks

- Failure to prevent a major accident/hazard.
- Failure to identify and secure new work.

Accident frequency rate

0.03

2018	0.03
2017	0.07
2016	0.09

CO_2 emissions (tCO_2e)

16,703

2018	16,703
2017	18,579
2016	18,523

Attract and develop new skills

Create a rewarding working environment which attracts, develops and motivates a diverse, highly skilled team and promotes continuous improvement

2018 achievements

We improved our overall employee engagement score to 79%, up from 74% in 2016, and increased female representation on our Executive Board from 22% in 2017 to 33% in 2018.

2019 focus

We will continue to increase the proportion of our employees in consultancy and technology roles through training, recruitment and targeted acquisition.

Associated risks

- Failure to attract and transform the skills, capabilities and competence of our resources.
- Failure to identify and secure new work.

Headcount

3,736

2018	3,736
2017	4,008
2016	4,180

Number of training hours

103,500

2018	103,500
2017	79,523
2016	68,882

Non-financial information statement

Our reporting is compliant with the new Non-Financial Reporting requirements contained in sections 414CA and 414CB of the Companies Act 2006. The below table, and information it refers to, is intended to help stakeholders understand our position on key non-financial matters. This is in addition to the reporting we already do under CDP and Global Reporting Initiative.

Reporting requirement	Policies and procedures	Risk management and additional information
Environmental	Environmental Policy	Creating a better environment **page 33** Responsible Business Report
Employees	Health And Safety Policy People Policy Drugs and Alcohol Policy Corporate Responsibility Policy Collaborative Working Policy Board Diversity Policy Ethical Business Conduct Policy	Costain is a safe and great place to work **page 32** Board composition and diversity **pages 60 and 61** Gender Pay Gap Report EDI Strategy
Human rights	Ethical Business Conduct Policy Modern Slavery and Human Trafficking Policy Corporate Responsibility Policy	Our approach **page 31** Responsible Business Report Modern Slavery Statement Sustainable Procurement Guidance
Social matters	Customer Service Policy Modern Slavery and Human Trafficking Policy People Policy Drugs and Alcohol Policy Employee Volunteering Guidelines	Supporting our local communities and creating a lasting legacy **page 34** Responsible Business Report Gender Pay Gap Report EDI Strategy
Anti-corruption and anti-bribery	Ethical Business Conduct Policy Corporate Responsibility Policy	Responsible Business Report Sustainable Procurement Guidance
Policy embedding, due diligence and outcomes	Principal risks and uncertainties **pages 48 to 53** Our approach **page 31** Responsible Business Report	
Description of principal risk and impact on the business	Principal Risks and Uncertainties **pages 48 to 53**	
Description of business model	Business model **pages 24 and 25**	
Non-financial KPIs	Sustainability **pages 30 to 37** Responsible Business Report	

Sustainability

Working responsibly

We believe that behaving in a responsible way is not just doing the right thing because we have to. For us, it is about wanting to make a difference and our commitment to improving lives

In 2016 we launched our 2025 sustainability strategy based on our four pillars of responsible business

Ensuring Costain is a safe and great place to work

→ See an example case study on **page 32**

Creating a better environment

→ See an example case study on **page 33**

Supporting our local communities and creating a lasting legacy

→ See an example case study on **page 34**

Providing sustainable solutions for the marketplace

→ See an example case study on **page 35**

Download our full Responsible Business Report at **www.costain.com**

Sustainability governance and ethics

The Board and Executive Board of Costain have overall responsibility for corporate responsibility activities and ensuring that the strategy is aligned with our wider business objectives.

Best ever safety record
0.03 AFR

Reduction in non-operational carbon footprint since 2013
42%

Science, technology, engineering, maths (STEM) engagements
20,000+

Supply chain performance score
68%

Governance

Our purpose is to improve people's lives, both through the services we provide and in the way in which we operate. Our sustainability strategy addresses the environmental, social and ethical challenges that are material to our business and our stakeholders.

Many of these issues are aligned with the UN Sustainable Development Goals and ensure that we are contributing to wider societal targets that will help us to achieve our purpose.

The Board and Executive Board of Costain have overall responsibility for corporate responsibility activities and ensuring that policies and strategies are aligned with our wider business objectives. They also lead by example and ensure that Costain's success is delivered responsibly.

We have a sustainability leadership group that is responsible for reporting our sustainability performance to the Board and holds direct responsibility for implementing and delivering policy across the organisation.

In addition to the annual report we publish a Responsible Business Report detailing the impact of our current responsible business activities and measuring our performance against our 2025 sustainability goals. The report is approved by the Board and produced in accordance with current GRI standards.

Further detail regarding our 2018 corporate responsibility performance can be found in our Responsible Business Report.
www.costain.com/ourculture/reports

Our approach

Being a responsible business underpins everything that we do. Every employee, supplier and partner has a part to play to ensure that we are working sustainably and responsibly. We have a range of policies designed to support them in ensuring that we always champion best practice in all our business activities. These include:

- health and safety
- environmental
- customer service
- people
- corporate responsibility
- ethical business conduct.

To support these policies, we have procedures and practices to ensure we truly live our principles and our audit and training programmes ensure that these policies are kept at the front of mind for our employees and partners.

We continually assess our anti-corruption and anti-bribery processes including having in place appropriate whistleblowing procedures to ensure their continued effectiveness. Compliance with our anti-bribery policy is reviewed on an annual basis by all relevant officers, employees and partners and associated persons within our supply chain.

We are committed to operating responsibly and with high ethical standards, particularly with regards to human rights issues. We will not tolerate human trafficking and other kinds of slavery within our operations and expect equally high standards from our supply chain.

We believe transparency is a key part of being a responsible business and we are pleased to report the actions we have taken to prevent modern slavery and human trafficking via our modern slavery statement. We have published our second Gender Pay Gap Report, demonstrating the measures we have taken to address our gender pay gap.

For more information on our policies or statements, please visit our website www.costain.com

Materiality and issues overview

To ensure we remain focused on the right issues we engage our stakeholders in a variety of ways, including a survey to gather feedback on the issues that matter to them. By engaging clients, suppliers, employees, NGOs, Government and our local communities, we gather intelligence that shapes our targets, ensuring we place appropriate resources on the important issues we can influence.

We have identified 17 issues that are materially important to Costain and our stakeholders which we have categorised under our four pillars of responsible business. We have reported progress against our targets in this report and in our Responsible Business Report, which details further information about our materiality assessment and our material issues.

Sustainability continued

Ensuring Costain is a safe and great place to work

Accident frequency rate (AFR)

0.03

2018	0.03
2017	0.07
2016	0.09

Equality, diversity and inclusion

Headcount

3,736 total

	Male	Female	Total
2018	♂ 2,845	♀ 891	3,736
2017	♂ 3,112	♀ 896	4,008
2016	♂ 3,291	♀ 889	4,180

Biennial employee engagement survey

Overall engagement

2018	79%
2016	74%

Costain is a great place to work

2018	82%
2016	76%

Understand values

2018	93%
2016	80%

Trained mental health first aiders

ratio of

1 to 15 employees

Employees who had a company medical in past two years

76%

We are committed to never compromising safety, always prioritising the health of our people, ensuring employees are treated and valued equally, investing in tomorrow's leaders today and communicating openly and engaging with our employees, listening to their views on the Company and the issues that matter to them.

A great place to work

Over the last 18 months Costain has raised awareness of LGBT+ inclusiveness by launching an employee network and marching in London and Manchester Pride parades.

Being at your best every day – Liz's story

"I have worked for Costain for many years, so I was extremely pleased to hear that an LGBT+ and allies network was being established. I have always been open and confident with who I am, and I wanted to become a role model to others and offer help and support.

Being part of the network has had a positive impact on my work life. I feel part of a supportive network of LGBT+ colleagues and allies, all working together to help create a more inclusive culture.

The support from the Costain leadership team has made the journey easier allowing the network to play an important role by providing a voice and the opportunity to consult on policies and procedures. As a result, we are working towards creating a more inclusive organisation which will benefit all current and future employees.

Volunteering for the network has provided many opportunities for my personal career development. I have gained exposure to the wider organisation and departments that I may never have previously worked with. People now approach me for LGBT+ advice either for themselves or for their families. The network is improving the lives of many people; allowing colleagues to be comfortable bringing their true self to work."

Find out more about our work at: www.costain.com

Creating a better environment

Environmental incident frequency rate (EIFR) is at its record lowest

0.13

2018	0.13
2017	0.15
2016	0.19

CO_2 emissions (tCO_2e)

16,703 total

2018	16,703
2017	18,579
2016	18,523

15,921 Scope 1

2018	15,921
2017	17,001
2016	15,255

782 Scope 2

2018	782
2017	1,578
2016	3,267

Emissions intensity (tCO_2e/£m)

11.21

2018	11.21
2017	10.70
2016	11.19

Non-operational carbon (tCO_2e/£m)

3.3

2018	3.3
2017	3.2
2016	4.3

Our commitment to creating a better environment goes far beyond legal compliance. We work with our clients and supply chain to deliver innovative, sustainable solutions that enhance the environment and improve the lives of the people living in the UK.

Our environmental management system is certified to ISO 14001:2015 and defines, measures and controls the processes and activities that are carried out across the business.

Focusing on sustainable project delivery

We recognise there is an urgent need to manage our planet's natural resources more efficiently and minimise Costain's contribution to climate change and air pollution.

This year we were proud to sign up to the BITC Waste to Wealth initiative to help fight against climate change.

In 2018 we launched the Costain Resource Efficiency Matrix, a maturity matrix which sets out actions and provides targets for contracts and offices to achieve bronze, silver or gold status. The actions focus on the effective management of energy, carbon, materials, waste and water, leading to sustainable project delivery.

All relevant Costain offices and contracts were set the target to achieve at least bronze status by the end of 2018. This target was achieved through interventions made by our contract teams including integrating sustainability into design processes and site set-up, the deployment of low carbon technologies (such as hybrid and solar plant), maximising the use of recycled/secondary materials, and minimising logistics and travel miles.

As a result, £4.9 million was saved in operational and delivery costs and over 1,246,000 tonnes of carbon emissions (tCO_2eq) were eliminated. A target of silver status has been set for 2019 which will drive further efficiencies through wider adoption of these innovations and technologies.

Find out more about our work at: www.costain.com

Sustainability continued

Supporting our local communities and creating a lasting legacy

Young people engaged in science, technology, engineering, maths (STEM) activities in the last two years

37,581

Considerate Constructors Scheme average score

43 out of 50

2018	43
2017	43
2016	42

Group charitable giving

£198,800

2018	198,800
2017	209,797

Employee volunteering hours

5,825

2018	5,825
2017	5,000

We believe that the solutions we provide to our clients will deliver significant improvements to the infrastructure in the UK and to the lives of the people using it. As a long-term sustainable business, we want to do more to maximise the social value that we create.

Supporting local communities

Rehabilitating lives

We have partnered with the London Community Rehabilitation Company (LCRC) to create an award-winning programme that identifies work placements and job roles for unemployed people in London with a recent criminal conviction. The partnership makes a real difference to local people's lives; people from diverse backgrounds who greatly benefit from this employment opportunity.

With over 10 million people in the UK having a criminal record, employing ex-offenders make us more diverse, creates social value and helps to reduce reoffending rates.

A new start

"Before my conviction I considered myself no different from the average person, a regular Joe. Degree educated, good relations with family and friends, staying out of trouble and just getting on with life. One thing I never planned for was a prison sentence.

On my release I didn't know what I was going to do regarding employment as I was aware that I would have to disclose my conviction and in so doing would be looked at and treated differently. Because of this I didn't attempt to gain employment straight away due to a fear of constant rejection. After a few months, I met a member of LCRC who interviewed me and took my details. Within two weeks, he introduced me to the work placement scheme with Costain which led to being offered a full-time position. I was in shock that I would be considered for the role – it meant so much for someone to have so much faith in me. I feel valued again and I am finally moving in a positive direction with my life. Without the help and support of the Costain/LCRC rehabilitation programme I wouldn't be where I am today."

Find out more about our work at: www.costain.com

Providing sustainable solutions for the marketplace

Percentage of total expenditure spent with SMEs (small, medium sized enterprises)

36%

Number of SMEs engaged in our Supply Chain Academy

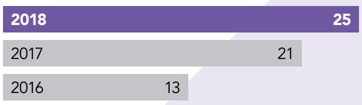
150

Value of collaborative research grants of which Costain has a share

£52m

Number of Costain sponsored PHDs

25



Working with our clients, partners and supply chain, we are committed to developing technology-enabled, sustainable solutions to help meet urgent national infrastructure needs.

Creating better environment

Tackling climate change at Gatwick Airport station

Costain has delivered design improvements which will transform the existing Gatwick Airport station and enhance passenger experience through the implementation of industry leading approaches to climate change mitigation.

To identify the most sustainable solutions applicable to the project, a range of sustainability and energy saving opportunities were reviewed throughout the supply chain from a technical, commercial and environmental perspective. The assessment highlighted that lighting, vertical transportation, and heating and cooling represented the largest proportion of the project's energy demand. These specific areas were targeted for further investigation and energy efficiency measures.

Working to whole life principles, the project team aimed to reduce the environmental footprint of the station's construction and operations.

As a result, the proposed design for all energy systems included a hybrid heating and cooling system, high efficiency gearless lifts and LED lighting for all lighting in lifts and permanent installations. This innovative design provides an estimated annual operational cost saving of £58,686 and an annual reduction of 143.6 tonnes of carbon emissions equivalent.

Significant focus was also placed on the whole life resilience of the station, especially with regards to flooding. This focus resulted in future proofing the project drainage design to take into account increased flood risk and a 30% increase in rainfall intensities due to climate change over the next 100 years. The increased resilience of the station was achieved while also enabling a significant reduction to the station's current water discharge rates by approximately 30%.

Find out more about our work at: www.costain.com

Sustainability continued

Engaging with our stakeholders

Stakeholder engagement

We are committed to building positive relationships with all our stakeholders and understanding their views so that these can be taken into account in our decision-making processes.

Shareholders

	Annual general meeting (AGM)	Annual report
Shareholders	Our AGM is attended by our Board and Executive Board members and is open to all our shareholders to attend. A summary presentation of our strategy and financial results is given by the chief executive before the chair deals with the formal business of the meeting.	This document is written to allow investors to understand our business.

Clients

	Client focused organisational structure	Key account directors	Key account plans
Clients	Our organisational design is aligned to our clients. We develop long-term, strategic relationships, leading to over 90% repeat business.	We have dedicated key account directors who are responsible for developing relationships and understanding key client needs, behaviours and priorities.	Key account plans are produced for all existing and potential clients. The plans consolidate client insight and opportunities enabling us to deliver the best solutions, quality products and services aligned to our clients' needs, ensuring client retention and attracting potential clients.

Workforce

	Costain people survey	Staff roadshows	Costain awards ceremony	Volunteering
Workforce	75% of staff responded to our biennial staff survey and of those, 82% said that Costain is a great place to work. The overall engagement score across the Group was 79% (2016: 74%).	Six road shows were held in October at various locations around the country attended by 1,250 staff.	The Costain awards ceremony was held to recognise great achievement across the Group and our supply chain.	During 2018 Costain employees completed over 700 volunteering projects in their local communities, donating over 5,800 hours to good causes.

Community

	Local training and employment	Apprenticeships/STEM activities
Community	We are currently supporting 137 apprentices on our award-winning programme.	Costain currently has 170 STEM ambassadors supporting a school engagement programme which in 2018 reached over 20,000 young people. We are particularly focused on engaging disadvantaged young people and through a programme with the Prince's Trust at our A14 contract, we were able to help seven young people into full time employment.

Suppliers

	Preventing modern slavery
Suppliers	Ten SMEs were supported through Costain's supply chain academy, completing 22 modules of free industry best practice training, including a dedicated module on slavery and human trafficking awareness. To date 150 SMEs have been through our academy. 87% of Costain managers and senior leaders have completed modern slavery awareness training, helping to ensure that 100% of strategic supply chain partners with a turnover over £36 million published their modern slavery statements.

Shareholder meetings

Throughout the year the management team meet with shareholders. For example there have been business briefings on our water sector and on connected and autonomous vehicles.

Following the full and half year results, a structured programme of meetings is put in place to allow management to meet with shareholders and prospective investors.

The executives and management team also engage regularly with sell-side analysts.

Client satisfaction surveys

We undertake satisfaction surveys with our key clients to ensure that we deliver consistently high quality and standards. In 2018, we continued to demonstrate high levels of client satisfaction at 86%.

Client events

Throughout the year we host a number of client focused events including site visits, conferences and issues-focused forums. In addition, we also attend events and meetings hosted by our clients that are focused on specific topics that they consider a priority. For example, we are a member of Highways England's supplier diversity forum and representatives of our Executive Board are members of BITC's leadership groups, collaborating with companies including National Grid and Anglian Water.

Diversity and inclusion

We were recognised in the Times Top 50 Employers for Women and as the WISE (Women in Science & Engineering) Employer of the Year.

We launched our inclusion board, chaired by Darren James, managing director, and also ran employee-led networks with a focus towards EDI. Each of the networks has an agreed strategy and senior sponsor.

Health and wellbeing

In February 2018 we launched our Group wellbeing strategy, championed by Tony Bickerstaff, chief financial officer.

We also signed the Time to Change pledge demonstrating our commitment to change how we think and act about mental health in the workplace. In support of our pledge, this year we have trained over 980 line managers in mental health awareness.

We also held Company-wide impact days focusing on mental health, fatigue and flexible working.

Social media

We increased our social media followers by 20% to c 85,000.

Internal communications

We increased our shared content by 57%, with an average of five articles published each week.

Visitor centres

Many of our complex project delivery contracts have local visitor centres to help with community engagement. We also set up public consultations using municipal locations to ensure that members of the public have a fair and equal opportunity to attend and share views on development plans.

Our efforts to maintain the highest standards of stakeholder engagement have seen Costain attain the third highest average Considerate Constructors Scheme score for the entire building, engineering and housing industries, retaining a top three position in the past three years.

Local fundraising

Linking to Costain's focus on mental health, the 2018 charity of the year was Samaritans. Costain colleagues took part in a variety of fundraising activities, raising over £16,000 for this charity. Our contracts have a strong local focus and working with various charities they raised over £198,000.

Supply chain conference

Our annual supply chain conference was held in April 2018 and was attended by 184 external participants of which 67% were strategic or preferred suppliers. A selection of up and coming suppliers were in attendance which included SMEs and technology suppliers.

Operational Review

Differentiated services and strong market positions

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

Infrastructure – revenue

£1,093.6m

2018	1,093.6
2017	1,379.7
2016	1,276.1

Infrastructure

The division, which operates in the highways, rail and nuclear markets delivered revenue (including joint ventures and associates) of £1,093.6 million (2017: £1,379.7 million) and underlying operating profit of £46.0 million (2017: £52.4 million). The margin in the year has increased to 4.2% from 3.8%, in line with the Group's strategic target range of 4%–5%. The revenue and profit reduction results from a lower level of lower-margin large capital project activity compared to the prior year. In 2019 we are targeting an increase in profit and margin on a lower revenue reflecting our strategic change in mix of activities and the timing of major regulatory investment programmes.

The division has an increased forward order book of £3.4 billion (2017: £3.0 billion).

Highways

Our highways clients are increasingly seeking technology solutions to reduce congestion and improve the safety of the road network. This year we successfully brought two new smart motorways online on the M1 and the M60. We have also started work on M1 J13–16, our largest smart motorway to date, as well as securing a new contract to deliver the M6 J21a–26. We are providing the signalling and sensing technologies which allow smart motorways to operate, as well as providing project and programme management for overall scheme delivery.

The Government and vehicle manufacturers are increasing their investment in connected and autonomous vehicles (CAV). Costain has secured a market leading position in CAV infrastructure by successfully delivering the first phase of the A2/M2 Connected Corridor and through our role on Midlands Future Mobility, the UK's largest CAV testbed. As CAV uptake grows over the next decade, we will continue to deliver improvements to capacity, journey time and road safety using technology, that were previously only possible through delivery of physical infrastructure.

We are delivering integrated maintenance and network management services to highways infrastructure owners including Highways England and East Sussex County Council. We are continually increasing the efficiency and effectiveness of our operations in this area through the application of digital technology, such as the East Sussex Digital Network Management Hub, ultimately reducing disruption and improving communication with communities and those using the road network.

Our track record of successfully delivering capital investment projects on nationally critical networks has continued in the year with the opening of the refurbished Brynglas tunnels and the remodelled junction 28 on the M4 for the Welsh Government. We are also delivering the technically complex A465 Heads of the Valleys scheme, due to be completed in 2020, and continue to make progress with our client to resolve the effect of additional scope and the associated cost and schedule impact.

We are making good progress on Highways England's major A14 upgrade contract, which is expected to deliver a significant increase in capacity on this major transport corridor. This track record of strong performance helped us to secure first place on Highways England's Regional Delivery Partnership, where we will deliver improvements to the strategic road network in the north and east regions to the value of c £1.5 billion over the life of the partnership.

Our ability to manage the impact of major infrastructure investment on communities and the environment continues to be valued by our clients, and this year we have successfully brought the A19 Testos Improvement and the M4 Corridor around Newport through the statutory planning process. The expertise of our people and the value placed on this by our clients is reflected in our growing advisory client base including TfL, local and combined authorities, sub-national transport bodies and Central Government.

With confirmation in the autumn 2018 budget that there will be c £25 billion investment in roads for the period from 2020–2025, we are well positioned to continue growing and excelling in this market.

Infrastructure – order book

£3.4bn

2018	**3.4**
2017	3.0
2016	2.9

Improving air quality by bringing hydrogen buses to Liverpool

We are conducting a collaborative feasibility study with INOVYN to shape an engineering solution to bring hydrogen buses to the streets of Liverpool, helping to improve air quality and meet UK emissions targets. The scheme aims to process hydrogen already being produced in Runcorn and deliver it in line with fuel grade specifications. Costain has a heritage of engineering hydrogen processing projects and our work on this scheme continues our drive to influence the future energy landscape by developing solutions to support decarbonisation.

Operational Review continued

Our expertise in the development of technology to solve client problems has been recognised

Rail

The rail sector in the UK is changing rapidly. Network Rail is introducing new digital technologies to increase the capacity and performance of the network and we are well positioned to take a key role in the delivery of this new generation of schemes by capitalising on our knowledge of the railway and of rail systems.

This year we have substantially completed the £1.0 billion upgrade of London Bridge Station, a flagship project for Network Rail that not only enhances capacity at one of Britain's busiest transport hubs but also transforms the customer experience at the station with over 70 new shops, cafés and leisure facilities.

Our work on High Speed 2 has continued to grow throughout the year. We are progressing well with the enabling works contract covering the southern section of the scheme and completing the design work on our two main civils contracts on the southern sections of the route.

Crossrail, which will be known as the Elizabeth Line, is one of Europe's largest and most complex infrastructure projects, and our remaining contracts on the scheme are being completed in accordance with supplemental agreements reached with the client. Our Crossrail Anglia contract for Network Rail, which involved readying their existing network east of London for the new Crossrail fleet, has now been completed.

For London Underground, discussions are well advanced to finalise the account for the completed Bond Street station upgrade, and the Bakerloo Line link to the Elizabeth Line at Paddington is nearing completion.

In Scotland, we have made excellent progress on the electrification of the routes between Stirling, Dunblane and Alloa, which will enable faster and more environmentally friendly trains to be introduced.

Fatal incidents at unguarded railway crossings continue to be a source of concern for Network Rail, who have commissioned Costain to develop and introduce a new technology that will alert pedestrians to the presence of an approaching train. The Project Meerkat technology has been under development throughout 2018 and in future years we expect to be installing innovative sensor and alarm systems up and down the railway network in the UK.

Nuclear

Costain's nuclear team is at the heart of a number of nationally strategic programmes in nuclear new-build and generation; delivering energy security for the UK, decommissioning; dealing with the UK's nuclear legacy and defence; supporting the security of our nation.

Transforming rail journeys in Scotland

Our work for Network Rail on the Stirling-Dunblane-Alloa electrification project reached a major milestone this year when the first electric passenger trains ran on the route as planned for the December timetable change. The electrification of this line will transform travel across central Scotland by increasing the number of seats, reducing journey times and cutting emissions by introducing more modern and greener trains.

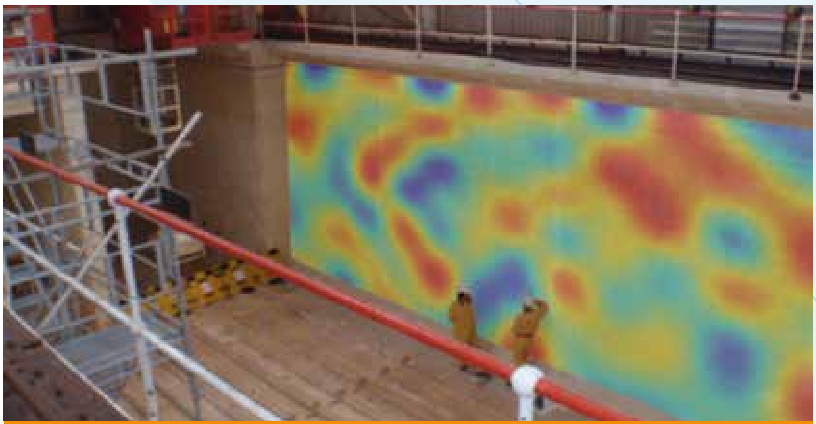
Group underlying[1] operating margin

3.5%

Our programme management contract for AWE continues to exceed performance expectations, allowing us to secure opportunities to support AWE on other projects. The recent annual Infrastructure Projects Authority review of the AWE project recognised the outstanding collaborative relationship between the Costain, client and contractors team.

Our expertise in the development of technology to solve client problems has been recognised, with our concrete contamination profiling system being highly commended at the recent NDA Supply Chain Awards and a trial of its use on the Sellafield site being awarded the prestigious Sellafield CEO's Award. This technology has the potential to significantly reduce the cost of the concrete decommissioning and waste storage programme for the UK. Another technology being developed to treat liquid radioactive waste is undergoing testing under contract with the Ministry of Defence.

Our contract with EDF Energy to provide consulting and project controls services across their portfolio continues to grow (from 40 to 60 staff in 2018) and we are supporting the development of a programme management office to plan for the eventual shutdown and decommissioning of all EDF reactors in the UK.



The safe decommissioning of nuclear waste

Our work on the development of technology to solve client problems has been recognised with our concrete contamination profiling system for the Nuclear Decommissioning Authority (NDA). This technology has the potential to significantly reduce the cost of the concrete decommissioning and waste storage programme for the UK. Another technology being developed to treat radioactive waste is undergoing testing under contract with the Ministry of Defence.

At Hinkley Point C we have substantially completed the marine aggregate jetty and have completed the logistics facilities, our final activities for EDF NNB. The contract was affected by scope increase and weather delays, and we are working with EDF to resolve the impact of the associated cost implications on the contract final account.

Our Sellafield decommissioning framework contract continues to perform in line with expectations and provides access to significant future revenue streams in support of the legacy clean-up mission.

1 Before other items; amortisation of acquired intangible assets, employment related deferred consideration, an exceptional one-off pension charge of £8.6 million in respect of the equalisation of Guaranteed Minimum Pensions (GMP) impacting UK companies with defined benefit pension schemes and a £2.6 million credit (2017: £2.5 million credit) for the reassessment of the accounting treatment of RDEC.

Operational Review continued

Natural Resources

The Natural Resources division, which operates in the water, power and oil and gas markets, made further significant progress during the period. Revenue (including share of joint ventures and associates) was £390.3 million (2017: £343.9 million) with an underlying operating profit of £14.1 million (2017: £5.0 million).

The significant improvement in the performance reflects growth in the division's water and power activities. We have delivered an improved underlying operating profit margin of 3.6% (2017: 1.5%) and in 2019 we are aiming to be operating within our target margin range of 4%–5% for the division, on higher revenue.

The division has a forward order book of £0.8 billion (2017: £0.9 billion).

Water

We are now in year four of the AMP6 five-year programmes for Thames Water, Severn Trent Water and Southern Water. We are supporting these clients to improve water quality standards, enhance supply resilience, meet anticipated demographic shifts and address their Totex (capital and operational costs) efficiency challenges. These programmes are performing well and we are using our full range of integrated capabilities to deliver improved customer service, innovative solutions, and achieve significant total whole life expenditure efficiency savings. Our AMP6 contract with Thames Water includes an element of incentivisation, aligned to the client's objectives, through the life of the contract and finalised at the end of the programme.

The Thames Tideway project, on which we are in joint venture to deliver the east section, continues to progress well and will form an integral part of the modernisation of London's Victorian sewerage system and significantly improve water quality in the River Thames, providing capacity to cope with the growing demands of the city well into the 22nd century. The tunnelling elements of the contract commence later this year with overall completion scheduled for 2024.

This year we completed the Shieldhall Tunnel for Scottish Water in Glasgow, one of the largest infrastructure investments in Scotland. This project is now operating successfully, improving water quality and resilience of supply through reduced flooding in the city's wastewater network.

Tender activity for targeted AMP7 advisory, asset delivery programmes and capital maintenance programmes has continued through the year, with several clients seeking contracts with early engagement from the supply chain to help develop robust business plans ahead of AMP7 formally commencing in 2020.

Power

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

The contract for the upgrade of National Grid's Peterborough and Huntingdon compressor stations, where we are designing the solution and managing the delivery, is progressing well. This programme of work is part of National Grid's Emissions Reduction Project to ensure that both compressor stations comply with the Industrial Emissions Directive and Pollution Prevention and Control regulations. The project will also increase system resilience and reduce overall risk on the National Transmission System by replacing ageing assets with modern, efficient equipment.

We continue to provide project services to deliver the replacement of the Humber Estuary crossing for National Grid. The River Humber pipeline is a strategically important asset, connecting the gas import facility at Easington on the Yorkshire coast and providing 70–100 million cubic metres of natural gas per day to the national network.

Improving water supply and quality for Scotland

We have completed our work on the Shieldhall Tunnel for Scottish Water which is one of their largest investments. The project, which is now operational, has enabled our client to improve water quality and reduce the risk of flooding from Glasgow's wastewater network.

We also continue to secure and provide a range of asset management, programme management, training, commercial, engineering and other advisory services for key strategic contracts with National Grid, Cadent, BAE Systems, Wales & West Utilities and SSE.

Oil and Gas

Work has completed on the Hydrochloric Acid Dosing Plant and Condensate Mercury Removal System for Total's Edradour-Glenlivet facility and the Stella field development programme for Ithaca.

We continue to provide ongoing support services to Total and Phillips 66 at their Immingham refineries, as well as programme development and design services to key energy operators both on and off-shore in the UK.

In the period we have continued to secure new contracts for our gas process technology service offering and a number of strategic development consultancy services. This includes the appointment by Infrastrata PLC for the FEED design on their Islandmagee gas storage facility in Northern Ireland, which will significantly increase the UK's gas storage capacity.

Although the market remains subdued, there has been a noticeable increase in new business opportunities as clients restructure their operations and investment projects to accommodate prevailing market conditions. We believe that oil and gas will remain an important part of the UK's energy requirements in the medium term, thus providing good future opportunities for Costain.

Securing future energy supply

We are helping to secure the future gas supply for Northern Ireland through our contract for InfraStrata Plc at Islandmagee in County Antrim. The proposed salt cavern gas storage project is a pioneering low-cost fast-cycle facility that will provide safe, secure and flexible gas storage which will in time serve the island of Ireland and the UK mainland. The Islandmagee facility is unique in being the only gas storage project in North West Europe to be awarded 'Project of Common Interest' (PCI) status by the European Union (EU), confirming its strategic importance to the entire continent. We are delighted to have successfully completed the FEED contract, further confirming Costain's position as the UK's leading underground gas storage engineering and technology solutions provider.

Alcaidesa

Alcaidesa is a non-core activity in Spain in which Costain owns operating assets of two golf courses with an associated consented parcel of land and a 624-berth marina concession, adjacent to Gibraltar.

Revenue in the year was £5.4 million (2017: £5.3 million). There has been an improvement in the trading returns from the operations and some early improvement in market conditions in Spain and we continue to review options for this non-core asset. The operating loss in the year was £0.7 million (2017: £1.4 million loss).

Natural resources – revenue

£390.3m

2018	**390.3**
2017	343.9
2016	377.3

Natural resources – order book

£0.8bn

2018	**0.8**
2017	0.9
2016	1.0

The continued delivery of good results and a sound financial base provide confidence for the future.

Anthony Bickerstaff
Chief Financial Officer

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

Overview

In 2018, the Group had another year of strong financial performance with an increase in underlying operating profit and earnings per share. This performance reflects the effective implementation of the Group's focused strategy which has delivered strong financial results over several years.

Revenue, including share of joint ventures and associates, was £1,489.3 million for the year to 31 December 2018 (2017: £1,728.9 million). Reported revenue, excluding share of joint ventures and associates, was £1,463.7 million for the year to 31 December 2018 (2017: £1,684.0 million). The reduction in revenue results from a lower level of capital project activity in line with our strategic change in mix of activities.

The Group generated a 7% increase in underlying operating profit to £52.5 million (2017: £49.1 million). The increased underlying profit reflects the Group's focus on long-term repeat orders with blue-chip clients and an increased margin from the changing mix of activities across the Group.

Reported operating profit for the year was £43.1 million (2017: £47.2 million), with the reduction from last year due to the impact of a one-off pension charge for the equalisation of guaranteed minimum pensions detailed later in this report.

Underlying profit before tax for the year was £49.7 million (2017: £43.8 million). Underlying basic earnings per share amounted to 38.2 pence (2017: 32.9 pence).

Reported profit before tax for the year was £40.2 million (2017: £41.8 million). Reported basic earnings per share were 30.9 pence (2017: 31.1 pence).

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.

Other items

To aid understanding of the underlying performance of the Group, throughout the annual report underlying operating profit and underlying profit before tax have been used.

Chief Financial Officer's Review

Another year of strong financial performance

These measures exclude 'other items' which are considered to be one-off and unusual in nature or related to accounting treatment of acquisitions. These include amortisation of acquired intangible assets, deferred consideration treated as an employment expense, an exceptional one-off pension charge in respect of the recent High Court ruling on the equalisation of Guaranteed Minimum Pensions (GMP) impacting UK companies with defined benefit schemes and a reassessment of the accounting treatment of Research and Development Expenditure Credits (RDEC). These 'other items' are shown in a separate column in the consolidated income statement.

Net finance expense

Net finance expense amounted to £3.2 million (2017: £5.7 million). The interest payable on bank overdrafts, loans and other similar charges was £3.1 million (2017: £4.2 million) and the interest income from bank deposits and other loans and receivables amounted to £0.4 million (2017: £0.4 million). In addition, the net finance expense includes the interest cost on the net liabilities of the pension scheme of £0.4 million (2017: £1.8 million) and £0.1 million (2017: £0.1 million) unwind of discount on deferred consideration.

Tax

The Group's effective rate of tax was 18.4% of the profit before tax (2017: 22.0% restated). The accounting treatment of research and development expenditure credits has been changed to include the credits as grant income in operating profit for 2018 and restated for 2017, previously these were included as a deduction from the tax expense. Changes to estimates of prior year research and development expenditure credits have been disclosed in operating profit as 'other items', giving rise to a credit of £2.6 million (2017: £2.5 million restated).

Dividend

The Board has recommended a final dividend for the year of 10.0 pence per share (2017: 9.25 pence per share) to bring the total for the year to 15.15 pence per share (2017: 14.0 pence per share).

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

Shareholders' equity

Shareholders' equity increased in the year to £182.3 million (2017: £154.0 million). The movements are detailed in the consolidated statements of comprehensive income and expense and changes in equity in the financial statements. The increase in the year includes a positive movement following the re-measurement of the Group's legacy pension scheme defined benefit obligations to reflect current market-based assumptions.

New accounting standard – IFRS 15

The new accounting standard, IFRS 15 revenue recognition, is applicable to Costain's financial statements in 2018. Full details of the impact of the standard are included in a note to the 2018 financial statements. In summary, the main impact arises from a change on one of the Group's long-term frameworks which has separate performance obligations within it and under IFRS 15 must be accounted for as separate contracts rather than one long-term framework contract. Application of IFRS 15, which has no impact on the Group's cash flow, has reduced the net assets of the Group by £4.6 million on 1 January 2018 (£2.7 million on 31 December 2018).

As the framework completes, which is anticipated to be by 2020, it is forecast that this amount will be generated and therefore reverse this impact on net assets.

New accounting standard – IFRS 9

The new accounting standard, IFRS 9 financial instruments, which is applicable to the financial statements in 2018, did not have any quantitative impact on the financial results.

New accounting standard – IFRS 16

The new accounting standard, IFRS 16 leases, will be applicable to the financial statements in 2019.
Full details of the impact of the new standard are included in a note to the 2018 financial statements.

Pensions

As at 31 December 2018, the Group's pension scheme deficit in accordance with IAS 19, was £4.2 million (2017: £23.9 million). The scheme deficit position has reduced significantly in the year due to returns on assets greater than assumed, a fall in liabilities arising from favourable experience over the period since the last triennial valuation, an update to more recent mortality tables and Company contributions.

Revenue
(including share of joint ventures and associates)

£1,489.3m

Underlying[1] operating profit

£52.5m

Underlying[1] basic earnings per share

38.2p

1 Before other items; amortisation of acquired intangible assets, employment related deferred consideration, an exceptional one-off pension charge of £8.6 million in respect of the equalisation of Guaranteed Minimum Pensions (GMP) impacting UK companies with defined benefit pension schemes and a £2.6 million credit (2017: £2.5 million credit) for the reassessment of the accounting treatment of RDEC.

Chief Financial Officer's Review continued

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

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

The next triennial actuarial review will be carried out as at 31 March 2019 and a revised recovery plan agreed accordingly.

Guaranteed minimum pension (GMP) equalisation

On 26 October 2018, the High Court issued a judgement involving Lloyds Banking Group defined benefit pension schemes. The judgement concluded that the schemes should be amended to equalise pension benefits for men and women in relation to GMP benefits. The judgement has implications for the majority of defined benefit schemes with liabilities before 1997, including the Costain Pension Scheme. In conjunction with Costain's actuarial advisers the best estimate of GMP equalisation to the Group is an increase of £8.6 million on the reported pension liabilities. This increase in liabilities represents a past service cost and has been recorded as a pre-tax exceptional expense on our income statement, shown within 'other items'.

Contract estimates

A significant proportion of the Group's activities are undertaken via long-term contracts. The majority of these contracts are not fixed-price in nature and are based on arrangements which allow for change which is expected during the contract term through the award of compensation events. Management uses detailed contract valuations and cost forecasts when formulating its estimate of costs and revenues and its assessments of the expected outcome of each long-term contractual obligation. This includes, among other things, consideration of the number of compensation events on the contract, changes in the design and construction requirements, and whether these all relate to the current obligation or create a new obligation, the impact of any third-party factors and progress to date on agreements with the client. Consideration is made on the extent to which events have impacted on the cost and programme to complete the contract and the associated level of estimation uncertainty and appropriate accounting treatment. In reviewing the contract estimates attention is also paid to past performance on contracts and the success or otherwise of resolving any contractual matters.

Project bank accounts

Several of the Group's contracts operate an arrangement with the client and suppliers, known as project bank accounts, whereby monies on the contract are paid into a separate bank account covered by a trust deed and distributed to the Group and all suppliers that join the trust deed, from that account. This is not a financing arrangement but is a form of payment administration, requested by the client, to provide transparency and security of payments to suppliers. The Group does not operate any supplier financing arrangements.

Cash flow and borrowings

The Group had a positive cash balance of £189.3 million as at 31 December 2018 (2017: £248.7 million), including cash held by joint operations of £84.5 million (2017: £87.8 million). The Group had borrowings of £70.5 million (2017: £71.0 million).

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

	2018 £m	2017 £m
Present value of defined benefit obligations	(752.7)	(803.4)
Fair value of scheme assets	748.5	779.5
Recognised liability for defined benefit obligations	(4.2)	(23.9)
Principal actuarial assumptions (expressed as weighted averages)	**%**	**%**
Discount rate	2.80	2.50
Future pension increases	3.00	2.90
Inflation assumption	3.20	3.10

Order book

£4.2bn

Total dividend per share

15.15p

Banking facilities

£191.0m

The decrease in the reported net cash position is due to the exceptional level of contract receipts in 2017, which were generated due to favourable timing at the year-end. Throughout the year the Group had a positive net cash position with an average month-end net cash balance of £77.1 million (2017: £96.7 million). The Group cash position is impacted by significant levels of work in progress on its large contracts and the period-end and month-end balances have reduced due to a lower level of revenue and therefore cash flow receipts and payments during the year.

Order book

During the year, the Group secured several new contracts and extensions and the Group's order book increased to £4.2 billion (31 December 2017: £3.9 billion).

The Group's order book is made up of an estimate of the value remaining on secured contracts, framework arrangements, service delivery arrangements and purchase orders. Several of the Group's contracts have an early contractor involvement (ECI) phase which involves planning activities and preparation pre-construction, in this case the Group's order book also includes the estimated value of the associated construction activities.

Contract bonding and banking facilities

The Group has in place banking and bonding facilities from banks and surety bond providers to meet the current and projected usage requirements. In December 2017, the Group increased its banking facilities to £191.0 million and extended the maturity date to 25 June 2022 with its relationship banks. These facilities are made up of a £131.0 million revolving credit facility and a £60.0 million term loan.

In addition, the Group has in place committed and uncommitted bonding facilities of £320.0 million. Utilisation of the total bonding facilities on the 31 December 2018 was £102.7 million (31 December 2017: £108.0 million).

Capital allocation

A key element in the successful implementation of the Group's strategy is the efficient allocation of capital. The Board regularly reviews the appropriate allocation with regard to ensuring that the Group can effectively exploit available organic and acquisition opportunities, deliver on its ongoing obligations, including making regular returns to shareholders, and address the Group's legacy pension contribution commitments. In addition, maintaining a strong and flexible balance sheet is a key requirement from clients for the pursuit of large long-term contracts. Typically, the Group will maintain a net cash balance, while being prepared to take on modest leverage if circumstances warrant. The Board believes that its approach to the optimal deployment of capital generates value for all stakeholders on an efficient and equitable basis.

Treasury

The Group's treasury and funding activities are undertaken by a centralised treasury function. Its primary activities are to manage the Group's liquidity, funding and financial risk, principally arising from movements in interest rates and foreign currency exchange rates.

The Group's policy is to ensure that adequate liquidity and financial resources are available to support the Group's growth development, while managing these risks and not to engage in speculative transactions. Group Treasury operates as a service centre within clearly defined objectives and controls and is subject to periodic review by internal audit.

Liquidity risk

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

Foreign currency exposure

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

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

Interest rate risks and exposure

The Group enters into financial instruments, where necessary, to finance its operations. Various financial instruments (for example, trade receivables and trade payables) arise directly from the Group's operations. The main exposure to interest rate fluctuations within the Group's operations arises from surplus cash, which is generally deposited with the Group's relationship banks, and bank borrowings against which the Group holds the appropriate interest rate hedging arrangements.

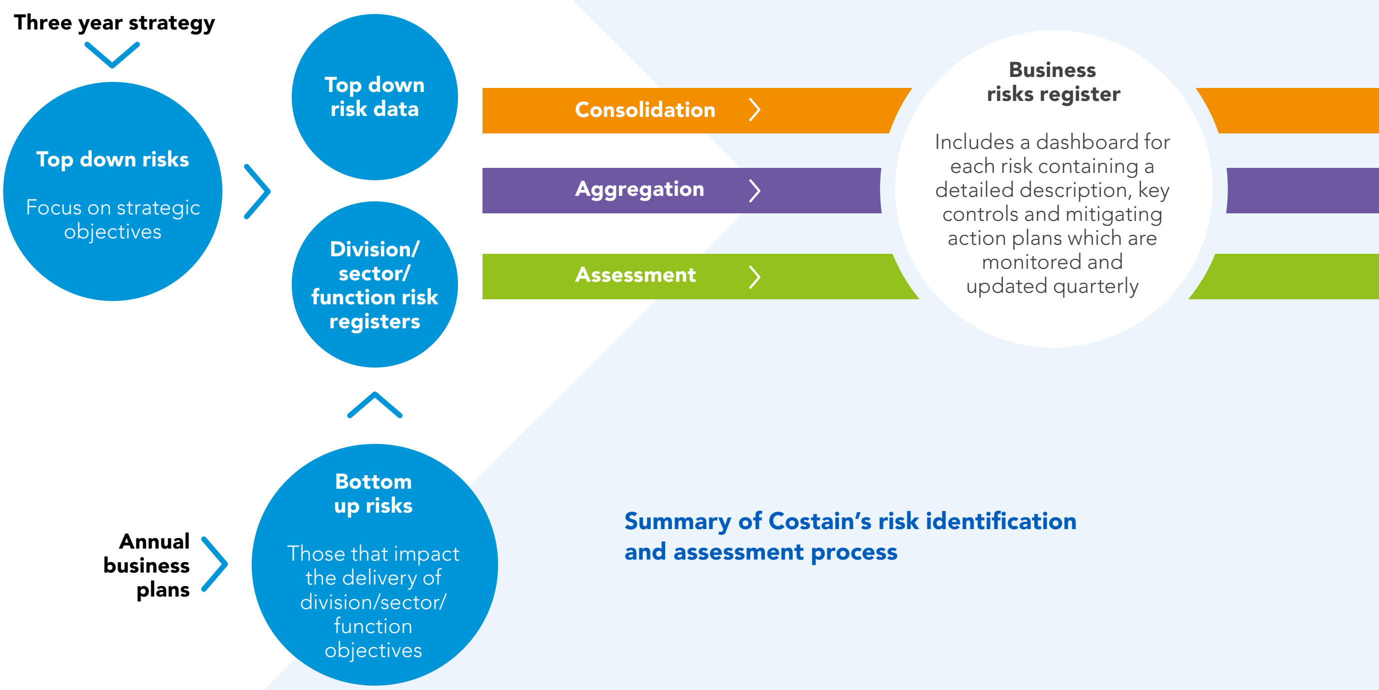
Anthony Bickerstaff

Chief Financial Officer

6 March 2019

Principal Risks and Uncertainties

Managing risks and opportunities is integral to the delivery of our strategic objectives



Summary of Costain's risk identification and assessment process

Approach to identifying our principal risks

Managing risks and opportunities is integral to the delivery of our strategic objectives. Costain's risk management approach is not designed to eliminate risk entirely, but provides a means to identify, prioritise and manage risks and opportunities in accordance with the Group's risk appetite.

Risks are identified both top down from the Group strategy and bottom up from operational activities, taking into consideration our business model and long-term strategic objectives. Risk registers are central to the risk management process and form the basis for capturing and discussing risk consistently throughout the organisation.

Once identified and assessed, the greatest risks and opportunities are aggregated and reported by the Group Risk team to the Executive Board and to the Board.

The main steps in our risk management process are illustrated in the diagram above.

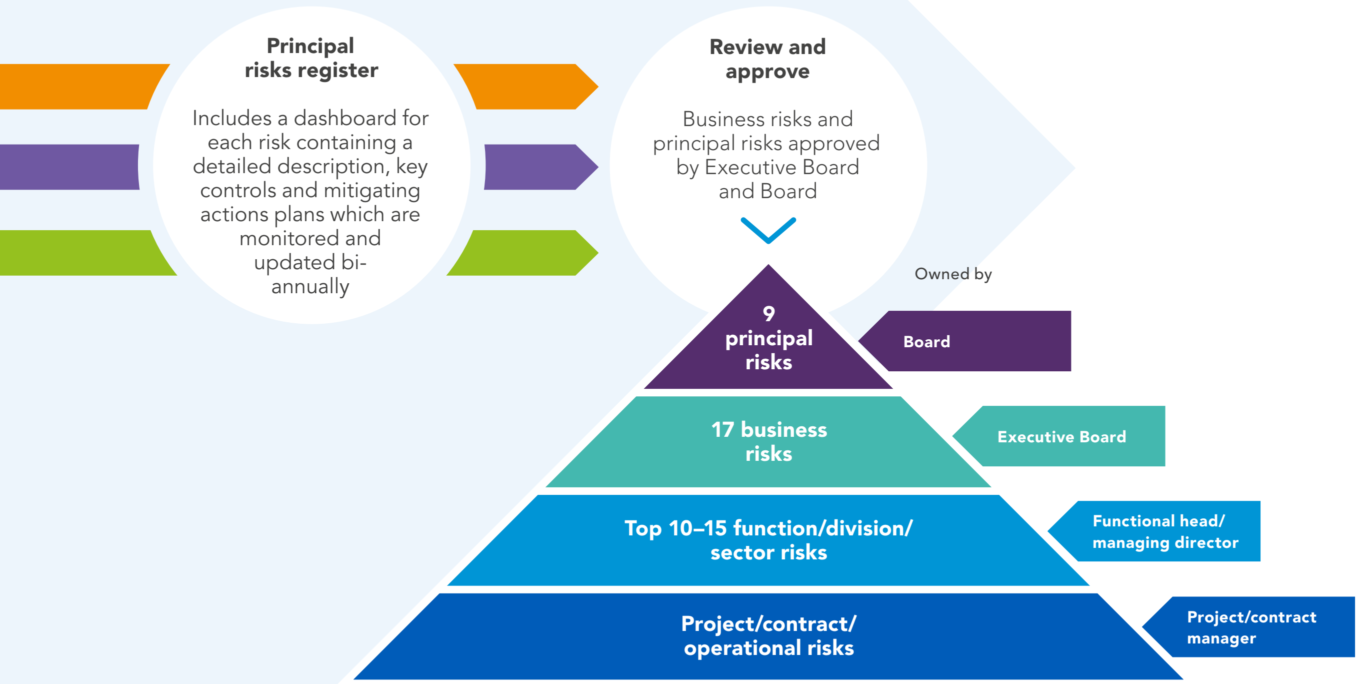
Emerging risk

Our approach to risk management is iterative and ongoing. By engaging in continuous conversations inside and outside of the organisation we capture emerging issues which are then discussed and considered by the Executive Board and the Board. If, or when, an emerging risk is considered to be significant a mitigation plan would be developed and the risk monitored as part of our overall framework.

Governance

The Board is responsible for defining risk appetite and determining the nature and extent of the principal risks the Company is willing to take to achieve its long-term strategic objectives. On behalf of the Board, the Audit Committee each year reviews the effectiveness of the Company's risk management and internal control systems. The process for doing this is set out in the Audit Committee Report on pages 72 to 75.

In order to undertake a robust assessment of the risks which could threaten the business model, performance, solvency or liquidity of Costain, the Board undertakes deep dives into each of our principal risks and mitigation plans during the year to ensure they are well understood and actively managed to reduce the potential impact.



Additionally, our principal risks are formally reviewed and approved by the Executive Board and Board twice-yearly in line with mid-year and year-end reporting.

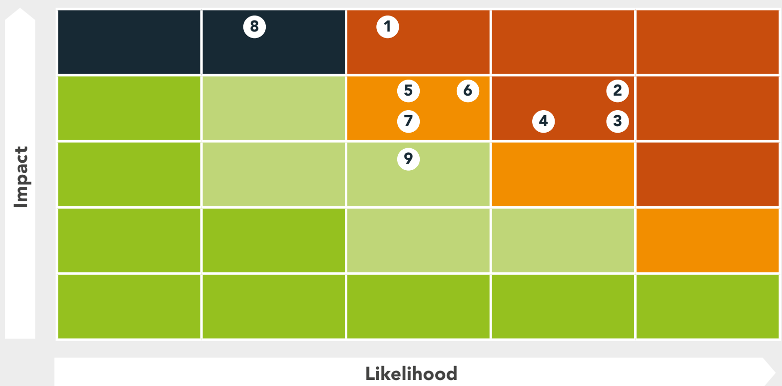
Find out more on **page 50**

Key areas of focus

While our risk profile has continued to evolve during the year, overall our principal risks have remained consistent. We have continued to enhance our reporting to provide better clarity on how these risks are being managed and the controls in place.

Risk heat map

To help visualise our principal risks we have plotted them on the heat map below. The individual risks are described more fully on the following pages.



1. Failure to prevent a major accident/hazard
2. Failure to deliver the business strategy
3. Failure to maintain a strong balance sheet
4. Failure to identify and secure new work
5. Failure to attract and transform the skills, capabilities and competence of our resources
6. Failure to manage projects effectively
7. Failure to manage the legacy defined benefit pension scheme
8. Failure to ensure our technology is robust, our systems are secure and our data protected
9. Failure to anticipate and respond to changes in client circumstances

Principal Risks and Uncertainties continued

The table below sets out the principal risks faced by the Company, the link to the Company's strategic priorities, movement in the risk score, examples of relevant controls and mitigating factors and risk appetite. Further information on our strategic priorities can be found on pages 26 to 28.

Principal Risk	Description and impact	Controls and key mitigations	Change in the year	Trend	Strategic Priority
1 **Failure to prevent a major accident/ hazard**	Failure to prevent a major accident or incident for which Costain is held primarily accountable resulting in personal or environmental harm, operational loss, regulatory, legal or financial penalties and/or reputational loss.	Safety, Health and Environment (SHE) management policies and procedures. SHE strategy and plans. The Costain Behavioural Safety (CBS) programme.	Activity in 2018 forms part of our three-year SHE strategy which is now reaching its conclusion. The trailing indicators that the strategy targeted – reportable injuries, lost time injuries and environmental incidents have all fallen in the year. The overall rate of each has fallen to around half the 2016 figure in line with our 'Halving Harm' ambition.	↔	**Operate responsibly and safely**
2 **Failure to deliver the business strategy**	The delivery of the future strategy involves growth in several business areas. Specifically, transforming our integrated service offering of consultancy, technology, complex delivery and asset optimisation which is fundamental to our future success. Failure to manage this risk could result in unsuccessful transformation, new opportunities being missed and/or loss of stakeholder confidence.	Board annual approval of plans, setting the strategic direction and confirming strategic choices that are embedded in targets across the business. Technology and consultancy strategy and business plan implementation. Strengthening of our leadership team to deliver in growth areas including monthly reporting to the Executive Board on the progress of the key hires.	Appointment of capability leads. Rigorous review of M&A targets which could have cross-sector benefit. A number of key hires in 2018. Appointing and upskilling of key account directors. A review of the top 30 roles to ensure we have the right people to deliver the business plan.	↔	**Broaden our integrated service capability**
3 **Failure to maintain a strong balance sheet**	Failure to maintain a strong balance sheet may limit our ability to grow due to failure to win work, inability to maintain competitive scale or failure to maintain adequate working capital.	Treasury function experienced in the management and oversight of investments. Bank and surety bonding facilities maintained to deliver finance requirements. Robust monitoring and management of amounts receivable.	Level of bank and bonding facilities maintained. Strengthening of processes and monitoring of key controls.	↔	**Achieve sustainable profit growth**
4 **Failure to identify and secure new work**	Costain's business strategy depends on winning work in both current, changing and diversified markets to maintain, grow and diversify a profitable future business which delivers stakeholder value. Failure to adequately manage this risk may mean that we fail to win work from current clients and/or new clients, resulting in an inability to demonstrate our diversified capability and failure to meet our profit targets.	Focus on key, blue-chip clients and understanding their needs including appointment of key account directors. Delivery of consultancy and technology services via strategic acquisitions. Continuing to develop and maintain strong relationships with clients and strategic partners.	Appointing and upskilling of key account directors. In addition, we have allocated a greater proportion of our work winning expenditure to technology and consultancy opportunities and will continue to do so in 2019.	↔	**Achieve sustainable profit growth**

Change in 2018

↑ Increased risk
↔ No change to risk
↓ Decreased risk

Principal Risk	Description and impact	Controls and key mitigations	Change in the year	Trend	Strategic Priority
5 **Failure to attract and transform the skills, capabilities and competence of our resources**	The attraction, retention and succession of the right people with the right skills in the right role at the right time, underpins the achievement of the Costain business strategy. Failure to manage this risk may result in an inability to grow the business as planned and impact short term performance.	A defined people strategy based on culture, Equality, Diversity and Inclusion (EDI), wellbeing, training and development, reward and recognition. Comprehensive and planned approach to address the consultancy, technology and advisory resource requirements. Strategic succession planning which targets the right competencies.	In 2018 we have continued to drive a positive HR strategy through the attraction, development and retention of our key capabilities. Overall engagement across the business is strong (79%) measured through our people survey.	↔	**Attract and develop new skills**
6 **Failure to manage projects effectively**	Costain has a strong reputation for project delivery, with over 90% repeat orders. Failure to maintain discipline in managing our projects could result in, for example, disputes, design faults and rectification works, failure of our supply chain, refusal of insurance claims for loss and/or increased compensation events which may not be fully reimbursable.	Risk assessment prior to contract commitments. Tender work winning gate controls with appropriate delegated authorities and Executive Investment Panel sign-off for appropriate opportunities. Robust financial management and weekly leading indicator reporting.	Improved joint venture governance. Strategic key hires to manage risks associated with specialist projects. Implementation of commercial deep dive reviews on key projects.	↔	**Deliver value and innovation for our clients**
7 **Failure to manage the legacy defined benefit pension scheme**	Failure to manage the legacy defined benefit pension scheme so that the liabilities are within a range appropriate to its capital base could result in Costain being exposed to additional liabilities.	Funding arrangement agreed with Trustees after each triennial valuation (next valuation in 2019). Regular reviews of the pension scheme funding position undertaken. Investment performance is monitored, and the Company provides input into the scheme's investment strategy.	Favourable market movements have reduced the scheme deficit by more than the agreed recovery plan. The scheme assets were changed in September 2018 to increase the level of liability hedging with the goal of reducing the level of future volatility.	↔	**Achieve sustainable profit growth**
8 **Failure to ensure that our technology is robust, our systems are secure and our data protected**	Effectiveness, availability, security and integrity of our systems and data are essential for our operations. Failure to manage technology and data risks could result in loss of confidential or personal data, regulatory fines, breach of contract and/or cyber attack.	Information security strategy that integrates information systems, personnel and physical aspects to prevent, detect and investigate information security threats and incidents. Engaging with key technology partners and suppliers to ensure potentially vulnerable systems are identified. Annual penetration tests and 24-hour threat monitoring by an external security company.	Move of key business systems into the Microsoft Cloud. Mitigating the risk of cyber breaches through deployment of an additional layer of password security (multi-factor-authentication). 2019 risk mitigation, prioritises activities to focus resources on cyber protection measures.	↑	**Operate responsibly and safely**
9 **Failure to anticipate and respond to changes in client circumstances**	Failure to anticipate and respond to changing client circumstances, particularly where we have new clients, due to different market, regulatory or political conditions and/or change of client leadership may result in a reduction of work won and impact our profitability and cash flow. Failure to understand and respond to the changing marketplace might result in a loss of market share as existing clients move to competitors and future client needs are not met by our service offering. Clients may implement new contract conditions which might adversely impact our business and financial results.	A track record of strong client relationships in target markets. Executive Board members actively engage in discussions with regulatory authorities. Development of effective key account plans and appointment of key account directors.	Appointing and upskilling of key account directors.	↔	**Deliver value and innovation for our clients**

Viability Statement

The Board maintains a sharp focus on assessing the Group's long-term prospects and the company's viability

Prospects and viability

As part of the Group's strategy and ambition to position ourselves at the forefront of the revolution in technology, the Board maintains a sharp focus on assessing the Group's long-term prospects and the Company's viability as a business on a three-year basis.

This period is considered appropriate as the Group has reasonable visibility of secured work and pipeline of opportunities and aligns with the period reviewed by the Board in the normal business planning process.

Assessing Costain's prospects

Costain delivers integrated smart solutions to meet urgent infrastructure needs across the UK. The rapidly-changing market offers the potential for long-term growth, with an addressable market of c £21 billion underpinned by regulation, legislation or strategic national needs.

Costain has all the elements necessary for continued success – valuable brand, long-term strategic client relationships, highly skilled and experienced leadership team and financial strength, with a strong balance sheet and positive net cash position.

The Group seeks to build on these strong foundations, with a clear focus on broadening our integrated technology-led service offering to bring innovative solutions to complex infrastructure challenges.

Costain runs a rigorous annual business planning process, involving divisional and Group management, with Board input and oversight. This produces divisional and Group strategic plans, which in turn generate three-year financial plans that drive the setting of in-year budgets. At the core of this process is the One Costain philosophy and while we operate with two divisions, we focus our resources on identifying and securing the most attractive opportunities across the markets we operate in.

This business planning process, combined with the Group's approach to identify, monitor and manage risk, is a significant contributor to the assessment of the Group's prospects.

Factors in assessing long-term prospects

Group's current position

- Responsible business, committed to the highest SHE standards and to operating sustainably, ethically and inclusively.
- Focused strategy based on blue-chip clients through long-term strategic relationships, leading to over 90% repeat business and a record higher-quality order book of £4.2 billion.
- A strong and robust balance sheet, with banking debt facilities of £191 million to June 2022, together with committed and uncommitted bonding facilities of £320 million.
- A rigorous work winning gate process where we seek to actively manage risk of client selection, opportunity and contract form, adopting the 'One Costain' philosophy.
- Strong balance sheet and robust financial management; fundamental to win work, invest and drive sustainable profitable growth.
- Broadening our integrated technology-led service offering with 34% of our people in consulting and technology roles.

Strategic and business model

- Clear strategy for continued organic growth and targeted acquisition.
- A clear strategy to position ourselves at the forefront of the revolution in technology impacting our market, as a smart infrastructure solutions company.
- Expertise in technology integration, consultancy, asset optimisation and complex delivery. Attracting industry-leading talent and investing in development.
- Clients are consolidating their supply chains and placing larger long-term contracts, we have the financial strength to capitalise on the changing procurement trends.

Principal risks related to the Group's business model

The assessment of viability has been made considering the principal risks as detailed on pages 50 and 51.

Impact of Brexit

The Group has completed a review of the implications of the decision to leave the EU and assessed scenarios around the current uncertainty as we approach the Brexit deadline of 29 March 2019.

While there remains uncertainty about the precise terms of Brexit, we have considered the impact on our business as part of our risk management process. We believe that because of our long-term regulated contract relationships with our clients, and over 90% cost reimbursable contracts in our order book, our business model will remain resilient under the range of most likely scenarios.

Structured strategic and financial planning process

The Group's prospects are assessed through the annual strategic planning process, which involves the creation of three-year divisional business plans which are reviewed in detail by the Executive Board.

To create these plans, each division assesses external factors – market trends, regulatory environment, legislative spend, strategic national needs and our clients' business plans, and internal factors – including capability, skills, technology and thought leadership.

This results in a set of objectives and a clear implementation plan, considering known and emerging risks and opportunities over a broader horizon. This includes a three-year financial plan, including detailed financial forecasts, resourcing and skills plan as well as research and development activity to support our clients to address complex infrastructure challenges.

The Board scrutinises and monitors the strategic and financial plans.

Assessing the Group's viability

The assessment of viability has been made considering the principal risks and testing several plausible, but severe and prolonged scenarios. These downside scenarios reflect a combination of risks, including the potential impact of a significant decline in activity resulting from an inability to secure new work, loss of reputation from a major incident and associated fines and the impact on working capital decline arising from a major dispute on contract delivery.

Viability statement

In accordance with provision C.2.2 of the UK Corporate Governance Code, the directors have assessed the prospects of the Group over a longer period than the 12 months required by the 'Going Concern' provisions.

Based on the results of this analysis, the Board confirms that it has a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period to 31 December 2021.

Board of Directors

Experience and effective leadership

Dr Paul Golby

CBE, FREng, FIET, FIMechE, FEI, FCGI

Non-Executive Chair

Appointment
May 2016

Skills and experience
Paul Golby was appointed as chair of Costain in May 2016. A fellow of the Royal Academy of Engineering, Paul has held a variety of roles within the engineering and energy industries. Following an early career with Dunlop Holdings plc and BTR plc he joined Clayhithe plc, becoming an executive director in 1992. In 1998, Paul joined East Midlands Electricity plc as managing director and following its acquisition by PowerGen (subsequently E.ON UK plc) was appointed executive director, UK operations. In 2002, Paul became chief executive and later executive chairman, stepping down from the E.ON Board in December 2011.

Paul was also non-executive chairman of AEA Technology Group plc (2009–2012), chairman of Engineering UK (2010–2016) and pro chancellor and chair of council of Aston University (2009–2017). He was chair of the Engineering and Physical Sciences Research Council (2012–2018).

External appointments
Non-executive director and chair of the safety, environment and health committee of National Grid plc, board member of the ERA Foundation (from 14 March 2019) and chairman of the National Air Traffic Services (NATS Holdings Ltd). Member of the Prime Minister's Council for Science and Technology.

Andrew Wyllie

CBE, 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, Asia and the UK.

Andrew has a MBA from the London Business School, is a fellow of the Royal Academy of Engineering, president of the Institution of Civil Engineers, a fellow of the Institute of Directors and the British American Project. He is also a member of the CBI Infrastructure Board and a companion of the Chartered Management Institute. He was non-executive director of Scottish Water from April 2009 to March 2017. Andrew was awarded a CBE for services to engineering and construction in the 2015 New Year's Honours List.

External appointments
Non-executive director of Yorkshire Water Services Limited.

Anthony Bickerstaff

FCCA

Chief Financial Officer

Appointment
June 2006

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

External appointments
Non-executive director and chair of the audit committee of Low Carbon Contracts Company Limited and Electricity Settlements Company Limited.

Jane Lodge

FCA, BSc

Senior Independent Director

Appointment
August 2012

Skills and experience
Jane Lodge was appointed as the senior independent director in May 2018 having been a non-executive director since August 2012 and chair of the Audit Committee from the end of October 2012. Jane spent 35 years at Deloitte LLP (UK), 25 as an audit partner advising global companies, particularly in the manufacturing, house-building and property and construction sectors. She was senior partner of the Birmingham office and the Deloitte UK Manufacturing Industry Sector. Jane was previously a non-executive director and chair of the Audit Committee, Moorgate Industries Limited (2014–2015) and a non-executive director of Black Country Living Museum Trust Limited.

External appointments
Non-executive director and chair of the audit committee at Devro PLC, DCC plc and Sirius Minerals plc. Non-executive director and chair of the audit and risk committee at Bakkavor Group plc and non-executive director of the Bromsgrove School Foundation.

Committee membership

Member of the Remuneration Committee

Member of the Audit Committee

Member of the Nomination Committee

C Chair of Committee

Alison Wood

MBA, BA

Independent Non-Executive Director

Appointment
February 2014

Skills and experience
Alison Wood was appointed as a non-executive director with effect from 1 February 2014 and was appointed as chair of the Remuneration Committee from the beginning of April 2014. Alison is the former global director of strategy and corporate development at National Grid plc (2008–2013). Before that, Alison spent nearly 20 years in a number of strategy and leadership roles at BAE Systems plc including group strategic development director. Alison has also held non-executive director positions at BTG plc (2004–2008), Thus Group plc (2007–2008) and e2v technologies plc (2013–2017) where she was senior independent director.

External appointments
Non-executive director and chair of the Remuneration Committee at Cobham plc, TT Electronics plc and the British Standards Institute.

C

David McManus

BSc

Independent Non-Executive Director

Appointment
May 2014

Skills and experience
David McManus was appointed as a non-executive director with effect from 12 May 2014. David began his career with the Fluor Corporation (1975–1980) after graduating in civil engineering and went on to hold a number of executive positions in Shell UK (1980–1989), LASMO plc (1989–1994), Atlantic Richfield Company (ARCO) (1994–2000), BG Group (2000–2004) and as executive vice president, international operations of Pioneer Natural Resources (2004–2012). David was formerly a non-executive director of Cape plc (2004–2012), where he served as chairman from 2006 to 2008 and was also a non-executive director of Caza Oil & Gas Inc. (2011–2015).

External appointments
Non-executive chairman of Rockhopper Exploration plc (stepping down from this board in May 2019) and of FlexLNG and a non-executive director at Hess Corporation.

Jacqueline de Rojas

CBE

Independent Non-Executive Director

Appointment
November 2017

Skills and experience
Jacqueline de Rojas was appointed as a non-executive director with effect from 20 November 2017. As president of techUK she is a leader in the UK technology sector and an experienced non-executive director who has held executive positions at global blue-chip software companies such as Citrix Systems, CA Technologies, McAfee and Novell. Jacqueline was previously a non-executive director of Home Retail Group prior to the divestment of this group. She is the co-chair at the Institute of Coding and advises the board of Accelerate-Her to stop the under representation of women in technology. Jacqueline also lends her support to the Girlguiding Association for technology transformation. She was awarded a CBE for services to international trade in technology in the 2018 New Year's Honours list.

External appointments
Non-executive director at Rightmove plc and AO World plc, chair of the Advisory Board at the Digital Leaders Technology Group and president of techUK.

Tracey Wood

LLB

General Counsel and Company Secretary

Appointment
July 2008

Skills and experience
Tracey Wood joined the Company in February 2006 as head of legal. She has a construction and commercial law background and was formerly a partner at Hammonds. She has held a number of senior roles and was appointed to the Executive Board as HR director in July 2008. She became general counsel and company secretary in June 2010 and currently also has responsibility for human resources across the Group and internal audit and risk. Tracey was previously a non-executive director of Bristol Water Plc.

Group Executive Board

An experienced leadership team to deliver the strategy

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

Andrew Wyllie

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

Chief Executive

Board of directors profiles
See page 54

Anthony Bickerstaff

FCCA

Chief Financial Officer

Board of directors profiles
See page 54

Sally Austin

BSc (Hons), FCIPD

Group HR Director

Appointment
July 2015

Skills and experience
Sally Austin joined Costain in 2005 and is currently Group HR director. She began her career with BAE Systems, moving to Eaton Corporation in 2000 where she held a number of HR management roles supporting US, EMEA and European facilities. In her current role she holds responsibility for executive remuneration, Group-wide HR operations, recruitment, learning and development, HR shared services and pensions. Sally holds a BSc(Hons) in psychology and is a fellow of the CIPD.

External appointments
Non-executive director of Warwick Independent Schools Foundation.

Dr Maxine Mayhew

FIoD, PhD

Group Capability Development Director

Appointment
November 2018

Skills and experience
Maxine joined the business in 2017. She is the Executive Board director responsible for Group capability including technology, consultancy, complex delivery and asset optimisation. In addition, Maxine has overall responsibility for the water sector. After completing a PhD in wastewater treatment, Maxine has held a variety of roles in her 20 years in the water industry focused on leadership, innovation, commercial development and strategy delivery across all aspects of the industry from operations and engineering, through to central support services (marketing, supply chain, SHEQ) and retail operations.

External appointments
Maxine is a non-executive director for Karbon Homes and also an independent council member for Cranfield University.

Martin Hunter

BA, ACA

Group Financial Controller

Appointment
April 1999

Skills and experience
Martin Hunter holds the position of Group financial controller and has held a number of head office finance positions since 1984. Previously, Martin worked for Stoy Hayward, a London based firm of chartered accountants.

He is a member of the Institute of Chartered Accountants in England and Wales.

Darren James

BEng (Hons), CEng, FICE, FCIHT, FIoD

Managing Director Infrastructure

Appointment
September 2008

Skills and experience
Darren James has held the position of managing director of the Infrastructure division since 2008. He initially joined as an industrial placement student during his undergraduate studies at the University of Surrey, where he obtained a degree in civil engineering. He has held a number of positions in the Group. In his current role Darren has profit and loss responsibility for the division which provides services to clients in the rail, highways and nuclear sectors. Additionally Darren has Group-wide responsibility for Health, Safety and Environment.

External appointments
Non-executive director of the Port of London Authority and a director of the Rail Industry Association.

Alex Vaughan

BSc (Hons) FRICS, Dip IoD, FIoD

Managing Director Natural Resources

Appointment
October 2006

Skills and experience
Alex Vaughan is managing director of the Natural Resources division, with responsibility for our services to water, oil and gas and power clients.
He has held this position since 2013. He is qualified as a chartered quantity surveyor. He has worked on infrastructure projects in the UK and internationally, as well as having held a number of corporate roles including Group HR director and corporate development director. In 2009 he completed the Harvard Business School Advanced Management Program (AMP). Alex is chair of the CBI regional council and is currently also responsible for the development of client-facing technology solutions across the Group.

David Taylor

FRICS, FIoD

Group Commercial Director

Appointment
January 2015

Skills and experience
David Taylor joined the Company in 2009 and was appointed Group commercial director in January 2015.
He has held a number of senior leadership roles within the business and is currently responsible for the commercial, supply chain and design management functions.

Prior to joining Costain, David acquired more than 25 years' experience with Taylor Woodrow where he held the position of commercial director for its UK operations.

Tracey Wood

LLB

General Counsel and Company Secretary

Profile see page 55

Governance Report
Chair's Statement

GOVERNANCE HIGHLIGHTS

Board evaluation
See more on **pages 68 and 69**

Board activity
See more on **page 66**

Diversity policy
See more on **pages 60 and 61**

Dear shareholder

Over the past year, the Board has continued its focus on maintaining high standards of corporate governance, by promoting integrity and openness, valuing diversity and being responsive to the views of shareholders and wider stakeholders.

The Board recognises the need to continually improve Board effectiveness and welcomes the changes brought about by the revised 2018 Code. This year, the Board is working towards the effective application of the main principles of the 2018 Code to ensure a robust governance framework is in place to deliver the Company's strategy.

For example, over the last few months, the Board has reviewed its activities and the roles of its Committees. In particular, the Remuneration Committee has been asked to increase its remit to look at the framework and broad policy on remuneration of senior management as well as the chair and executive directors.

As can be seen in the Directors' Remuneration Report on page 82, for LTIP awards granted from 2019, shares which vest after three years will only be released after five years. We have also extended our malus and clawback circumstances to include serious reputational damage and corporate failure.

The Board recognises the need to continually improve Board effectiveness and welcomes the changes brought about by the revised 2018 Code.

Dr Paul Golby
Chair

In addition, at our forthcoming AGM we are proposing to shareholders that the Company's articles of association be amended to incorporate the annual re-election of directors in compliance with the 2018 Code together with other amendments to reflect developments in practice since the articles were last approved in 2010. All our directors (with the exception of Andrew Wyllie who will step down from the Board from the conclusion of the AGM) will be standing for re-election this year.

Main priorities during the year:

Succession and diversity

As announced today, Andrew Wyllie, after 14 years as chief executive, is retiring to pursue a non-executive career. Alex Vaughan will be appointed as CEO with effect from the conclusion of the Company's AGM on 7 May 2019. Andrew Wyllie will remain an employee of the Company until 6 September 2019 to effect an orderly handover. Alex's appointment is in accordance with the Board's succession plan which included an extensive internal and external search process led by Russell Reynolds Associates. Full details of this process will be included in the Company's 2019 Nomination Committee Report.

James Morley stepped down as a non-executive director and senior independent director and Jane Lodge was appointed to act as senior independent director with effect from the conclusion of the 2018 AGM and continued her role as chair of the Audit Committee.

During the year, the Nomination Committee continued to concentrate on executive and senior leadership succession planning. We spent considerable time assessing the talent pipeline and identifying the skills needed to support our strategy and business long-term.

As described on pages 60 and 61, Board and Group-wide diversity continues to be an important focus for Costain. The Board has 43% female representation which exceeds the Hampton-Alexander Review voluntary target for women on boards of FTSE 350 companies.

Our principles on Board diversity also apply to the Executive Board and we have made significant progress with 33% of our Executive Board now being female up from 15% in 2015. It is important, however, that we continue to build the pipeline within the business and in 2018, for the first time, over 50% of our new graduates were female and 30% BAME.

Workforce and stakeholders

It is important Costain builds trust by forging strong relationships with key stakeholders and that the culture at Costain is aligned with our purpose of improving millions of people's lives across the UK through the deployment of technology-based engineering solutions to address urgent national needs. Pages 36 and 37 detail the ways in which Costain engages with our key stakeholders.

Board effectiveness

This year the Board undertook an internal evaluation. The results of this review can be found on pages 68 and 69. The conclusions of this year's review have been positive and confirmed that the Board and its Committees operate effectively and each director contributes to the overall effectiveness of the Group.

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

Dr Paul Golby CBE

Chair

6 March 2019

Compliance with the UK Corporate Governance Code

As a premium listed company on the London Stock Exchange, and in respect of the financial year ended 31 December 2018, the Company is reporting in accordance with the UK Corporate Governance Code published in April 2016 (the 2016 Code), which sets out standards of good practice in relation to Board leadership, effectiveness, accountability, remuneration and relations with shareholders. The Code is published by the Financial Reporting Council (FRC) and is available on its website www.frc.org.uk. Throughout the entire year, the Company complied with all the provisions of the 2016 Code. The Audit Committee Report on pages 72 to 75, the Nomination Committee Report on pages 76 and 77 and the Directors' Remuneration Report on pages 78 to 97 are also incorporated into this report by reference. It is noted that a revised UK Corporate Governance Code (the 2018 Code) has been published which applies for financial years beginning on or after 1 January 2019, against which the Company will be reporting in respect of its 31 December 2019 financial year-end.

Governance Report continued

Board Leadership

Board composition and diversity

The Board is committed to ensuring that it remains diverse and has set a clear policy on boardroom diversity, including gender diversity, which is reviewed every year. We believe that diversity in all its forms is a strategic business issue and is essential for introducing different perspectives into our debates and decision-making.

Our policy applies to the whole workforce including the Board and Executive team. The Board supports the target set by the Hampton-Alexander Review regarding gender balance within the leadership structure of listed companies which recommended a voluntary target of 33% for women represented on boards by 2020. The Board also supports the Parker Review for FTSE 250 companies to have at least one non-white director on their Boards by 2024.

We aim to maintain a level of at least 33% female directors on the Board. Currently, three of our directors are women (43%) and one director is Mixed White Asian. In addition, the Board places high emphasis on the importance of developing diversity in the senior management and therefore oversees the Group's aim to ensure 33% female representation within senior positions across the Group by 2020. Currently there is 33% female representation within the Executive Board and over the last three years we have grown our senior female management population from 15% to 22%.

Looking beyond the Board there are a number of ongoing activities across the Group to promote diversity:

36%

We actively promote and encourage flexible working. Currently 36% of employees work flexibly.

1,000

1,000 line managers trained in 'unconscious bias' which aims to build awareness and challenge commonly held myths around diversity. This training is also available to our supply chain and clients.

Employee networks established for LGBT+, gender, parents and carers and REACH (religion, ethnicity and cultural heritage), that report into the Group Inclusion Board. The Board is chaired by an Executive Board member.

65

First gender network event attended by 65 female colleagues and their line managers. Discussions were focused on understanding the challenges we face in attracting, developing and retaining female talent.

Female representation

Level	Minimum target by June 2020	Actual 31 Dec 2018 (%)	Actual 31 Dec 2018 (Number)
Board	**33%**	**43%**	**3 of 7**
Executive Board	**33%**	**33%**	**3 of 9**
Direct reports to Executive Board	**33%**	**45%**	**31 of 69**
Senior Management	**33%**	**22%**	**10 of 45**

TOP 50

Times top 50 employer for women in 2018.

52

Dedicated careers events held which are aimed at attracting female talent. Our 'Future Female' career event at the London Transport Museum attracted 52 female final year under-graduates. At the event, the attendees met with women from across the Company who perform a variety of roles, from apprentices and graduates to Board members. Of those that attended 58% applied for a graduate position, with four candidates successfully gaining a place on our graduate programme.

MIN 2

Recruitment practices reviewed for key hires. We use search firms who are signatories to the voluntary code of conduct for executive search firms which seeks to address gender diversity on boards and best practice for the related search process. Our aim is to have a minimum of two females on each short-list.

FEB

In February, our high potential females attended our first 'Women in leadership' networking event. It provided the opportunity to meet inspirational female role models and share their thoughts on how to continue to drive the equality and diversity agenda.

24.25%

In March 2019, we published our second gender pay report revealing a 24.25% (median) gender pay gap (2017: 24.69%). Over the last year we have been focused on trying to reduce this gap by taking affirmative action to improve our gender balance, which we believe will close our gender pay gap.

Governance Report continued

Our Governance Structure

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

Our Board

Key responsibilities:

The Board is collectively responsible for the management of the Company. The Board's main role is to create long-term value for shareholders by providing entrepreneurial and prudent leadership of the Company. It does this by setting the Company's strategic aims and overseeing their delivery, ensuring that the necessary financial and other resources are available, and by maintaining a balanced approach to risk within a framework of effective controls.

Audit Committee

Key responsibilities:

– Monitors and reviews the integrity of Costain's financial statements.

– Manages the relationship with the external auditor.

– Oversees the Company's systems for internal control and risk management.

Nomination Committee

Key responsibilities:

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

– Undertakes the management of Board effectiveness reviews.

– Reviews management training and succession planning in respect of the Company's senior executives.

The Committees are governed by terms of reference which are reviewed annually and can be viewed in the corporate governance section of the Company's website. The members of each Committee and details of their attendance are shown on page 67.

BOARD COMMITTEES

Board Committees

Key responsibilities:

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

REMUNERATION COMMITTEE

Remuneration Committee

Key responsibilities:

– Determines the remuneration for the chair, executive directors and certain senior management.

– Oversees Costain's overall remuneration policy, strategy and implementation including the alignment of incentives with reward and culture and taking into account employees' pay and rewards when setting the policy for directors' remuneration.

EXECUTIVE BOARD

Executive Board

Key responsibilities:

– Accountable for the day-to-day running of the business and delivering the Group strategy following policies laid down by the Board.

See **Executive Board biographies** on **pages 56 and 57.**

INVESTMENTS COMMITTEE

Investments Committee

Key responsibilities:

– Responsible for allocating the Group's work winning resources and authorising certain investments.

HEALTH AND SAFETY COMMITTEE

Health and Safety Committee

Key responsibilities:

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

Governance Report continued

Board Engagement

Board engagement with the workforce

Engagement with and feedback from the workforce is vital to maintaining a sustainable business. This is carried out in a variety of different ways:

Staff roadshows

- Regular staff roadshows are held across the country and attended on average by 1,250 people per annum. These events offer the opportunity for staff to hear about the implementation of our strategy and the progress made against our strategic priorities. In order to facilitate two-way communication, a 'question and answer' session with the chief executive, the chief financial officer and the group HR director also take place at the end of each roadshow. Questions can be submitted in advance by employees who cannot attend in person, or raised on the day.
- This year, as part of our ongoing commitment to deliver meaningful engagement with the Board, the chair also took part in a 'question and answer' session at the end of the Manchester roadshow. Any views raised during the session were fed back to the Board. A short film was also made of the event and shown on our intranet site thus making it available to all employees. In 2019, it is planned that a non-executive director attend each of our six roadshows.

Engagement survey

- The results of the staff engagement survey were reviewed and evaluated by the Board including a summary by the Group HR director to the Board of the 1,960 comments received as part of the survey. Staff sentiment and key areas of concern were also discussed, as were the key actions taken by the Company as a result of the feedback.

91%

of employees feel committed to helping Costain succeed.

Site visits

- Non-executive directors regularly carry out engagement tours on our projects and sites to gain further insights into the business and to examine in particular our health and safety performance. As part of these visits a 'question and answer session' is normally held with members of the site team (including staff, operatives and members of the supply chain) to allow two-way communication with the Board member.

Dr Paul Golby	M1 Smart Motorways, AWE, Manchester Office, Thames Tideway
Jacqueline de Rojas	AWE, Crossrail Paddington, Manchester Office, Thames Tideway,
Alison Wood	Crossrail Canary Wharf, Crossrail C610 Systemwide, Thames Water Basingstoke
Jane Lodge	Crossrail C610 Crossrail Systemwide, Crossrail C695 Plumstead
David McManus	C412 Bond Street, Yatton Office

July 2018 Board visit to Birmingham:

Offsite visits and Board meetings give the Board further insights into the business. In July 2018, a three-day Board visit to Birmingham included:

- a visit to Jaguar Land Rover, which included a discussion on current progress and future strategy concerning connected and autonomous vehicles (CAV)
- a visit to Network Rail, focusing on both the future pipeline and current projects including Costain's Project Meerkat, a landmark technology offering to supply automated level crossing alerts in mainly rural locations.

Other ad hoc events

- Throughout the year, non-executive directors took part in other ad hoc events including our Costain Awards Ceremony in January 2018, 'Future Female' career event and the Costain Leadership day in September 2018. Each of our non-independent directors also acts as a mentor to a participant on our executive development programme.

Governance Report continued

Key Activities

The following summarises the Board's main activities over the course of the year

Key area of activity	Matters considered, decisions and actions
Business performance and oversight	Received during the year regular updates on how the business is performing against our strategic priorities and KPIs.
Strategy and progress	Participated in three interactive workshops attended by members of the Executive Board and the corporate development director. The Board also received input from third party advisers to obtain better visibility of the market landscape. For example, in October the Board received a 'spare chair' presentation from Jamie Houghton, Public Sector Transport Leader, PwC and in November, a market update from its financial adviser, Rothschild.
Risk and opportunity	Taken part in deep dive reviews with senior management on each of the nine principal risks to re-validate these risks and the risk appetite framework. In November, the Board attended a joint workshop with the National Cyber Security Centre (NCSC) to discuss the top cyber security threats and to provide feedback on NCSC's Board toolkit.
Culture and governance	Revised Board agendas and format of papers to ensure the most effective use of the Board and Committee time. Set and agreed a Board planner for 2018 and monitored progress against this plan. Approved updated Terms of Reference for the Remuneration Committee, Audit Committee and Nomination Committee and an updated matters reserved for the Board. Conducted an internally facilitated Board effectiveness review. Further information about this process can be found on pages 68 and 69. Approved the Group's Modern Slavery Statement for publication on the corporate website and the Board's Diversity Policy and Gender Pay Gap reporting.
Talent and people	Starts every Board meeting with health, safety and wellbeing. As part of the Company's commitment to health and wellbeing the Board has also recently undertaken mental health training. Discussed succession planning and talent development for the chief executive and chief finance officer. Talent Reviews – reviewed the current priorities in terms of succession and talent development across the business. Engaged with high potential candidates through presentations at the Board meetings. Discussed and reviewed the results of the staff engagement survey. Discussed and reviewed the feedback from the Manchester Staff Roadshow. Discussed the Company's gender pay in the context of the wider market. Diversity and inclusion – discussed the action plan to address the pipeline of women in senior roles and at graduate level and the plan to drive greater diversity and inclusion.

How we divide up our responsibilities

Chair	The chair, Dr Paul Golby, is responsible for the effective leadership and operation of the Board.
Chief executive	The chief executive, Andrew Wyllie, is responsible for managing the business of the Company through the implementation of policies and strategies as determined by the Board.
Senior independent director	The role of the senior independent director involves providing a sounding board for the chair, acting as a point of contact for shareholders to raise concerns should they arise and meeting with the other non-executive directors, without the presence of the chair or executive directors, to discuss such matters as the appraisal of the chair's performance. The current senior independent director is Jane Lodge following the retirement of James Morley at the conclusion of the Company's 2018 AGM.
Independent non-executive directors	The non-executive directors all bring valuable experience, insight and perspective to the Board, through their former executive roles and their other non-executive positions, which are held across a wide range of businesses and disciplines, and this facilitates robust decision-making by the Board as a whole. The non-executive directors, including the chair, also meet without the executive directors being present from time to time as a matter of good corporate governance.

Non-executive director tenure

- 1 to 3 years 2
- 4 to 7 years 3

Meeting attendance

The Board meets regularly, with seven scheduled meetings having taken place during the year. The directors' attendance record at the scheduled Board meetings and Board Committee meetings for the year ended 31 December 2018 is shown in the table below. For the Board and Committee meetings, attendance is expressed as the number of meetings that each director attended out of the number that they were eligible to attend. In addition, ad-hoc meetings were arranged to deal with matters between the scheduled meetings as appropriate.

Board attendance	Board Maximum 7	Audit Committee Maximum 4	Remuneration Committee Maximum 3	Nomination Committee Maximum 2
Executive directors				
Andrew Wyllie	7/7	4[a]	3[a]	2[a]
Anthony Bickerstaff	7/7	4[a]	3[a]	2[a]
Non-executive directors				
Paul Golby	7/7	4[a]	3[a]	2/2
James Morley[b]	2/2	1/1	2/2	1/1
Jane Lodge	7/7	4/4	3/3	2/2
Alison Wood	7/7	4/4	3/3	2/2
David McManus	7/7	4/4	3/3	2/2
Jacqueline de Rojas	7/7	4/4	3/3	2/2

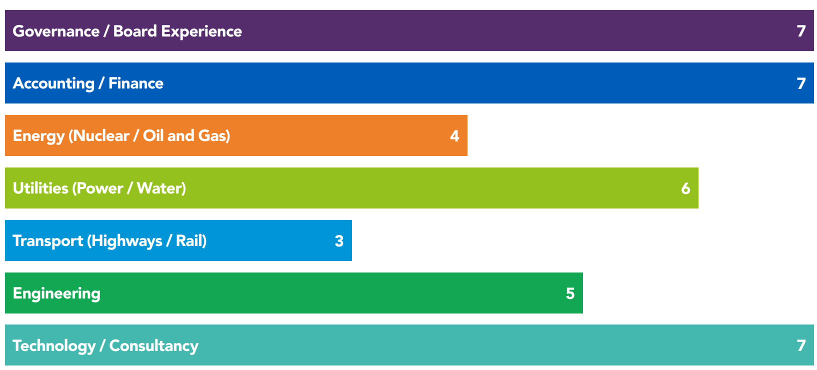
(a) Not a member of the Committee – attendance at meeting by invitation.
(b) Retired from the Board with effect from 08 May 2018.

Board composition

The Board currently comprises the chair, two executive directors and four independent non-executive directors. The membership of the Board and biographical details of all the directors can be found on pages 54 and 55.

The biographies illustrate that the non-executive directors have a range of business, sector 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 enhanced by the varying lengths of service, gender balance and expertise of all the directors, the latter as depicted below.

Skills and experience (all directors)



Governance Report continued

Board effectiveness

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

2017
external evaluation

2018
internal evaluation

2019
internal evaluation

For the 2018 financial year, the Board's annual evaluation was carried out internally. It was facilitated by the company secretary under the direction of the chair. The process involved each of the directors completing a high-level questionnaire and a comprehensive discussion between the chair and each of the Board members. Separately, the senior independent director met with the other non-executive directors, without the chair being present to appraise the chair's performance and then also met with the chair. The senior independent director then reported their findings back to the board.

After reviewing the outcomes of the evaluation process, the chair prepared a summary report that was discussed by the Board. It was concluded that the Board's strength continued to be demonstrated through its composition, diversity, clarity of roles and clear focus on strategy. The performance reviews showed that each director continues to have sufficient time, knowledge and commitment to contribute effectively to the Board and its Committees, and that the Board as a whole demonstrates good practice on the key indicators of Board effectiveness.

The procedures, effectiveness and development of the Board will continue to be kept under review. The last externally facilitated Board review was conducted by Dr Tracy Long of Boardroom Review Limited in respect of the 2017 financial year, details of which were included in last year's Corporate Governance Report. Progress made against the areas of focus that were identified during last year's external evaluation are shown below.

The next independently facilitated external review is expected to take place in respect of the 2020 financial year.

Board independence and effectiveness

Having due regard to the results of this internally facilitated review of the Board performance, the Board considers each of its non-executive directors standing for re-election continue 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 Board also confirms that these directors continue to perform effectively, that they demonstrate commitment to their particular roles, that they ensure proper time is devoted to Board and Committee meetings and should therefore be re-elected at the forthcoming AGM. The current terms of appointment of all the directors are set out in the Directors' Remuneration Report on page 94.

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

Board Effectiveness

Areas of focus identified:	**Action taken:**
The need to develop the model through: • better visibility of the market landscape • aligning expectations of pace and change • continued focus on diversity of perspective.	Workshops with Corporate Development Director and Executive Board. Workshops with third party advisers.
The need to continue the work on executive talent management and succession planning through the Nomination Committee.	Focus on succession planning and talent reviews through the Nomination Committee. Reviewed the current priorities in terms of succession and talent development across the business. Engaged with high potential candidates through presentations at the Board meetings.

The Company complies with the requirement under provision B.1.2 of the 2016 Code that at least half of the Board, excluding the chair, should comprise non-executive directors determined by the Board to be independent, notwithstanding that this requirement is waived in respect of smaller companies, such as the Company, which is a member of the FTSE SmallCap Index.

Board induction

On appointment, new members of the Board take part in a tailored induction programme, organised by the company secretary and general counsel.

The induction programme for new directors covers the following activities and meetings:

1. Meeting with the Board, its Committees and other external stakeholders

As part of the appointment process, a newly appointed director has meetings with the chair, the senior independent director and Committee chairs to build up their understanding of the Costain business and its markets. Additionally, they will have the opportunity to meet with other key advisers and stakeholders, including the Company's financial advisers/brokers.

2. Meeting with senior management and staff

A newly appointed director will spend time at the Group's headquarters meeting the chief executive and chief financial officer. They will also have meetings with all the members of the Executive Board.

3. Understanding the business

A newly appointed director (accompanied by the relevant managing director) will carry out engagement tours at various operational sites. These tours will involve meeting with various members of the project team, including the supply chain, and learning about the nature of each of the projects including health, safety and environment aspects, and obtaining feedback.

4. Training

An electronic induction pack is provided to ensure a thorough understanding of the role of the newly appointed director and the framework within which the Board operates. This is coupled with a training session with the company secretary and General Counsel covering director's duties and the Group's corporate governance practices and procedures.

Ongoing Board training

As regards the continuing professional development of the executive and non-executive directors, Board members, independent of any formal training arranged by the Company, are encouraged to attend seminars and conferences on issues relevant to their appointment as directors of a public company, particularly matters concerned with corporate governance, audit and remuneration issues. In addition, Board site visits are considered essential to ensure that directors have a thorough understanding of the business operations and issues that affect the Group. The Board also takes part in the Company's health and safety training sessions.

Operation of the Board

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

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

In addition, between Board meetings, the chair and non-executive directors have access to the chief executive, chief financial officer and company secretary to progress the Company's business. The chair and non-executive directors also receive a weekly report from the chief executive, monthly management accounts, internal audit reports and regular management reports and information, which enable them to scrutinise the Group and its management's performance against agreed objectives. The Board is also kept up to date on legal, regulatory and governance matters by both the company secretary and external advisers.

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

Governance Report continued

How the non-executive directors are kept informed

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

Health and Safety

The Board considers health and safety its number one priority.

- All Board members hold a Construction Site Visitor Card certificated under the Construction Skills Certification Scheme.
- The Board also take part in twice yearly health and safety impact days which take place across all our sites.
- As part of the Company's commitment to health and wellbeing, all members of the Board have undertaken mental health awareness training.

Corporate Responsibility

The Board receives reports from the Company's corporate responsibility director and monitors progress on a regular basis.

Diversity

Details of the Company's diversity policy, in relation to the Board and senior executives, can be found on pages 60 and 61 and in the Nomination Committee Report on page 77.

Details of the Company's Group-wide approach to issues of diversity and equality can also be found on pages 60 and 61 of this annual report.

Directors' external appointments

The non-executive directors may serve on a number of other company boards provided they continue to demonstrate the requisite commitment to discharge their duties to the Company effectively and such external appointments are seen as being beneficial to the overall decision-making process of the Board as a whole. The Company also encourages the executive directors to take up non-executive positions, with the prior consent of the Company, in the belief that such appointments broaden their skills and enhance the contribution which they can make to the Company's performance. Generally, no more than one such appointment may be undertaken by the executive directors.

Remuneration

Details of the Company's remuneration policy and how it has been implemented, together with the activities of the Remuneration Committee are to be found on pages 78 to 97 of the Directors' Remuneration Report.

Shareholder communication and engagement

The Company remains committed to maintaining good relationships with both institutional and private shareholders. There continues to be regular dialogue with institutional investors and brokers. Additional details of how the Company engages with shareholders can be found on pages 36 and 37 of the Strategic Report.

The chair is available to discuss strategy and governance issues with shareholders. The senior independent director, Jane Lodge, is available to shareholders if they have any concerns that have not been, or cannot be, addressed through the normal channels of chair, chief executive or chief financial officer.

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

The Board regards the AGM as an important opportunity to communicate directly with shareholders. The AGM provides shareholders with an opportunity to ask questions of the directors during the meeting and also on a more informal basis following the conclusion of the meeting, at which senior members of staff are also present. The AGM also gives shareholders an opportunity to listen to a presentation from the chief executive on the current trading performance and developments within the business. Board members, including the chairs of the Remuneration, Nomination and Audit Committees, attended the 2018 AGM and propose to attend the 2019 AGM, where they will be available to answer questions.

Shareholders may raise issues or concerns by contacting the Group's investor relations director via the email address stated on the Company's website or by writing to the company secretary.

Accountability

Financial and business reporting

The Board is required by the 2016 Code to present a fair, balanced and understandable assessment of the Company's position and prospects and reference is made to the statement of directors' responsibilities on page 103 together with the statement on the status of the Company as a going concern and the financial Viability Statement on pages 52 and 53.

As can be seen from page 72 the preparation of this annual report involved input from a number of functions across the Group and the Board was involved at an early stage to enable review, challenge and discussion ahead of approving the final publication.

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

Business model

The Strategic Report on pages 1 to 53 gives details of the Company's business model and the strategy for delivering the objectives of the Company.

Going concern and viability

The directors consider that the Group and the Company have adequate resources to remain in operation for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. The 2016 Code requires the directors to assess and report on the prospects of the Group over a longer period. The longer-term Viability Statement is set out on pages 52 and 53.

Risk and internal control

Risk management

The Board is responsible for undertaking a robust assessment of the principal risks facing the Group, as described on pages 50 and 51 of the Strategic Report, including those that would threaten its business model, future performance, solvency and liquidity and ensuring that appropriate mitigating actions are in place to manage them.

The Group's approach to risk management as more fully described on pages 48 and 49 ensures that, on an ongoing basis, the most significant risks to the Group's objectives are identified, assessed and managed.

The Costain Way, which forms the basis of the Group's control framework, contains all policies, procedures and controls and is regularly updated to reflect the output of risk and assurance activity to ensure that there is continuous improvement to the control environment.

Internal control

The Board is responsible for the Group's systems of risk management and internal control and is required to regularly review their effectiveness. The Audit Committee has undertaken this review in accordance with the requirements of the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, published by the FRC, throughout the year and up to the date of this annual report. Further details can be found on page 74 of the Audit Committee Report.

The Group uses the Costain Way as the framework for the systems and controls in place to ensure that exposure to significant risks is managed appropriately. The Board recognises that such a system can only manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, but not absolute, assurance against material misstatement or loss.

The Group also has an independent internal audit function which undertakes a programme of risk based audits across all operations throughout the year. All audit reports are shared with the relevant business owners who are accountable for implementing appropriate measures to address any risks or controls weaknesses. The results of all internal audit activity are also shared with the chief executive, chief financial officer and scrutinised by the Executive Board and Audit Committee on a regular basis, further details of which can be found on page 74 of the Audit Committee Report.

Audit Committee Report

AUDIT COMMITTEE

Governance of the committee

The Audit Committee (the Committee) is comprised exclusively of independent non-executive directors, with myself acting as chair. The members of the Committee and details of their attendance at Committee meetings are given on page 67 and their biographies are shown on pages 54 and 55.

The company secretary is secretary to the Committee.

The Company considers that I, as chair, possess the necessary recent and relevant financial experience to effectively chair the Committee and am competent in accounting and auditing. In addition, the Company considers that the members of the Committee as a whole possess relevant skills and sector experience to meaningfully discharge the responsibilities of the Committee.

During 2018, the Committee held four meetings. The meetings of the Committee are normally also attended by the Group chair, the chief executive, the chief financial officer, the head of internal audit and risk, the financial controller and the external auditor. Other senior executives will attend as required to provide information on matters being discussed which fall into their area of responsibility. The Committee also regularly meets privately with the external auditor and the head of internal audit and risk.

Role of the Committee

In accordance with its terms of reference and in compliance with the 2016 Code, on behalf of the whole Board, the Committee is responsible for:

- monitoring the integrity of the Group's financial statements and any formal announcements relating to the Group's performance, and reviewing significant financial judgements contained in them
- providing advice (where requested by the Board) on whether the annual report, taken as a whole, is fair balanced and understandable, and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy
- reviewing the effectiveness of the Group's system of internal financial controls and internal control and risk management systems and the processes for management of the principal risks facing the Group
- monitoring and reviewing the effectiveness of the internal audit and risk function and approving, in consultation with the chief executive, the appointment and termination of employment of the head of that function
- reviewing the effectiveness of the external audit process and making recommendations to the Board in relation to the appointment, reappointment and remuneration of the external auditor
- ensuring that an appropriate relationship between the Group and the external auditor is maintained, including reviewing non-audit services and fees and the external auditor's independence
- reviewing its terms of reference and its effectiveness from time to time and recommending to the Board any changes required.

How do we ensure that the Group's financial statements, taken as a whole, are fair, balanced and reasonable?

The process is:

- comprehensive guidance issued to all contributors
- a verification process dealing with the factual content of the report
- review of the disclosure judgements made by the contributors of each section
- comprehensive reviews undertaken to ensure consistency and overall balance
- review undertaken by the Committee prior to recommendation to the Board.

The Audit Committee has ensured that the Group continues to have effective internal control and risk management systems and processes.

Jane Lodge
Chair

Activities

In 2018, the principal activities of the Committee and the manner in which it discharged its responsibilities were as follows:

Financial statements

The Committee reviewed and evaluated the Group's draft financial statements, preliminary and interim results and reports from the external auditor on the outcome of its reviews and audits in 2018.

Significant accounting matters

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

(A) Key contract judgements

As detailed in note 2 on pages 120 to 129 of the financial statements, a significant proportion of the Group's activities are undertaken via long-term contracts. These contracts are accounted for in accordance with IFRS 15, Revenue Recognition, which requires them to be accounted by their separately identifiable performance obligations. The costs and revenues of some of these performance obligations 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 any uncertainties are resolved.

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

The main contracts considered were:

- Thames Water AMP6
- London Bridge Station
- HS2 Enabling works
- A14
- Thames Tideway Tunnel
- A465 Heads of the Valleys
- Crossrail Bond Street, Paddington, Anglia and Systemwide
- Severn Trent AMP6
- Hinkley Jetty
- Peterborough and Huntingdon compressor stations
- BSSU.

This review included, among other things, consideration of the number of compensation events on the contract, changes in the design and construction requirements, the impact of any third-party factors and progress to date on negotiations with the client. The Committee considered in particular the extent to which events have impacted on the cost and programme to complete the contract and the associated level of judgement and appropriate accounting treatment. In reviewing the contract judgements consideration is also made to past performance on contracts and the success or otherwise of resolving any disputed matters. On the basis of its review of material contracts, the Committee concluded that it was content with the judgements that had been made by management and that appropriate disclosures had been made at the relevant times.

(B) Pension

The Group's defined benefit pension scheme requires significant judgements to be made in relation to the assumptions for inflation, future pension increases, investment returns and member longevity that underpin the valuation. Each year, in selecting the appropriate assumptions, the Company takes written advice from an independent qualified actuary. These assumptions and sensitivities are set out in note 21 on page 158 of the financial statements.

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

(C) Guaranteed minimum pension (GMP) equalisation

On 26 October 2018, the High Court issued a judgement involving Lloyds Banking Group defined benefit pension schemes. The judgement concluded that the schemes should be amended to equalise pension benefits for men and women in relation to GMP benefits. The judgement has implications for the majority of defined benefit schemes with liabilities before 1997, including the Costain Pension Scheme. In conjunction with Costain's actuarial advisers the best estimate of GMP equalisation to the Group is an increase of £8.6 million on the reported pension liabilities. This increase in liabilities represents a past service cost and has been recorded as a pre-tax exceptional expense on our income statement, shown within 'other items'.

(D) The carrying value of goodwill and intangible assets

As set out in note 11 on pages 137 and 138 of the financial statements, the goodwill and acquired intangible balances within the Group relate to companies acquired by the Group. In particular, the Committee reviewed the carrying value of the goodwill within the Natural Resources division. The Committee also critically reviewed the impairment considerations in respect of the goodwill and intangibles. The Committee agreed with the amortisation charge in respect of intangibles, and the conclusion that no impairment to goodwill was necessary.

Audit Committee Report continued

(E) Going concern and viability statement

The Committee reviewed the Group's processes for the management of cash flow and working capital, committed funding, its ability to generate cash and its ability to raise further funding. It also challenged management's sensitivity analysis including in relation to mitigating actions. The Committee also considered the period over which the Viability Statement (set out on pages 52 and 53) should apply. Based on this analysis, the Committee recommended to the Board that it could approve the Viability Statement and that the Group can adopt the going concern basis in preparing its financial statements.

(F) Future IFRS and UK GAAP developments

During the year, the Committee received reports from both the external auditor and the financial controller regarding the accounting developments likely to affect the presentation of the Group's financial statements, including IFRS 15 (Revenue from Contracts with Customers) and IFRS 9 (Financial Instruments) which first apply for the 2018 accounts, and IFRS 16 (Leases) which first applies for 2019.

The impact on the Group of these standards is explained in note 27 on page 170.

Audit, risk and internal control

The Board assumes ultimate responsibility for the effective management of risk across the Group. However, the Committee helps the Board in its monitoring of the Company's internal financial control, and internal controls and risk management systems and monitoring and reviewing the work of the internal audit function.

Internal audit

The internal audit and risk function plays an integral role in the Company's governance structure, providing independent assurance and advice to the help the Group achieve its strategic priorities. In December 2017, the Committee agreed the FY18 audit plan to be undertaken by the internal audit team and assessed the adequacy of the budget and resources. The audit plan is based on risk, strategic priorities and consideration of the strength of the control environment, and progress against the plan is monitored. The Committee reviews the results of the internal audit reports during each meeting which are graded. Management is responsible for ensuring that issues raised by internal audit are addressed within the agreed timetable and their timely completion is reviewed by the Committee. Where internal or external circumstances give rise to an increased level of risk, the audit plan is modified accordingly during the year.

The head of internal audit and risk continues to report directly into the chair of the Committee with a second reporting line to the company secretary for administrative purposes. During the year the Committee received the results of her annual performance review and reviewed statistics on key staff numbers, qualifications and experience which the Committee considered to be satisfactory.

The Committee also reviewed the results of the internal quality assurance reviews on the effectiveness of the internal audit function which evidenced continued improvement across all areas, including better alignment between audit planning and the Group's strategic objectives, resulting in the improved effectiveness of the internal audit function and improved reporting.

Accordingly, the Committee is satisfied that the quality, experience and expertise of the function is appropriate for the business.

Internal control and risk

Details of the Group's internal controls and risk management framework are more fully set out on pages 48 and 49 in the Strategic Report and page 71 in the Governance Report. The Group's principal risks are set out on pages 50 and 51.

The Committee has evaluated the effectiveness of the systems operated within the Group pursuant to the FRC's guidance on internal control. The evaluation covered all material controls, including financial, operational and compliance controls and encompassed a review of the management confirmation reports submitted by all senior management, controls reports, reports on fraud perpetrated against the Group, the Group's approach to anti-bribery and corruption and whistle-blowing and reports from both the internal and external auditors.

The review did not identify any significant weaknesses in the system of internal control and risk management.

External auditor

The Company's external auditor is PricewaterhouseCoopers LLP (PwC). The audit partner is Jonathan Hook.

Audit quality review

The FRC's Audit Quality Review team (AQR) carried out a review of the external audit of our financial reporting for the 31 December 2017 financial year as part of their routine processes. The chair of the Committee was involved in the planning for the review which included a preparatory call with the FRC. Following completion of the AQR, the Committee received a report on the outcome from the FRC.

The Committee was pleased to note that the audit work within the scope of the FRC's review was assessed as requiring limited improvements.

Effectiveness of the external audit process

Following the end of the 2017 financial year, the Committee considered the effectiveness of PwC as external auditor. As part of this process, external audit effectiveness questionnaires were completed by members of the Committee, the executive directors, other members of the Executive Board and certain members of the finance team. Based on the responses to the questionnaires, the company secretary produced a report for detailed consideration by the Committee. The Committee confirms that it remained satisfied with the efficiency and effectiveness of the external audit in respect of the year ended 31 December 2017.

During the year, the Committee has also kept under review the ongoing effectiveness of PwC as the Company's external auditor, for example, through the quality of the external auditor's reports and the audit partner's interaction with the Committee.

At its meeting in December 2018, the Committee considered and approved the external audit plan for the audit of the Group for the year ended 31 December 2018. The Committee considered significant risk areas for the audit, the proposed scope, and the materiality threshold.

Auditor independence and objectivity

Auditor independence and objectivity is an essential part of the audit framework and the assurance it provides. The auditor's independence is therefore monitored throughout the year. For example, the Committee has reviewed PwC's own policies and procedures for safeguarding its objectivity and independence and the arrangements that PwC have in place to identify, report and manage conflicts of interest. PwC are also required to rotate the lead audit partner every five years to ensure a fresh look without sacrificing institutional knowledge. Jonathan Hook has served two years out of five.

The Committee is not aware of any relationships between the external auditor and the Company that may reasonably be thought to bear on their integrity, independence and objectivity. The Committee reviews all services being provided by the external auditor annually to assess the independence and objectivity of the external auditor, taking into consideration relevant performance and regulatory requirements, so as to ensure that these are not impaired by the provision of permissible non-audit services.

The Committee confirms that it believes that the independence and objectivity of PwC and the effectiveness of the audit process remains strong and has therefore recommended the reappointment of PwC for 2019.

Non-audit fees

The Company has a policy on the provision of non-audit services by the external auditor, with the objective of ensuring that such services do not impair the independence or objectivity of the external auditor.

The policy also sets out a number of key principles that underpin the provision of non-audit services by the external auditor: the external auditor should not audit its own firm's work; make management decisions for the Group; have a mutuality of financial interest with the Group; or be put in the role of advocate for the Group.

Approval of the Committee is required for any services provided by the external auditor where the fee is likely to be in excess of £30,000.

In 2018, other than the interim review, the external auditor performed very limited non-audit services and fees payable to the external auditor were less than £0.1 million (2017: less than £0.1 million).

Evaluation of performance of the Committee

As part of the Board's annual evaluation, a review of the performance of the Committee was carried internally and facilitated by the company secretary under the direction of the chair. The effectiveness of the Committee and its chair was commended, and the review concluded that there were no significant areas for concern in respect of the performance of the Committee or any of its members

Whistle blowing and fraud

During 2018, the Committee on behalf of the Board has also considered the confidential reporting and whistle-blowing procedures the Company has in place and is satisfied with these procedures. The Committee also reviews any instances of fraud perpetrated against the Company and the action taken by management to prevent recurrences.

Jane Lodge

Chair

6 March 2019

Nomination Committee Report

AUDIT
COMMITTEE

Governance of the committee

The Nomination Committee (the Committee) is comprised exclusively of independent non-executive directors, with myself acting as chair. The members of the Committee and details of their attendance at Committee meetings are given on page 67 and their biographies are shown on pages 54 and 55.

The company secretary is secretary to the Committee.

Only members of the Committee have the right to attend Committee meetings. Other individuals, such as the chief executive, Group HR director, members of senior management and external advisers, may be invited to attend meetings as and when it is considered appropriate.

The outcome of all Committee meetings are reported to the Board for its consideration. The senior independent director of the Company will chair any meetings of the Committee that may deal with the appointment of my successor as chair of the Company. The Committee may take independent professional advice on any matters covered by its terms of reference at the Company's expense.

Role of the Committee

In accordance with its terms of reference and in compliance with the 2016 Code, the Committee is responsible for:

- reviewing the overall size, structure and composition of the Board
- identifying and nominating for the Board's approval, candidates to fill Board vacancies as and when they arise
- receiving notifications from directors of situations, such as proposed external appointments, in which a potential conflict of interest might arise and/or their time commitment to the Board could be compromised
- recommending to the Board the reappointment of those directors who are offering themselves for re-election at the Annual General Meeting following due consideration of the Board's policy on independence and the results of periodic Board performance reviews
- formulating plans for succession for both the executive directors and non-executive directors
- reviewing succession planning arrangements and development plans for other senior employees
- directing periodic Board effectiveness reviews, both internal and external, which form part of the regular evaluation and development work conducted by the Board to ensure it continues to improve its overall effectiveness.

Board composition is a key focus for the Nominations Committee, ensuring that the Board has the right skills and experience to direct the Company.

Paul Golby
Chair

Activities

In 2018, the principal activities of the Committee and the manner in which it discharged its responsibilities were as follows:

Succession planning

Succession planning has continued to be a key area of focus during the year, both in respect of the Board, including both Executives, and for those high performing individuals below Board level, together with an ongoing review of the structure and composition of the Board. This focus is aligned with and supportive of the Group's key strategic objective of enhancing its ability to provide smart infrastructure solutions that expertly integrate consultancy, complex delivery, technology and asset optimisation services.

Following the retirement of James Morley at the AGM in 2018, Jane Lodge became senior independent director while remaining chair of the Audit Committee.

In order to develop future executive talent, and to ensure that appropriate succession is in place, specific actions have been undertaken during the year in respect of certain members of the Executive Board, including the chief executive. This process has been conducted with the help of external consultants, Russell Reynolds Associates (formerly known as The Zygos Partnership), having no other connection with the Company, who undertook both a benchmarking exercise and facilitated personal assessments to discover both external and internal candidate's skills, potential and further development requirements.

In the year under review, the Committee also received updates from Sally Austin, the Group HR director, on the talent management and succession planning activities within the wider Group including those individuals within the Group who have been identified as having longer-term potential for senior roles. The Committee is satisfied that adequate succession planning is in place and will keep this under review.

Board diversity

The Company recognises the importance of diversity at the Board and all levels of the Group. Further details of the work undertaken in this area, including the Board's policy on diversity, our measurable objectives that have been set for implementing the policy and progress made on achieving these objectives, can be found at pages 60 and 61.

A copy of the Board's Diversity Policy relating to the whole of the workforce can be found on the Company's website at: www.costain.com.

The composition of our Board and Executive Board can be found on pages 54 and 55, and 56 and 57 of this annual report respectively.

Board evaluation

The Committee oversaw the internal evaluation of the Board and Committees during the year under review. Details of the review and actions to be taken can be found at page 68.

Reappointment of directors

Following the results of resolution 6 at last year's AGM regarding the re-election of David McManus, the Committee spent time during the course of the year considering all Board members' other appointments and the impact on their time availability in view of shareholders' concerns regarding overboarding. The Committee is satisfied that all Board members have, and commit, the time required to discharge their roles at Costain effectively. Although, it is considered that Mr McManus is also able to discharge his role effectively, the Committee notes the recent announcement by Rockhopper Exploration plc that Mr McManus is standing down as chairman at their forthcoming AGM in May 2019. Further, there were no significant changes to the chair's other commitments in the year.

Appointment of directors

There is a formal, rigorous and transparent procedure for the appointment of new directors to the Board which involves the use of an external search firm. Careful consideration is given to ensure the proposed candidates have the right skills, knowledge and experience and can devote sufficient time to the role.

Dr Paul Golby CBE

Chair

6 March 2019

Directors' Remuneration Report

Remuneration at a glance

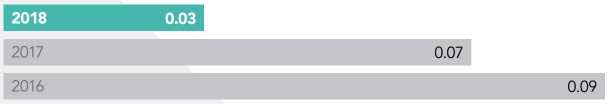
How did we perform in the year?

Group EBITA

£52.8m

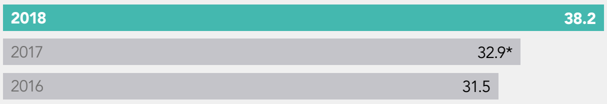
Group health and safety

0.03AFR[1]



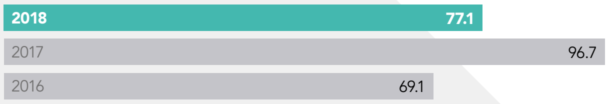
Underlying[2] earnings per share

38.2p



Cash flow (Average month end cash balance)

£77.1m



How was our performance reflected in our pay?

AIP – Award achieved by executive directors

	Group EBITA[3] (max opportunity: 50%)	Group Health and Safety (max opportunity: 10%)	Order Book (max opportunity: 10%)	Cash Flow[4] (max opportunity: 10%)	Personal Performance (max opportunity: 20%)	Total Achieved
Andrew Wyllie	30.8%	10%	0%	3.8%	18%	62.6%
Anthony Bickerstaff	30.8%	10%	0%	3.8%	18%	62.6%

LTIP – Award achieved by executive directors

	Aggregate EPS[5] (for financial years ended 31 December 2016, 2017 and 2018)	Total Achieved
Andrew Wyllie	107.14 pence (maximum vesting level: 101.70 p or more)	100%
Anthony Bickerstaff	107.14 pence (maximum vesting level: 101.70 p or more)	100%

Ensuring shareholder alignment

33% of AIP bonus is automatically deferred into Costain shares with a two year holding period.

50% Subject to performance targets being met, 50% of LTIP shares vest after three years; the remaining 50% vest after five years. For LTIP grants from 2019, LTIP shares which vest after three years will only be released after five years.

100% Company's Share Ownership Guidelines are currently set at 100% of salary for the executive directors. Both the current executive directors have exceeded this target.

1 Accident frequency rate.

2 Before other items; amortisation of acquired intangible assets, employment related deferred consideration, an exceptional one-off pension charge of £8.6 million in respect of the equalisation of Guaranteed Minimum Pensions (GMP) impacting UK companies with defined benefit pension schemes and a £2.6 million credit (2017: £2.5 million credit) for the reassessment of the accounting treatment of RDEC.

3 Earnings before interest, tax and amortisation; calculated on an underlying basis.

4 Measured pre-acquisition and investments.

5 Adjusted to exclude pension interest and other items considered to be one-off and unusual in nature or related to the accounting treatment of acquisitions.

* 2017 has been restated in accordance with common practice to reflect the decision to change the accounting treatment of Research and Development Expenditure credits (RDEC) which is a reclassification between operating profit and taxation. The 2017 reported basic earnings per share of 31.1p remains unchanged as a result of the restatement.

REMUNERATION COMMITTEE

Annual statement by chair of the Remuneration Committee

At a glance summary: executive directors' remuneration

2018 variable pay outcomes

2018 AIP outcome of 62.6% (chief executive) of maximum and 62.6% (chief financial officer) of maximum (see page 88).

One third of the amount earned under the 2018 AIP deferred in shares for two years.

Vesting of the 2016 LTIP award at 100% of maximum supported by an aggregate EPS of 107.14 pence for the three years ended 31 December 2018 (see page 89).

50% of the 2016 LTIP award vesting is subject to a two year holding period.

Implementation in 2019

Salary increase of 2% for chief financial officer from 1 April 2019.

Pension provision for any new executive directors appointed to the Board from 2019 will be subject to a maximum limit aligned with the majority of the wider workforce, which is currently 10% of salary.

Maximum 2019 AIP opportunity equal to 150% of salary subject to a mixture of financial and non-financial performance measures (see page 91).

Maximum 2019 LTIP award opportunity equal to 100% of salary subject to aggregate EPS performance and cash conversion performance over the three financial years ending 31 December 2021 (see page 92). For LTIP grants from 2019, LTIP shares which vest after three years will only be released after five years.

Enhanced AIP (including the deferred awards delivered under the SDP) and LTIP recovery provisions to include serious reputational damage, serious corporate failure, any material misstatement regardless of whether it leads to an over grant/payment/vesting; and in the event of gross misconduct without it being limited to the bonus year.

I am pleased to present our Directors' Remuneration Report, on behalf of the Board, for the year ended 31 December 2018.

Performance and variable pay outcomes for the year ended 31 December 2018

The Company has delivered another strong performance this year underpinned by a clear strategy and robust financial control, with continued growth in underlying profit, and an increase in higher value forward order book at £4.2 billion of revenue. Performance against the strategic priorities underpinning our strategy is set out on pages 26 to 28 of the Strategic Report.

The 2018 AIP award, one third of which is deferred in shares for two years, was subject to a mixture of financial and non-financial performance measures aligned with key strategic priorities. 50% was linked to EBITA and the remainder to continued improvement of our health and safety performance, order book profitability, cash management and the delivery of critical project and corporate activities which were the personal responsibility of our executive directors.

Based on 2018 EBITA of £52.8 million and taking into account performance in the year against the non-financial performance measures, the chief executive and chief financial officer will both receive 62.6% of their maximum AIP opportunity respectively, one third of which is deferred in shares for two years. Recognising that Andrew Wyllie was chief executive for the whole of 2018 and is stepping down and retiring from the Board on 7 May 2019, the Committee has awarded him a bonus based on the achievement of the applicable performance conditions. One third of this award will continue to be deferred in shares for two years. Performance against the non-financial performance measures has been rigorously reviewed by the Committee against tangible outcomes in 2018. In addition, the Committee considered underlying business performance during the period when determining the bonus outcomes. Further details are set out on page 88.

The LTIP award granted on 6 April 2016 was subject to an aggregate EPS target for the three financial years ended 31 December 2018 of 91.7 pence (15% vests) to 101.7 pence (100% vests). Based on aggregate EPS performance of 107.14 pence over the three years, 100% of the LTIP award is due to vest in April 2019. 50% of the amount vesting is subject to a two year holding period for the executive directors. Further details are set out on page 89. Since Andrew Wyllie was employed for the whole of the three-year performance period, the Committee intends to allow him to retain the benefit of this award. There will be no early release of the award, 50% of the amount vesting will continue to be subject to a two year holding period.

I am pleased to present our Directors' Remuneration Report, on behalf of the Board, for the year ended 31 December 2018.

Alison Wood
Chair

Directors' Remuneration Report continued
Annual statement by chair of the Remuneration Committee continued

Definitions used in this report

AIP: Annual Incentive Plan

EBITA: Underlying Earnings Before Interest, Tax and Amortisation as adjusted by the Remuneration Committee to exclude other items considered to be one-off and unusual in nature or related to the accounting treatment of acquisitions and to ensure that the performance measures are assessed on a consistent basis year-to-year

EPS: Underlying Earnings Per Share as adjusted by the Remuneration Committee to exclude pension interest and other items considered to be one-off and unusual in nature or related to the accounting treatment of acquisitions and to ensure that the performance measures are assessed on a consistent basis year-to-year

LTIP: Long-Term Incentive Plan

SDP: Share Deferral Plan

Remuneration policy

Our remuneration policy was approved by shareholders at our 2017 AGM, supported by over 98% of the votes cast.

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

Work responsibly and safely.	• AIP includes health and safety performance metrics.
Ensure we remain competitive and continue to deliver sustainable growth in profits and shareholder value within a challenging market.	• AIP performance measures aim to balance earnings growth and other key financial objectives (cash flow and order book) with non-financial indicators, particularly health and safety targets and specific individual objectives linked to the delivery of project and corporate activities critical to the strategic development of the business. • Our LTIP captures long-term growth in earnings and cash conversion, recognising that the sustainable generation of cash backed profits is a key element to the future success of the Company. Performance targets are set to reward sustainable business performance, while not encouraging inappropriate business risks to be taken.
Develop a best-in-class team.	• Our remuneration policy is designed to attract and retain high-calibre individuals in an increasingly competitive market and to remunerate executives fairly and responsibly.
Building a long-term sustainable business.	• One-third of any AIP award earned is deferred into shares to ensure that executives consider the longer-term impacts of their decisions and the effect on the sustainability of the business. • To further support longer-term alignment between executives and shareholders, subject to performance targets being met, 50% of LTIP shares vest after three years; and the remaining 50% vest after five years. For LTIP grants from 2019, LTIP shares which vest after three years will only be released after five years. • Further alignment between executives and shareholders is provided through our 100% of salary shareholding guidelines (or 200% of salary should the annual LTIP opportunity exceed 100% of salary).

Remuneration disclosure

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

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

The report is in two sections:

- Extract from the remuneration policy. This section contains the policy table summarising the remuneration policy approved at the 2017 AGM and is for information only. The full remuneration policy is available in the 2016 annual report on the Company's website at www.costain.com
- The annual report on remuneration. This section sets out details of how our remuneration policy was implemented for the year ended 31 December 2018 and how we intend for the policy to apply for the year ending 31 December 2019 and is the subject of an advisory shareholder vote at the 2019 AGM.

Executive Director changes

As announced on 6 March 2019, Andrew Wyllie, after 14 years as chief executive, is retiring to pursue a non-executive career. He will remain as chief executive and on the Board until 7 May 2019 and as an employee of the Company until 6 September 2019. He will be succeeded by Alex Vaughan who will be appointed as chief executive with effect from the conclusion of the Company's AGM on 7 May 2019.

In summary, the remuneration arrangements in respect of Andrew Wyllie's retirement, which are in line with the directors' remuneration policy, are:

Salary, pension and benefits	Andrew will continue to receive his current salary, benefits and pension allowance until his employment with the Group ends on 6 September 2019.
AIP 2018 and 2019 SDP	Recognising that he was employed for the whole of 2018, Andrew has earned a bonus for the year based on the achievement of the applicable performance conditions. He will be treated as a 'good leaver' for the purposes of the AIP as he is retiring and accordingly will be paid his performance-tested 2018 bonus at the time such bonuses are ordinarily paid (the end of March 2019). One third of the bonus will be delivered in the form of a deferred share award vesting on the normal vesting date (i.e. April 2021). Andrew will not be eligible to earn a bonus for the period of his service in 2019.
Unvested SDP awards	Andrew holds deferred share awards in respect of his 2016 and 2017 bonuses. Recognising his contribution to the business over the relevant bonus periods and the fact that the awards were not subject to further performance conditions, he will be treated as a 'good leaver' and he will be eligible to retain these awards. They will be released on the normal vesting date (i.e. April 2019 and April 2020 respectively). Both awards will remain subject to the malus and clawback provisions as set out in the SDP rules at the date of grant.
Unvested LTIP awards	50% of his 2015 LTIP award (which is vested over 56,046 shares) is due to be released in March 2020. Since this award was earned based on performance over the three years to 31 December 2017, the Committee has exercised discretion to allow him to retain this award. There will be no early release of this award. Again, since Andrew was employed for the whole of the three-year performance period in respect of his 2016 LTIP award over 132,678 shares, the Committee has also exercised discretion to treat him as a 'good leaver' and to allowed him to retain the benefit of this award subject to the satisfaction of the relevant performance conditions. There will be no early release of the award, and 50% of the amount vesting will continue to be subject to a two year holding period. Taking into account his significant contribution to the business and the fact he is retiring from the Board, the Committee has exercised discretion to treat him as a 'good leaver' and allowed him to retain his 2017 LTIP award over 103,491 shares and 2018 LTIP award over 104,707 shares subject to the satisfaction of the performance conditions at the end of the respective three year performance periods. These awards will be time pro-rated to reflect his period of service during the three year vesting period. There will be no early release of these awards, and 50% of the amount vesting will continue to be subject to a two year holding period. Andrew will not be eligible for an LTIP in 2019.
SAYE	Andrew holds SAYE options over 3278 shares which may be exercised in accordance with the rules of the scheme.
Legal Fees	Andrew will also receive a capped contribution of up to £3,300 (excluding VAT) towards legal fees incurred in connection with cessation of employment, the actual amount of which will be based on fees actually incurred.

The remuneration arrangements for Alex Vaughan are in line with the directors' remuneration policy and incorporate the best practice changes being adopted from 2019 as outlined below.

Reward for the year ending 31 December 2019

We approved, for the chief financial officer, a salary increase of 2% with effect from 1 April 2019 after carefully considering his performance and the range of salary increases awarded to other employees. Andrew Wyllie will not receive a salary increase for 2019 given he is stepping down as chief executive as from 7 May 2019. The base salary for Alex Vaughan on his appointment as chief executive will be £425,000. This was set balancing market rates taking into account the size and complexity of the Company, his skills and experience, his remuneration package as a whole, internal relativities and affordability to the Company, and ensuring that the Company does not pay more than is necessary.

Directors' Remuneration Report continued

Annual statement by chair of the Remuneration Committee continued

No changes are proposed to the quantum or structure of the AIP or LTIP for 2019. The AIP will be weighted 70% as regards financial measures, 10% as regards health and safety measures and 20% as regards other non-financial group and personal strategic measures including targets to specifically address growth in consultancy, advisory and technology capability. The Committee considers that this weighting appropriately aligns the AIP performance measures with key financial and strategic areas of the business. Details of the AIP performance measures are provided on page 92 and the targets with performance against them will be provided in the 2019 Directors' Remuneration Report. Details of the LTIP performance measures and targets are also provided on page 92.

Andrew Wyllie will not be eligible to earn a bonus for the period of his service in 2019 and he will not be granted an LTIP for 2019.

In line with the remuneration policy, Alex Vaughan's maximum 2019 AIP opportunity will be 150% of salary on his appointment as chief executive (applied on a time pro-rated basis from his appointment). One third of the bonus earned will be deferred under the SDP. His 2019 LTIP will be 100% of salary. LTIP shares which vest after three years will only be released after five years as detailed below.

The non-executive directors' basic fee and the Group chair's basic fee for 2019 is to increase by 2%.

UK Corporate Governance Code

Costain currently complies with the new UK Corporate Governance Code in a number of areas and will be considering its approach to compliance in the remaining areas during 2019, including developing a post-employment shareholding policy. This will form part of a wider remuneration policy review, which will be subject to shareholder approval at the 2020 AGM.

However, the Committee considers that the following areas of immediate change are warranted:

1. Pension provision for any new executive directors appointed to the Board from 2019 will be subject to a maximum limit aligned with the majority of the wider workforce, which is currently 10% of salary. Accordingly, Alex Vaughan's pension provision on his appointment as chief executive has been set at 10% of base salary.
2. As noted above, for LTIP awards granted from 2019, LTIP shares which vest after three years will only be released after five years.
3. For AIP (including the deferred awards delivered under the SDP) and LTIP awards granted from 2019, malus and clawback circumstances will be extended to include serious reputational damage, serious corporate failure, any material misstatement regardless of whether it leads to an over grant/payment/vesting; and in the event of gross misconduct without it being limited to the bonus year.
4. We have also augmented the Committee's ability to exercise discretion to make adjustments to the formulaic payout / vesting of variable incentives if the formulaic outcome is not considered to be appropriate.

The Committee is well placed to take into account wider workforce remuneration and related policies when reviewing the remuneration policy for executive directors.

Conclusion

We remain committed to a responsible approach to executive pay. Overall, given the Company's performance over the one and three-year periods ended 31 December 2018, we believe that the remuneration of the executive directors in respect of 2018 continues to reflect our success in the delivery of our strategy and the drive for profitable and sustainable long-term growth for our shareholders. The following pages describe in further detail how we have implemented our remuneration policy in 2018, together with our approach for 2019, the agenda of which will continue to focus on aligning reward with our strategy. We do not envisage any significant changes.

The remuneration policy approved at our 2017 AGM remains in force and we have therefore published the policy table only. The remuneration policy in its entirety is available in the 2016 annual report on our website.

Alison Wood

Chair

6 March 2019

Extract from the remuneration policy

The remuneration policy was approved by shareholders under a binding vote at the AGM on 8 May 2017. We have set out below the policy table and the full remuneration policy is available in the 2016 annual report on the Company's website at www.costain.com.

For ease of reference, we have noted below where we are making changes to the implementation of the policy in 2019. These changes do not currently form part of the binding policy but will form part of a wider remuneration policy review, which will be subject to shareholder approval at the 2020 AGM.

Remuneration policy for executive directors is set out below.

Element	Purpose and link to strategy	Operation	Performance metrics	Maximum opportunity
Salary	• To attract and retain high-calibre individuals. • Reflects skills, experience and performance in role. • Provides an appropriate level of basic fixed income while avoiding excessive risk arising from over reliance on variable income.	• Generally reviewed annually (with any change usually effective from 1 April) but exceptionally at other times of the year. • Set with reference to individual performance, experience and responsibilities. • Reflects the market rate for the individual and their role, determined with reference to remuneration levels in companies of similar size and complexity, taking into account pay levels within the Company in general. • Increases will usually be in line with average salary increases for the wider workforce (in percentage terms). • Higher increases may be appropriate in certain circumstances, which include but are not limited to, where an individual is promoted, changes role or where an individual is appointed on a below market salary with the expectation that their salary will increase with experience and performance.	• N/A	• To avoid setting expectations of future salary increases there is no maximum salary value set under the policy.
Annual Incentive Plan (AIP)	• To incentivise the achievement of key financial and strategic targets for the forthcoming year without encouraging excessive risk taking. • Promotes greater alignment with shareholders. • To facilitate share ownership.	• Two-thirds paid in cash. • Not pensionable. • Deferral into shares of one-third of earned AIP; this vests on the second anniversary of grant (subject, ordinarily, to continued employment and not being under notice of termination, either given or received, on the date of vesting). Deferred share awards may be granted as conditional awards or nil or nominal cost options. • The Committee may decide not to operate deferral where the amount of the bonus otherwise to be deferred would, in the opinion of the Committee be so small as to make deferral unduly administratively burdensome. Executives may, with the approval of the Committee, elect for a greater proportion of the AIP award to be deferred into shares. • Deferred share awards may include the right to receive a benefit (in cash or in shares) determined by reference to the value of dividends that would have been paid by reference to dividend record dates in the period from grant to vesting. The benefit may assume the reinvestment of dividends. • Shares provided under the AIP are typically purchased by a trust on behalf of the Group so as to not lead to any dilution of shareholder interest. • Awards may be subject to malus and clawback as described on pages 82 and 85.	• The Committee considers and approves the performance measures and targets at the start of each year and ensures they are aligned with business strategy and are sufficiently stretching. • Financial metrics will comprise at least 50% of AIP opportunity. The balance of the AIP opportunity will be based on financial metrics and/or non-financial metrics such as health and safety targets and personal objectives. • In setting financial parameters, the Committee takes into account the Company's internal budgets and, where applicable, investors' expectations. The targets applying to financial measures are based on a sliding scale between 0% and 100%. Up to 60% of the maximum potential will be earned for on-target performance. • The Committee may amend the pay-out if the formulaic output does not reflect its assessment of overall business performance.	• Maximum: 150% of salary. • The combined AIP and LTIP maximum opportunities for any year may not exceed 250% of salary.

Directors' Remuneration Report continued

Extract from the remuneration policy continued

Element	Purpose and link to strategy	Operation	Performance metrics	Maximum opportunity
Long-Term Incentive Plan (LTIP)	• Aligned to main strategic objectives of delivering sustainable performance which in turn should deliver enhanced returns.	• Annual grant of performance shares, half of which vest after three years subject, ordinarily, to continued service and subject to performance targets, and half of which vest after five years (the final two years being subject only to continued service). Awards may be granted as conditional awards or nil or nominal cost options. • For LTIP awards granted from 2019, LTIP shares which vest after three years will only be released after five years. • LTIP performance will be measured over three years. • LTIP awards may include the right to receive a benefit (in cash or in shares) determined by reference to the value of dividends that would have been paid on vested shares by reference to dividend record dates in the period from grant to vesting. The benefit may assume the reinvestment of dividends. • Awards may be subject to malus and clawback as described below.	• The performance condition will be based on key metrics aligned to the business strategy, including but not limited to EPS, return measures and cash-based measures. • At least 50% of the opportunity will be subject to an EPS performance measure. • Up to 25% of the maximum is earned for threshold performance, 100% for maximum with straight line vesting usually applying between these points.	• LTIP awards with a face value of not more than 150% of salary. • The combined AIP and LTIP maximum opportunities for any year may not exceed 250% of salary.
SAYE Scheme	• Offered to all UK employees, to facilitate share ownership and provide further alignment with shareholders.	• Periodic grants which normally vest after three or five years subject to continued service. • Operated under HMRC requirements as a tax qualifying plan.	• N/A	• Participation on the same basis as all other employees.
Pension	• To aid retention and remain competitive in the market place.	• Annual pension allowance. • Paid as a cash contribution to the defined contribution pension scheme, personal pension arrangements and/or a cash supplement.	• N/A	• 22% of base salary. • Pension provision for any new executive directors appointed to the Board from 2019 will be subject to a maximum limit aligned with the majority of the wider workforce, which is currently 10%.
Other Benefits	• To aid retention and be competitive in the market place. • Healthcare benefits to minimise business disruption.	• Company car (or car allowance) and fuel allowance. • Medical insurance. • Life assurance. • Other benefits as appropriate, for example, relocation expenses and travel and subsistence.	• N/A	• N/A
Share Ownership Guidelines	• Further alignment of interests between Costain Board and shareholders.	• Executive directors are expected to build and maintain a shareholding of not less than 100% of base salary (or 200% of salary should the annual LTIP opportunity exceed 100% of salary). Shares subject to LTIP awards for which the performance period has ended and which are subject, ordinarily, only to continued employment (or subject to an LTIP or SDP award where the award is exercisable but not exercised) count towards the shareholding guideline, on a net of assumed tax basis. Executive directors are required to retain half of the shares acquired pursuant to the LTIP and SDP (after sales to cover tax) until the shareholding guideline is met.	• N/A	• N/A

Notes to the Remuneration policy table

Performance measures

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

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

Recovery provisions

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

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

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

For AIP (including the deferred awards delivered under the SDP) and LTIP awards granted from 2019, malus and clawback circumstances will be extended to include serious reputational damage, serious corporate failure, any material misstatement regardless of whether it leads to an over grant/payment/vesting; and in the event of gross misconduct without it being limited to the bonus year.

Incentive plan operation

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

Share awards under the SDP and LTIP (and any applicable performance conditions) may be adjusted in the event of a variation of the Company's share capital or a demerger, special dividend or other event which affects the market price of a share.

Share awards under the SDP and LTIP may be satisfied in cash and may vest early, in accordance with the plan rules, in the event of a change of control or other relevant event (such as a winding-up or demerger). Where an LTIP award vests early, the extent of vesting will be determined taking into account the extent to which the performance condition has been satisfied (as assessed by the Committee) and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed. A copy of the plan rules is available on request from the company secretary.

Remuneration policy for the Group's chair and non-executive directors is set out below.

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

Directors' Remuneration Report continued
Annual report on remuneration

Governance of the Committee

The Remuneration Committee (the Committee) is comprised exclusively of independent non-executive directors. The members of the Committee and details of their attendance at Committee meetings are given on page 67. Biographies are shown on pages 54 and 55. The Committee is chaired by Alison Wood. The company secretary is secretary to the Committee.

Terms of reference

The Committee's terms of reference are available on the Company's website at www.costain.com. 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
9 February 2018	Consideration given to the extent to which the performance measures were likely to have been met with regard to the LTIP granted in 2015
	Approved the 2017 AIP annual cash bonuses subject to final audit of the 2017 accounts
	Approved the 2018 AIP performance measures and list of participants
	Approved indicative performance targets for the 2018 LTIP grant
	Noted the automatic vesting of the 2016 SDP Share Awards on 6 April 2018
	Reviewed the chair's and non-executive directors' fees for 2018
	Approved the executive directors and senior executives salaries for 2018
	Reviewed the Directors' Remuneration Report
	Approved the Gender Pay Gap Report for 2017
4 April 2018	Granted awards under the 2018 LTIP
	Granted awards under the SDP relating to the 2017 year-end AIP bonus
17 December 2018	Reviewed the performance targets and participants in respect of the proposed 2019 LTIP
	Reviewed the proposed 2019 AIP performance measures and list of participants
	Reviewed the 2019 annual salary increases for the executive directors, Group Executive Board and the wider workforce

Advice provided to the Committee

Advice was sought, where appropriate, from a number of sources. During the course of the year, the chief financial officer, the Group's chair, the Group HR director, and the legal director and company secretary were invited to attend various meetings of the Committee, although none was present when their own remuneration was being discussed.

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

It is the policy of the Committee to put the remuneration consultant function out to tender on a periodic basis to ensure that the Committee continues to receive independent support and advice of a high standard. Deloitte LLP was appointed in 2014 following a competitive tender process to act as the Committee's remuneration consultants. Deloitte LLP received fees of £20,100 (2017: £29,040) for the year ended 31 December 2018 in respect of services provided to the Committee.

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

Voting on the Remuneration Report at the AGM in 2018

Last year's Remuneration Report was approved by shareholders with a 99.58% (2017 AGM: 99.74%) vote in favour (including discretionary votes).

Voting on the remuneration policy at the AGM in 2017

The current remuneration policy was approved by shareholders with a 98.24% vote in favour (including discretionary votes) at the Company's 2017 AGM.

Implementation of policy in the year to 31 December 2018

Single total figure of remuneration for each director

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

	2018						2017					
	Salary and fees £	Taxable benefits £	Pension* £	Annual incentive £	LTIP** £	Total £	Salary and fees £	Taxable benefits £	Pension *** £	Annual incentive £	LTIP**** £	Total £
Executive directors												
A Wyllie	479,746	13,173	105,544	453,255	508,883	1,560,601	468,013	13,252	102,963	572,125	550,741	1,707,094
A O Bickerstaff	317,852	11,673	69,928	300,292	337,187	1,036,932	310,107	11,752	68,224	379,092	364,866	1,134,041
Non-executive chair												
P Golby	163,000	–	–	–	–	163,000	160,000	–	–	–	–	160,000
Non-executive directors												
J A Lodge	59,551	–	–	–	–	59,551	54,400	–	–	–	–	54,400
D McManus	45,844	–	–	–	–	45,844	45,000	–	–	–	–	45,000
J Morley[1]	18,510	–	–	–	–	18,510	51,600	–	–	–	–	51,600
A J Wood	52,844	–	–	–	–	52,844	52,000	–	–	–	–	52,000
J de Rojas[2]	45,844	–	–	–	–	45,844	5,308	–	–	–	–	5,308

* A pension contribution of £10,000 was paid to Andrew Wyllie's chosen pension arrangement and the balance was paid to him directly as a taxable benefit. The amount quoted for Anthony Bickerstaff was paid to him directly as a taxable benefit.

** The value of the 2016 LTIP which is due to vest in 2019, subject to the Committee's determination (see note (c) below), is based on the average share price over the final three months of 2018, being 364 pence per share.

*** A pension contribution of £12,500 was paid to Andrew Wyllie's chosen pension arrangement and the balance was paid to him directly as a taxable benefit. The amount quoted for Anthony Bickerstaff was paid to him directly as a taxable benefit.

**** The value of the 2015 LTIP which vested in March 2018, is based on the share price as at the date of vesting, 9 March 2018, being 474 pence per share. In accordance with the applicable regulations, the value included in the 2017 Directors' Remuneration Report was based on the average share price over the final three months of 2017, being 438 pence per share.

1 Retired as non-executive director w.e.f. 8 May 2018.

2 Appointed as non-executive director w.e.f. 20 November 2017.

Directors’ Remuneration Report continued

Annual report on remuneration continued

Additional notes to the single total figure of remuneration

(a) Taxable benefits provided to executive directors

The main benefits available to the executive directors during 2018 (and their approximate values) were a car allowance of £12,000 (2017: £12,000) for Andrew Wyllie and £10,500 (2017: £10,500) for Anthony Bickerstaff, together with private medical insurance for both executive directors of £1,173 (2017: £1,252). This package of benefits was unchanged from 2017.

(b) Determination of the 2018 annual incentive

The maximum AIP opportunity for the chief executive and the chief financial officer for the year ended 31 December 2018 remained unchanged from 2017 at 150% of base salary, with one third of the earned AIP award to be deferred into shares for a further two years and two thirds of the earned AIP award paid in cash. Grants will be made under the SDP in April 2019.

Recognising that Andrew Wyllie was chief executive for the whole of 2018, the Committee has awarded him a bonus based on the achievement of the applicable performance conditions. One third of this bonus will continue to be deferred in shares for two years.

The performance measures established by the Committee for the 2018 AIP continued to align with the Company’s strategy while not encouraging inappropriate business risks to be taken. These included inter alia a maximum target of £57.9 million for Group EBITA.

The achievement of the performance measures has been reviewed, with appropriate input from the Audit Committee, following the end of the 2018 financial year. The maximum 2018 AIP opportunity against each of the performance measures is shown below, together with the AIP award actually achieved.

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

	AIP opportunity – maximum percentage of bonus		AIP award – as a percentage of bonus		AIP performance measure		
Performance measures	**Andrew Wyllie**	**Anthony Bickerstaff**	**Andrew Wyllie**	**Anthony Bickerstaff**	**Threshold**	**Maximum**	**Actual performance**
Group EBITA[1]	50%	50%	30.8%	30.8%	£47.3m	£57.9m	£52.8m
Group Health and Safety[2]	10%	10%	10%	10%	n/a	AFR 0.04	AFR 0.03[4]
Order Book (level of secured gross profit)	10%	10%	0%	0%	£75.9m	£92.8m	£67.5m
Cash Flow[3] (average month end cash balance)	10%	10%	3.8%	3.8%	£72m	£88m	£77m
Personal Performance	20%	20%	18%	18%	see personal performance section below		
Total	100%	100%	62.6%	62.6%			

1 Calculated on an underlying basis as approved by the Committee.
2 Includes leadership of health and safety engagement and culture.
3 Measured pre-acquisition and investments.
4 AFR of 0.03 represents a record safety performance for the Group.

Personal performance

Personal performance was based on the delivery of project and corporate activities critical to the strategic development of the business which were the personal responsibility of the executive directors. Details of the executive directors' performance against their personal objectives is set out below.

Andrew Wyllie and Anthony Bickerstaff

Objective	Achievement during the year	Maximum	Award
Technology and consulting	• Forthcoming move to an enlarged technology facility near Bristol. • A number of technology contracts won and significant increase to the pipeline of opportunities.	5	4
Developing the senior team, including EDI performance	• Successful appointments made to strengthen senior succession planning including executive director succession. • Significant progress on our Inclusion Strategy, including WISE Employer of the Year, Times Top 50 Employer for Women and our Executive Board is now 33% female.	5	5
Transformational change	• Considerable progress made during the year transforming Costain into a smart infrastructure solutions company including important contract wins such as the CAV testing contract on the A2/M2 for Highways England. • BUY Recommendations from our analysts with an increasing understanding of the Company's differentiation and clear focused strategy. • An increasing margin from 2.8% to 3% reflecting impact of transformational change.	10	9
		20%	18%

(c) Vesting of the 6 April 2016 LTIP award

The LTIP award granted on 06 April 2016 was based on performance for the three years ended 31 December 2018.

Since Andrew Wyllie was employed for the whole of the three-year performance period, the Committee intends to allow him to retain the benefit of this award. There will be no early release of the award, 50% of the amount vesting will continue to be subject to a two year holding period.

100% of this award is subject to the following performance measure:

Aggregate EPS for the financial years ended 31 December 2016, 2017 and 2018	Vesting level
Below 91.7 pence	0%
91.7 pence	15%
Between 91.7 pence and 101.7 pence	15% – 100% pro rata
101.7 pence or more	100%

For the purposes of the LTIP, EPS is adjusted by the Committee to take account of relevant events (such as acquisitions or disposals and excludes pension interest) and to ensure that the performance measures are assessed on a consistent basis year-to-year. Aggregate EPS for the financial years ended 31 December 2016, 2017 and 2018, calculated on an adjusted basis approved by the Committee, was 107.14 pence as a result of which the LTIP award granted on 6 April 2016 is due to vest by 100%.

	Number of shares granted	Number of shares due to vest [1, 2]	Number of shares due to lapse [1]	Number of dividend shares due to vest [3, 4]	Total shares due to vest [1, 2]	Estimated value [3]
Andrew Wyllie	132,678	132,678	–	7,125	139,803	£508,883
Anthony Bickerstaff	87,913	87,913	–	4,721	92,634	£337,187

1 Subject to the Committee's official determination that the performance measure has been met and to any other adjustment.

2 50% of the award is subject to a two-year holding period.

3 Value based on the average share price over the final three months of the financial year ended 31 December 2018, being 364 pence per share.

4 Relating to 50% of the award vesting and capable of exercise three years after grant only. Additional dividend shares will also be payable on the 50% of the award subject to a two-year holding period.

Directors' Remuneration Report continued
Annual report on remuneration continued

(d) Pensions and life assurance

Under their terms of engagement, the executive directors are entitled to an annual pension allowance of 22% of base salary. Life assurance cover of four times base salary is provided through the Costain Life Assurance Scheme. The annual premiums payable in respect of life assurance for Andrew Wyllie and Anthony Bickerstaff were £2,481 (2017: £2,392) and £1,644 (2017: £1,585) respectively.

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

e) Chair

Remuneration for the chair comprises a basic annual fee of £164,000.

(f) Non-executive directors

Remuneration for non-executive directors, other than the Group's chair, comprises a basic annual fee for acting as a non-executive director of the Company and additional fees for the senior independent director and chairship of the Audit and Remuneration Committees. The annual fees set with effect from 1 April 2018 were as follows:

2018 Fees	Basic Fee	Senior independent director	Audit Committee chair	Remuneration Committee chair
Fees	£46,125	£6,600	£9,400	£7,000

Grants made during the year

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

2018 LTIP Grant

Grants were made under the LTIP on 4 April 2018. The grant level for the executive directors remains at 100% of salary. Half of the award vests after three years, subject to continued service and the achievement of performance measures (as set out below), and the other half vests after five years (the final two years being subject only to continued service), thereby ensuring long-term alignment of the executive directors' and shareholders' interests.

Performance measures for the 2018 LTIP are as follows:

(A) EPS performance measures (relating to 75% of the award):

Aggregate EPS over the financial years ended 31 December 2018, 2019 and 2020	Vesting level
Below 117.2 pence	0%
117.2 pence	15%
128.9 pence or more	100%
Between 117.2 pence and 128.9 pence	Between 15% and 100% pro rata on a straight-line basis

(B) Cash conversion performance measures (relating to 25% of the award)

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

The share awards granted under the 2018 LTIP are as follows:

	Number of shares	Face value[1]	End of performance period	Threshold vesting	Weighting (% of award)
Andrew Wyllie	104,707	£482,700	31 December 2020	15%	100%
Anthony Bickerstaff	69,370	£319,800	31 December 2020	15%	100%

1 Valued using the share price on the business day prior to the date of grant (3 April 2018), being 461 pence per share.

2018 SDP Grant

The Company granted awards under the Costain Share Deferral Plan (SDP) to the executive directors during 2018, details of which are shown on page 96.

All-employee share plan

The Company granted options under the Costain SAYE scheme to the executive directors during 2018, details of which are shown on page 96.

Implementation of policy in the year to 31 December 2019

Salary

For 2019, the Committee approved a 2% increase for the chief financial officer, effective 1 April 2019. A 2% salary increase budget will also be applied across the Company in 2019. The Committee confirmed that Andrew Wyllie will not receive a salary increase for 2019 given he is stepping down as chief executive. The base salary for Alex Vaughan on his appointment as chief executive will be £425,000. This was set balancing market rates taking into account the size and complexity of the Company, his skills and experience, his remuneration package as a whole, internal relativities and affordability to the Company, and ensuring that the Company does not pay more than is necessary.

	Salary 2019	Salary 2018	% change
Andrew Wyllie	£482,700	£482,700	Nil%
Anthony Bickerstaff	£326,196	£319,800	2%

Non-executive director fees

Non-executive directors' fees (basic fees only) are to increase by 2%, with effect from 1 April 2019, as shown in the table below:

2019 Fees	Basic Fee	Senior Independent director	Audit Committee chair	Remuneration Committee chair
Fees	£47,048	£6,600	£9,400	£7,000

2019 Annual incentive

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

The maximum bonus opportunity for the chief executive and the chief financial officer for the year ending 31 December 2019 will remain unchanged from 2018 at 150% of base salary, with one third of earned bonus deferred into shares for a further two years, to be awarded under the SDP, and two thirds of earned AIP paid in cash.

Directors' Remuneration Report continued
Annual report on remuneration continued

The performance measures for the 2019 AIP are as follows:

	2019 AIP opportunity – maximum percentage of bonus	
Performance measures	**Chief Executive Officer**	**Chief Financial Officer**
Group EBITA	50%	50%
Group health and safety	10%	10%
Order book percentage of target gross profit	10%	10%
Cash flow (average month end cash balances)	10%	10%
Personal performance	20%	20%
Total	100%	100%

Andrew Wyllie will not be eligible to earn a bonus for the period of his service in 2019.

In line with the remuneration policy, Alex Vaughan's maximum 2019 AIP opportunity will be 150% of salary on his appointment as chief executive (applied on a time pro-rated basis from his appointment). One third of the bonus earned will be deferred under the SDP.

The Committee has chosen not to disclose in advance the performance targets for the year ending 31 December 2019, as these include items which the Committee considers commercially sensitive. The Committee will continue to provide retrospective disclosure of performance targets in next year's annual report on remuneration to the extent the Committee determines these targets are not commercially sensitive.

2019 LTIP Grant

The grant level for the executive directors remains at 100% of salary. Subject to the achievement of performance measures as set out below, LTIP shares which vest after three years will only be released after five years, thereby ensuring long-term alignment of the executive directors' and shareholders' interests.

Andrew Wyllie will not be granted an LTIP for 2019.

It is proposed that the 2019 LTIP awards will be subject to EPS performance (75% of the award) and cash conversion performance (25% of the award).

It is proposed that the targets for the 2019 LTIP award will be as follows:

EPS performance measure

Sum of the EPS for the financial years ending 31 December 2019, 2020 and 2021	Vesting level for awards
Below 128.2 pence	0%
128.2 pence	15%
141.0 pence or more	100%
Between 128.2 pence and 141.0 pence	Between 15% and 100% pro rata on a straight-line basis

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

Cash conversion performance measure

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

Cash conversion is adjusted cash flow from operations (excluding cash movements in provisions and pension deficit) divided by EBITDA. It is measured as average cash flow conversion over the three-year period ending 31 December 2021.

Cash flow from operations will be adjusted to recognise the timing of cash inflows at the year-end.

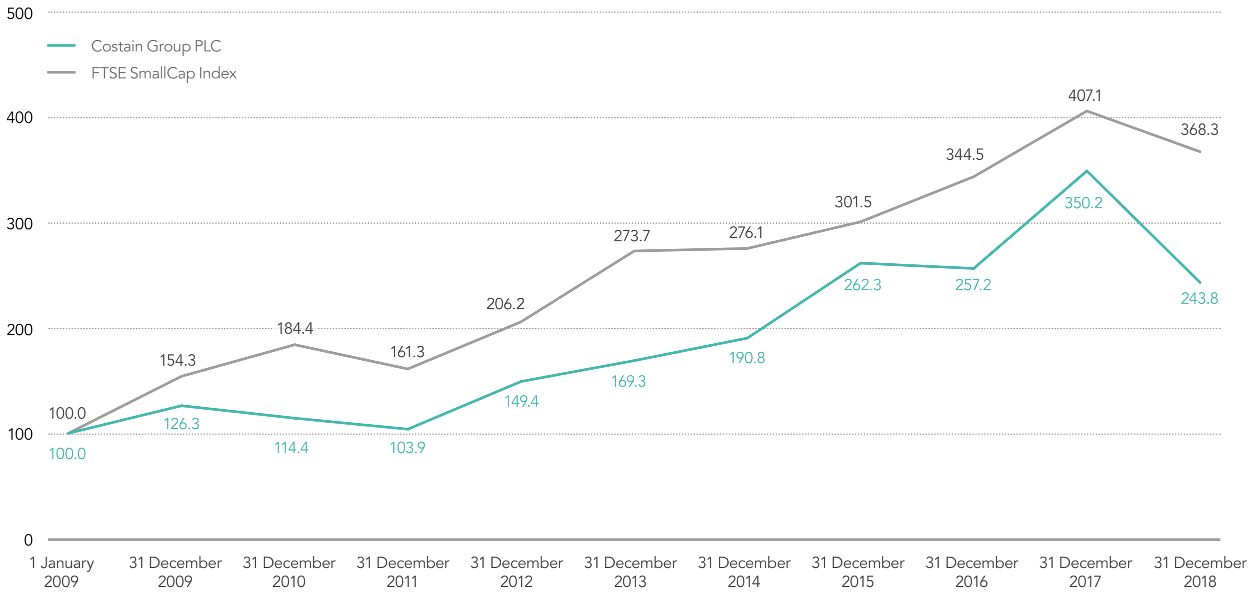
The Committee has the discretionary power to vary these targets, should circumstances change, so that the original targets are no longer considered appropriate, for example in the case of a material acquisition or divestment in the Group.

A clawback and malus provision is incorporated in the AIP and the LTIP 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, reputational damage and a serious corporate failure. The Committee also has the ability to exercise discretion to make adjustments to the formulaic payout / vesting of variable incentives if the formulaic outcome is not considered to be appropriate.

Other information

Performance graph

The graph below shows the value, to 31 December 2018, of £100 invested in Costain Group PLC on 1 January 2009 compared with the value of £100 invested in the FTSE SmallCap Index. The Committee believes that the SmallCap Index is a more appropriate index to use than the FTSE All-Share Index as it is the index in which the Company is a constituent and comprises companies of a similar size to Costain.



Source: Thomson Reuters DataStream

Change in chief executive's remuneration

	Year ending 31 December									
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total remuneration	£887,814	£1,603,014	£1,228,332	£1,089,337	£1,251,239	£1,329,007	£1,414,381	£1,089,943	£1,707,094	£1,560,601
AIP (%)	84%	94%	86%	55%	75%	71.6%	79.8%	75.4%	81%	62.6%
LTIP vesting (%)	Nil%	96%	100%	100%	50%	50%	50%	Nil%	79.1%	100%

Directors' Remuneration Report continued
Annual report on remuneration continued

Statement of change in pay of chief executive compared to other employees

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

	2018	2017	% change
Chief executive			
– salary	£479,746	£468,013	2.5%
– benefits	£13,173	£13,252	(0.1)%
– bonus (annual incentive)[1]	£453,255	£572,125	(20.8)%
Average per employee			
– salary[2]	£47,964	£45,893	4.5%
– benefits[3]	£5,307	£5,090	4.3%
– bonus (annual incentive)[4]	£3,976	£3,485	14.1%

1 Bonus figures for the chief executive are calculated on the basis of the combined cash bonus actually achieved and the value of the share options that were granted/to be granted under the AIP.

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

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

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

Relative importance of spend on pay

The table below illustrates the change in expenditure by the Company on remuneration paid to all the employees of the Group and distributions to shareholders from the financial year ended 31 December 2017 to the financial year ended 31 December 2018.

	2018 £m	2017 £m	% change
Overall expenditure on pay	225.0	222.0	1.35%
Dividends and share buybacks	15.2	13.7	10.9%

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

Directors' appointment

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

Director	Date of original appointment	Expiry of current term [1, 2]	Next AGM at which the director is required to stand for re-election[2]
Andrew Wyllie	25 April 2005	Terminable on 12 months' notice	2019 AGM
Anthony Bickerstaff	3 March 2006	Terminable on 12 months' notice	2019 AGM
Paul Golby	5 May 2016	5 May 2019	2019 AGM
Jane Lodge	1 August 2012	1 August 2021	2019 AGM
Alison Wood	1 February 2014	1 February 2020	2019 AGM
David McManus	12 May 2014	12 May 2020	2019 AGM
Jacqueline de Rojas	20 November 2017	20 November 2020	2019 AGM

1 The appointment of a non-executive director can be terminated by reasonable notice on either side (of not less than one month).

2 In accordance with the 2018 UK Corporate Governance Code, at each AGM all the directors are required to seek re-election.

External directorships

Andrew Wyllie was appointed as a non-executive director of Yorkshire Water Services Limited on 1 September 2017 and, in respect of his appointment for the year ended 31 December 2018, he was paid £50,000 (2017: £16,667).

Anthony Bickerstaff was reappointed, with effect from 12 November 2017, for a second three year term as a non-executive director and chair of the Audit Committee of Low Carbon Contracts Company Limited and Electricity Settlements Company Limited and, in respect of his appointment for the year ended 31 December 2018, he was paid £31,000 (2017: £31,000).

The executive directors have retained these fees in accordance with the policy set out in the Policy Report.

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

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

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

Director	Date granted	Balance at 1 January 2018	Granted during year	Share price at date of grant	Vested during year	Lapsed during year	Market price at date of exercise	Average market price at date of sale/ retention of balance	Value of shares at date of sale/ retention of balance (excluding shares deducted to settle tax sold at market price on date of exercise)	Balance at 31 December 2018	Actual/ expected vesting date
Andrew Wyllie	09.03.15[1]	141,710	–	316p	56,046*	29,618	474p	476p	£151,730	56,046	March 2018 March 2020
	06.04.16[2]	132,678	–	346.25p	–	–	–	–	–	132,678	April 2019 April 2021
	05.04.17[3]	103,491	–	455p	–	–	–	–	–	103,491	April 2020 April 2022
	04.04.18[4]	–	104,707	461p	–	–	–	–	–	104,707	April 2021 April 2023
Anthony Bickerstaff	09.03.15[1]	93,883	–	316p	37,131*	19,622	474p	476p	£100,522	37,130	March 2018 March 2020
	06.04.16[2]	87,913	–	346.25p	–	–	–		–	87,913	April 2019 April 2021
	05.04.17[3]	68,573	–	455p	–	–	–		–	68,573	April 2020 April 2022
	04.04.18[4]	–	69,370	461p	–	–	–	–	–	69,370	April 2021 April 2023

* In addition, dividend shares were awarded upon vesting – Andrew Wyllie: 4,098 shares; Anthony Bickerstaff: 2,715 shares.

1 100% of the award was subject to an aggregate EPS target for the financial years ended 31 December 2015, 2016 and 2017 of 83.9 pence (15% vests) to EPS of 96.9 pence (100% vests) on a sliding scale between 15% and 100% pro rata to the EPS actually achieved. 50% of the award will normally vest three years after grant, subject to the satisfaction of the performance conditions over the three-year financial period ended 31 December 2017, while the remaining 50% of the award will normally vest on the fifth anniversary of the date of grant (with no further performance conditions applying) provided, ordinarily, the individual remains an employee or officer of the Company. This award vested by 79.1% based on aggregate EPS performance during the period.

2 100% of the award is subject to an aggregate EPS target for the financial years ended 31 December 2016, 2017 and 2018 of 91.7 pence (15% vests) to EPS of 101.7 pence (100% vests) on a sliding scale between 15% and 100% pro rata to the EPS actually achieved. 50% of the award will normally vest three years after grant, subject to the satisfaction of the performance conditions over the three-year financial period ending 31 December 2018, while the remaining 50% of the award will normally vest on the fifth anniversary of the date of grant (with no further performance conditions applying) provided, ordinarily, the individual remains an employee or officer of the Company. This award is due to vest by 100% based on aggregate EPS performance during the period.

3 Performance targets are as follows:

(a) an EPS target (relating to 75% of the award) of 101.4p (for 15% vesting) and 113.6p (for 100% vesting), with vesting on a straight-line basis between the two; and

(b) a cash conversion target (relating to 25% of the award) of 80% (for 15% vesting) and 100% (for 100% vesting), with vesting on a straight-line basis between the two.

50% of the award will normally vest three years after grant, subject to the satisfaction of the performance conditions over the three-year financial period ending 31 December 2019, while the remaining 50% of the award will normally vest on the fifth anniversary of the date of grant (with no further performance conditions applying) provided, ordinarily, the individual remains an employee or officer of the Company.

4 Performance targets are as follows:

(a) an EPS target (relating to 75% of the award) of 117.2p (for 15% vesting) and 128.9p (for 100% vesting), with vesting on a straight-line basis between the two; and

(b) a cash conversion target (relating to 25% of the award) of 80% (for 15% vesting) and 100% (for 100% vesting), with vesting on a straight-line basis between the two.

50% of the award will normally vest three years after grant, subject to the satisfaction of the performance conditions over the three-year financial period ending 31 December 2020, while the remaining 50% of the award will normally vest on the fifth anniversary of the date of grant (with no further performance conditions applying) provided, ordinarily, the individual remains an employee or officer of the Company.

The LTIP awards, which are expressed as options, have a nil exercise price. At 31 December 2018, the derived mid-market price of the ordinary shares in the Company, as advised by the Company's brokers, was 315.50 pence. The range of the closing share price of the ordinary shares during 2018 was 302 pence to 488.50 pence.

Directors' Remuneration Report continued

Annual report on remuneration continued

Share awards under the Share Deferral Plan (SDP)

Details of the executive directors' participation in the SDP are as follows:

Director	Date granted	Balance at 1 January 2018	Granted during year	Share price at date of grant	Vested during year	Lapsed during year	Market price at date of exercise	Average market price at date of sale/retention of balance	Value of shares at date of sale/retention of balance (excluding shares deducted to settle tax sold at market price on date of exercise)	Balance at 31 December 2018	Actual/expected vesting date
Andrew Wyllie	06.04.16	51,643[1]	–	346.25p	51,643[3]	–	460.50p	460.60p	£132,837	–	April 2018[2]
	05.04.17	38,064[1]	–	455p	–	–	–	–	–	38,064[1]	April 2019[2]
	04.04.18	–	41,368[1]	461p	–	–	–	–	–	41,368[1]	April 2020[2]
Anthony Bickerstaff	06.04.16	34,428[1]	–	346.25p	34,428[3]	–	460.50p	460.60p	£88,555	–	April 2018[2]
	05.04.17	25,221[1]	–	455p	–	–	–	–	–	25,221[1]	April 2019[2]
	04.04.18	–	27,410[1]	461p	–	–	–	–	–	27,410[1]	April 2020[2]

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

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

3 In addition, dividend shares were awarded upon vesting – Andrew Wyllie: 2,773 shares; Anthony Bickerstaff: 1,848 shares.

Share Options under the SAYE Scheme (SAYE)

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

Director	Date granted	Balance at 1 January 2018	Granted during year	Exercise price	Exercised during year	Lapsed during year	Market price at date of exercise	Market price at date of retention	Value of shares at date of retention	Balance at 31 December 2018	Exercised/exercisable from/to
Andrew Wyllie	28.09.15	1,834	–	314p	1,834	–	360p	360p	£6,602.40	–	Nov 2018 May 2019
	26.09.16	645	–	279p	–	–	–	–	–	645	Nov 2019 May 2020
	25.09.17	1,319	–	357.40p	–	–	–	–	–	1,319	Nov 2020 May 2021
	24.09.18	–	1,314	336.80p	–	–	–	–	–	1,314	Nov 2021 May 2022
Anthony Bickerstaff	28.09.15	1,834	–	314p	1,834	–	360p	360p	£6,602.40	–	Nov 2018 May 2019
	26.09.16	1,251	–	279p	–	–	–	–	–	1,251	Nov 2019 May 2020
	25.09.17	1,289	–	357.40p	–	–	–	–	–	1,289	Nov 2020 May 2021
	24.09.18	–	1,314	336.80p	–	–	–	–	–	1,314	Nov 2021 May 2022

The gain realised in total by the executive directors on exercising their SAYE share options was £1,687 in 2018.

Directors' shareholdings

Details of the directors' share interests in the Company as at 31 December 2018, and at the date of this report, are as follows:

Director	Beneficially owned	Outstanding SDP awards	Outstanding LTIP awards	Outstanding SAYE awards	Shareholding guidelines (% of salary/fee)	Actual shareholding (% of salary/fee)[3]
Andrew Wyllie[1]	454,611	79,432	396,922	3,278	100%	251.31%
Anthony Bickerstaff[1]	258,601	52,631	262,986	3,854	100%	217.36%
Paul Golby[2]	35,000	–	–	–	100%	69.44%
Jane Lodge	24,658	–	–	–	100%	90.68%
Alison Wood	6,666	–	–	–	100%	28.23%
David McManus	0	–	–	–	100%	0%
Jacqueline de Rojas[2]	3,194	–	–	–	100%	32.51%

1 Part held by persons closely associated.

2 Held by persons closely associated.

3 Based on the calculation methodology set out in the Company's Share Ownership Guidelines.

The executive directors are expected to build and maintain a shareholding of not less than 100% of base salary through the retention of vested share awards or through open market purchases. This increases to 200% of salary should the annual LTIP opportunity exceed 100% of salary. The non-executive directors are also expected to build and maintain a shareholding of 100% of their fee.

Directors' Report

The directors submit to the members their report and accounts of the Company for the year ended 31 December 2018.

The Governance Report on pages 54 to 97 and the Strategic Report on pages 18 to 53 (and in particular pages 32, 33 and 61 with regard to information about employee involvement and greenhouse gas emissions) are also incorporated into this report by reference.

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

Incorporation and constitution

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

Annual General Meeting (AGM)

The Company's 2019 AGM will be held on 7 May 2019 at The Lincoln Centre, 18 Lincoln's Inn Fields, London WC2A 3ED. A circular incorporating the Notice of AGM accompanies this annual report.

Profit and dividend payments

Profit after tax for the financial year ended 31 December 2018 amounted to £32.8 million (2017: £32.6 million). An interim dividend of 5.15 pence per share (2017: 4.75 pence) amounting to £5.5 million (2017: £5.0 million) was paid on 19 October 2018.

A final dividend at the rate of 10.0 pence per share (2017: 9.25 pence) amounting to £10.7 million (2017: £9.8 million) will also be recommended to shareholders at the Annual General Meeting (AGM) to be held on 7 May 2019. If approved, the dividend will be paid on 17 May 2019 to shareholders registered at close of business on 12 April 2019.

Dividends and other distributions

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

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

Share capital

The Company's share capital consists of ordinary shares with a nominal value of 50 pence each. The issued share capital of the Company as at 31 December 2018 was £53,506,924, consisting of 107,013,848 ordinary shares of 50 pence each. Further details of the share capital of the Company can be found in note 22 on page 161.

The awards granted in March 2015 under the 2014 Long-Term Incentive Plan (LTIP) matured as at 31 December 2017, resulting in the vesting of awards in March 2018 over 368,937 ordinary shares of 50 pence each (excluding dividend shares) with a nil exercise price. A further 93,176 awards granted under the LTIP in March 2015 are due to vest in March 2020. Further details regarding the vesting of the 2015 LTIP awards can be found in the Directors' Remuneration Report on page 95. Details regarding the 2016 LTIP awards that are due to vest in April 2019 can be found in the Directors' Remuneration Report on page 89.

Share options granted under the Company's Save As You Earn Scheme (SAYE) in November 2015 (at an option price of 314p) matured as at 1 November 2018, resulting in the exercise of options as at 31 December 2018 over 541,548 ordinary shares of 50 pence each. Further details of the SAYE Scheme can be found on page 96 of the Directors' Remuneration Report.

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

In May 2018, 266,271 ordinary shares of 50 pence each were allotted to shareholders in respect of the final dividend for 2017 and, in October 2018, 65,892 ordinary shares of 50 pence each were allotted to shareholders in respect of the interim dividend for 2018. Further information on the scrip dividend scheme is set out on page 174. Details about joining the scrip dividend scheme can also be found on the Company's website at www.costain.com.

Restrictions on transfer of securities

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

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

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

Major shareholders

As at 31 December 2018 the Company had been notified, under the Disclosure Guidance and Transparency Rules issued by the Financial Conduct Authority (DTR5), of the following notifiable interests in its ordinary share capital:

Shareholder	Date of notification	Number of shares/voting rights	% of voting rights	Number of shares/ voting rights attaching to financial instruments	% of voting rights	Aggregate % of voting rights
Standard Life Aberdeen plc	09/07/2018	7,886,465	7.41	n/a	n/a	7.41
Polar Capital LLP	21/12/2018	6,053,095	5.65	n/a	n/a	5.65
Ennismore Fund Management Limited	19/12/2018	5,367,059	5.02	n/a	n/a	5.02
GLG Partners LP*	15/12/2017	4,227,732	4.01	1,140,688	1.08	5.09

* Subsequent notification received from GLG Partners LP on 14 January 2019 that they had increased their total interest to 10,787,638 shares representing 10.08% (7.87% of voting rights attached to shares and 2.21% of voting rights through financial instruments) of the Company's issued share capital. In addition, notifications were received from KBI Global Investors Ltd on 5 February 2019 that they had increased their total interest to 3,215,400 shares representing 3%, on 22 February 2019 that they had decreased their total interest to 3,209,847 shares representing 2.99% and on 25 February 2019 that they had again increased their total interest to 3,212,629 shares representing 3.00% of the Company's issued share capital, all at the time of the notification.

Save as noted above in respect of GLG Partners LP and KBI Global Investors Ltd, the Company did not receive any further notifications pursuant to DTR5 in the period from 31 December 2018 to the date of this report (being a date not more than one month prior to the date of the Company's Notice of AGM).

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 resolution passed by the shareholders or by the directors as long as there is no conflict with any resolution passed by the shareholders. Subject to the articles of association, the Companies Act 2006 and other shareholders' rights, the issue of shares is at the disposal of the Board.

Authority to issue shares

The directors may only issue shares if authorised to do so by the articles of association or the shareholders in general meeting. At the Company's AGM held on 8 May 2018, shareholders granted an authority to the directors to allot ordinary shares up to an aggregate nominal amount of £17.7 million. As at 31 December 2018, the only shares that had been allotted were to satisfy awards under the Company's share schemes and scrip dividends.

As this authority is due to expire on 7 May 2019, shareholders will be asked to renew and extend the authority, given to the directors at the last AGM, to allot shares in the Company, or grant rights to subscribe for, or to convert any security into, shares in the Company for the purposes of Section 551 of the Companies Act 2006. Further details on the resolution are provided in the Notice of this year's AGM.

Disapplication of pre-emption rights

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

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

Directors' Report continued

Power in relation to the Company buying back its own shares

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

The Company did not buy back any of its shares during the year ended 31 December 2018 or during the period from 1 January 2019 to the date of this report.

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

Securities carrying special rights

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

Restrictions on voting

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

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

Employee Share Trust

As at 31 December 2018, Buck Trustees (Guernsey) Limited (formerly, ACS HR Solutions Share Plan Services (Guernsey) Limited), as Trustee of the Costain Group Employee Trust, held 0.46% of the issued share capital of the Company on trust for the benefit of those employees who exercise their share awards/options under the Company's Long-Term Incentive Plan, Deferred Share Bonus Plan, Share Deferral Plan and Save As You Earn Scheme (the latter 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.

Amendment of articles of association

Unless expressly specified to the contrary in the articles of association of the Company, the Company's articles of association may be amended by special resolution of the Company's shareholders. A copy of the current articles of association is available on the Company's website at www.costain.com. As stated above, a resolution will be put to shareholders at the 2019 AGM to approve new articles of association of the Company, further details of which are provided in the Notice of AGM accompanying this report.

Political donations

No political donations were made during the year ended 31 December 2018 (2017: nil). The Company has a policy of not making donations to political organisations. As a precautionary measure, shareholder approval is being sought at the forthcoming AGM for the Company and its subsidiaries to make donations and/or incur expenditure which may be construed as 'political' by the wide definition of that term included in the relevant legislation. Further details on the resolution are provided in the Notice of this year's AGM.

Independent auditors

PricewaterhouseCoopers LLP (PwC) were reappointed as auditor of the Company at the 2018 AGM. The Board is proposing the reappointment of PwC as auditor from the conclusion of the AGM in May 2019 until the conclusion of the next general meeting at which the accounts are laid before the Company. See pages 74 and 75 of the Audit Committee Report and the Notice of this year's Annual General Meeting, available on the Company's website at www.costain.com, for further details.

Financial instruments

Details of the Group's use of financial instruments, together with information on policies and exposure to price, liquidity, cash flow, credit, interest rate and currency risks, can be found in note 18 on pages 145 to 153. All information detailed in this note is incorporated into the Directors' Report by reference and is deemed to form part of the Directors' Report.

Significant agreements – change of control

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

Post-balance sheet events

As announced today, Andrew Wyllie, after 14 years as chief executive, is retiring to pursue a non-executive career. He will be succeeded by Alex Vaughan with the Board change effective 7 May 2019.

Research and development

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

Greenhouse gas emissions

The Strategic Report on page 33 details the greenhouse gas emissions disclosures required by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. This information is incorporated by reference into (and shall be deemed to form part of) this report.

Information required by LR 9.8.4R

There is no information required to be disclosed under LR 9.8.4R.

Directors

Biographies of the Board are given on pages 54 and 55 and include details of the skills, experience and career history of directors in post as at the date of this report, and the Committees on which they serve. James Morley resigned from the Board on 8 May 2018. 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.

Overseas interests

Details of the Company's overseas subsidiary undertakings can be found in note 25 on pages 163 to 168. The Company has one overseas branch in Abu Dhabi which it is in the process of closing.

Appointment and replacement of directors

The appointment and replacement of directors is governed by the Company's articles, the 2016 Code, the Companies Act 2006 and related legislation. The articles may be amended by a special resolution of the Company's shareholders. Directors may be appointed by the Company by ordinary resolution or by the Board. The Company's current articles require that all directors should be subject to election by shareholders at the first opportunity after their appointment and to re-election thereafter at intervals of no more than three years and 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 complied with provision B.7.1 of the 2016 Code, as applicable to smaller companies below the FTSE 350, for the year ended 31 December 2018.

However, in compliance with the 2018 Code, applicable for financial years beginning on or after 1 January 2019, at every AGM of the Company commencing with the Company's 2019 AGM on 7 May 2019, all directors of the Company are now required to retire from office and may offer themselves for reappointment by the members.

New articles reflecting the requirements of the new UK Corporate Governance Code in relation to annual reappointment of directors, and other changes to modernise the articles, will be put to shareholders for approval at the forthcoming AGM.

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

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

The executive directors have contracts of employment with the Company, terminable on 12 months' notice, while the chair and non-executive directors all have letters of appointment with the Company. An independent non-executive director's appointment is for an initial period of three years, at the expiry of which time the appointment is reviewed to determine whether the appointment should continue. All contracts and letters of appointment are available for inspection at the Company's registered office during normal business hours.

Directors' conflicts of interest

The Company has procedures in place for managing conflicts of interest. Directors are required to declare all external appointments or relationships with other companies and the Board has adopted appropriate processes to manage and, if appropriate, approve any such appointment or relationship which could result in a possible conflict of interest. The Board has satisfied itself that there is no compromise to the independence of the directors who have appointments on the boards of, or relationships with, other companies.

Directors' Report continued

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, which 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.

Directors' interests

No director had any material interest in any contract of significance with the Group during the period under review. Details of directors' emoluments and interests in shares (including their connected persons' beneficial interests) in the Company, including any changes in interests during 2018, are contained in the Directors' Remuneration Report, which appears on pages 78 to 97.

Directors' indemnity

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

Diversity

Details of the Company's policy on diversity within the business (including at Board level), is provided in the Nomination Committee Report on page 77 and the Strategic Report on pages 60 and 61.

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

Employee information

The average number of employees within the Company and Group is shown in note 5 to the financial statements on page 133.

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. Regular staff engagement surveys are run by the Company, the results of which are communicated to employees.

Employees are also kept informed of the financial and economic factors affecting the Company's performance, and other matters of concern to them as employees, through various means including regular updates from the chief executive and other senior managers and a Costain online news service. Employees also have the opportunity to provide feedback and ask questions at the annual staff road shows which take place around the country.

The Company also operates an all employee share plan enabling employees to become shareholders and build a stake in the future success of the Company.

Essential contracts or other arrangements

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

Disclosure of information to auditor

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

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

By Order of the Board

Tracey Wood

Company Secretary

6 March 2019

Directors' Responsibility Statement

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

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

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

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

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

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

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

Under applicable law and regulations, the directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement which comply with that law and those regulations. The directors are also responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The directors consider the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's and the Group's position and performance, business model and strategy.

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

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

On behalf of the Board

Dr Paul Golby CBE
Chair

Andrew Wyllie CBE
Chief Executive

6 March 2019

Independent Auditor's Report
To the members of Costain Group PLC

Report on the audit of the financial statements

Opinion

In our opinion, Costain Group PLC's Group financial statements and Company financial statements (the 'financial statements'):

- give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2018 and of the Group's profit and the Group's and the Company's cash flows for the year then ended
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Company's financial statements, as applied in accordance with the provisions of the Companies Act 2006 and
- 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.

We have audited the financial statements, included within the annual report, which comprise: the Consolidated statement of financial position and the Company statement of financial position as at 31 December 2018; the Consolidated income statement and Consolidated statement of comprehensive income and expense, the Consolidated cash flow statement and Company cash flow statement, and the Consolidated statement of changes in equity and Company statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

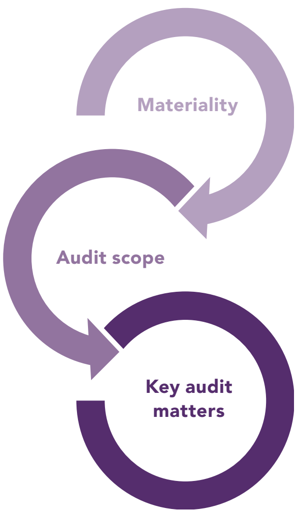
We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under ISAs (UK) are further described in the auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company.

Other than those disclosed in note 4 to the financial statements, we have provided no non-audit services to the Group or the Company in the period from 1 January 2018 to 31 December 2018.



Our audit approach

Overview

- Overall Group materiality: £2.3 million (2017: £1.9 million), based on 5% of profit before tax.
- Overall Company materiality: £1.8 million (2017: £1.5 million), based on 1% of net assets.
- We identified six reporting units which accounted for 98% of Group revenues and 89% of Group Profit before tax.
- Timing and accuracy of contract revenue and profit recognition including recoverability of amounts due from clients.
- Impairment of goodwill and other intangible assets.
- Valuation of defined benefit pension schemes' obligation.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industry in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. Based on our understanding of the Group and the industry in which it operates, we identified that the principal risks of non-compliance with laws and regulations related to non-compliance with health and safety legislation (see page 50 of the annual report). We designed audit procedures at Group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group and Company financial statements, including, but not limited to, the Companies Act 2006, the Listing Rules, Pensions legislation and UK tax legislation. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, and management bias in accounting estimates. The Group engagement team shared this risk assessment with the component auditors referred to in the scoping section of our report below, so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the Group engagement team and/or component auditors included:

- Discussions with management, internal audit and the Group's in-house legal advisers, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud
- Evaluation of management's controls designed to prevent and detect irregularities
- Review of the financial statement disclosures to underlying supporting documentation
- Assessment of matters reported on the Group's whistleblowing helpline and the results of management's investigation of such matters
- Challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to contract accounting and impairment of goodwill and intangible assets (see related key audit matters below) and
- Identifying and testing journal entries, in particular any journal entries posted with unusual account combinations or posted by senior management.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Independent Auditor's Report

To the members of Costain Group PLC continued

Our audit approach continued

Key audit matter	How our audit addressed the key audit matter
Group **Timing and accuracy of contract revenue and profit recognition including recoverability of amounts due from clients** Refer to page 72 (Audit Committee Report), pages 120 to 129 note 2 (Summary of significant accounting policies and significant areas of judgement and estimation). The valuation of amounts recoverable on construction contracts is dependent on judgements around stage of completion and remaining costs to complete, as well as the associated provisions. In a number of the Group's projects there are assumptions within revenue regarding recovery of contractual entitlement from clients. These assumptions are required as a result of compensation events that have arisen due to change under the terms of the contract. The valuation of these compensation events can involve a significant degree of estimation in the end of life forecast revenue for a project and the estimated final revenue may not yet have been certified of fully agreed with the customer. This impacts on the recorded work in progress at the balance sheet date. Provisions are recorded by the Group where there are concerns over recoverability or the Group does not feel that recognition of revenue meets the criteria under IFRS 15 of being highly probable of not reversing.	We obtained an understanding of and evaluated management's own process and controls for reviewing long-term contracts and gained an understanding of the key judgements involved and background to the specific contracts selected in our sample. We selected a sample of contracts for our testing, based on both quantitative and qualitative criteria including: • high levels of revenue recognised in the year • low margin or loss making contracts • contracts with significant balance sheet exposure and • through our discussions with management, review of Board minutes, review of legal reports and review of publicly available information. The majority of the Group's contracts are target cost, cost reimbursable arrangements and some include pain/gain arrangements therefore we focused on the significant judgements adopted by management in relation to the revenue and margin recognition, and the percentage completion. For the sample of contracts selected our testing included: • obtaining an understanding of the contract and its particulars • agreeing forecast revenue to signed contracts, signed variations, agreed compensation events or other supporting documentation • where applicable, we agreed the pain/gain mechanism to relevant contracts, recalculated the forecast impact on the outturn margin and challenged where there was judgement taken; • reconciling revenue recognised with amounts applied for and amounts certified by clients, agreeing the amounts received to cash in December and confirming, using our industry knowledge and experience, that the reconciling items were appropriate; • re-performing the key calculations behind the margin applied, the profit taken and the stage of completion, as well as balance sheet exposure • testing a sample of actual costs incurred • agreeing forecast costs to complete to documentary evidence (such as orders signed with subcontractors or supporting calculations) and applying industry knowledge and experience to challenge the completeness of the forecast costs to completion; • assessing the recoverability of balance sheet items by comparing to external certification of the value of work performed • holding discussions with management to understand and challenge other areas of judgement taken and • where necessary, reviewing legal correspondence and expert advice obtained in respect of the judgements. For the remaining contract population we performed the following: • reviewed the forecast margins for the population of contracts. For those which had moved significantly since tender and / or the prior reporting period, we obtained explanations from management • considered management provisions across all contracts • recalculated the percentage completion based on costs to date and recalculated revenue to agree to those reported by management and • for all contracts which generated in excess of £1.5 million of revenue in the year, we agreed the December certificate to cash received, verified cumulative costs to the underlying cost ledgers and recomputed the cumulative revenue recognised. Based on all of the evidence obtained in the above procedures, we are satisfied the recognition of contract revenue and profit and the recoverability of amounts due from clients is supportable. Given the degree of estimation, we have also considered the disclosures around significant ongoing contracts included on pages 44 to 47 of the chief financial officer's report.

Key audit matter	How our audit addressed the key audit matter
Group and Company **Impairment of goodwill and other intangible assets** Refer to page 72 (Audit Committee Report), pages 120 to 129 note 2 (Significant areas of judgement and estimation), and page 137 note 11 – Intangible Assets. At 31 December 2018 the Group had a net balance of £54.1 million of goodwill (2017: £54.1 million) and £4.5 million of intangible assets (2017: £8.4 million) predominantly comprising client relationships. The Company had a corresponding investments in subsidiaries balance of £111.0 million (2017: £108.1 million). Goodwill has been allocated to the applicable cash generating units of the Infrastructure segment (£15.5 million, 2017: £15.5 million) and the Natural Resources segment (£38.6 million, 2017: £38.6 million). The carrying values of goodwill and intangible assets, and of the Company's investments in subsidiaries, are contingent on future cash flows and there is a risk that the assets will be impaired if these cash flows do not meet the Group's expectations. The impairment reviews performed by the Group contained a number of judgements and estimates including discount rates, growth rates and expected changes to revenue and direct costs during the period. Changes in these assumptions could lead to an impairment to the carrying value of the assets.	We obtained the directors' future cash flow forecasts, which were prepared to a sufficiently detailed level. Initially, we evaluated management's basis of determination of the CGUs between Infrastructure and Natural Resources. We performed the following testing: • we compared the cash flows to the latest Board approved budgets, tested the integrity of the underlying calculations and assessed how both internal and external drivers of performance were incorporated into the projections • we challenged the discount rate used by independently recalculating the cost of capital, which was consistent with the discount rate used • we tested the level of secured work by tracing it to supporting orders • we tested the cost forecasts by comparing a sample to tenders from subcontractors or calculations of man hours required, noting that 68% of the 2019 forecast revenue has been secured • we compared 2018 financial performance to budget and understood the drivers of improvement in profitability and • we performed sensitivity analysis around the key drivers of the cash flow forecasts, in particular the revenue growth and margin assumptions. We concluded management's assessment was reasonable.
Group **Valuation of defined benefit pension schemes' obligation** Refer to page 72 (Audit Committee Report), pages 120 to 129 note 2 (Significant areas of judgement and estimation), and page 156 note 21 – Employment Benefits. The Group has significant retirement benefit obligations. At 31 December 2018 the present value of these obligations was £752.7 million (2017: £803.4 million) offset by plan assets at fair value of £748.5 million (2017: £779.5 million) in respect of funded schemes. These retirement benefit obligations were determined based on a number of actuarial assumptions and calculations, which were subject to significant judgement and estimate. Changes in these assumptions can have a material impact on the quantum of obligations recorded in the Consolidated statement of financial position.	We obtained the actuarial valuation at 31 December 2018 and tested the valuation of the pension liabilities as follows: • in conjunction with our pension specialists, we challenged the actuarial assumptions by comparing these against benchmark ranges based on the market conditions and expectations at 31 December 2018. Based on our review of the assumptions, in each case we found that the actuarial assumptions used were reasonable and sat within our acceptable range and, where appropriate, were applied on a basis consistent with previous years • we also reviewed the methodology and challenged the assumptions used in calculating the impact of the equalisation of Guaranteed Minimum Pensions which has been recognised in the Consolidated income statement this year; • we independently confirmed the pension assets held by the schemes with the third-party custodians and fund managers. We also performed an independent assessment of the asset valuations and concluded that they were appropriate and • we tested the underlying census data to supporting documents to confirm completeness and accuracy. We did not identify any issues within our testing and were satisfied the assumptions applied are within an appropriate range.

Independent Auditor's Report

To the members of Costain Group PLC continued

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which they operate.

The Group is primarily UK based and has two main segments; Infrastructure and Natural Resources. There is also a non-core overseas segment Alcaidesa, based in Spain. In establishing the overall approach to the Group audit, we determined the type of work needed to be performed at these reporting units. Making up the Group's reporting segments, we identified the following six legal entities required a full scope audit; Costain Limited, Costain Oil and Gas Process Limited, Costain Engineering & Construction Limited, Richard Costain Limited, Alcaidesa Holdings SA and Costain Group PLC, which in our view, required an audit of their entire financial information, either due to their size or their risk characteristics. These accounted for accounted for 98% of Group revenues and 89% of Group Profit before tax. The percentage of Group Profit before tax is calculated on an absolute basis, which aggregates component profits and losses. In addition to this we performed work over specific balances in other Group entities, which in our view, required an audit of such balances, either due to their size or their risk characteristics. The required work was performed by the Group team. Alcaidesa was audited by a local component team, based on full scope instructions issued by the Group engagement team. The Group engagement team remained in contact throughout the component team's work.

All component materiality allocations were based on the Group profit before tax.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	**Company financial statements**
Overall materiality	£2.3 million (2017: £1.9 million).	£1.8 million (2017: £1.5 million).
How we determined it	5% of profit before tax.	1% of net assets.
Rationale for benchmark applied	Based on the benchmarks used in the annual report, profit before tax is the primary measure used by the shareholders in assessing the performance of the Group, and is a generally accepted auditing benchmark.	The Company primarily holds intercompany receivables, investments in subsidiaries and debt. There are no trading activities in the Company therefore we considered a balance sheet measure to be the most appropriate auditing benchmark.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £0.9 million and £2.3 million. Certain components were audited to a local statutory audit materiality that was also less than our overall Group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £100,000 (Group audit) (2017: £100,000) and £100,000 (Company audit) (2017: £100,000) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group's and the Company's ability to continue as a going concern over a period of at least 12 months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union, which is currently due to occur on 29 March 2019, are not clear, and it is difficult to evaluate all of the potential implications on the Group's and Company's trade, clients, suppliers and the wider economy.
We are required to report if the directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

Reporting on other information

The other information comprises all of the information in the annual report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report, Directors' Report and Corporate Governance Statement, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006 (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report
In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)
In light of the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

Independent Auditor's Report
To the members of Costain Group PLC continued

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

- The directors' confirmation on pages 50 and 51 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on pages 48 and 49 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the Code); and considering whether the statements are consistent with the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit. (Listing Rules)

Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the directors, on page 103, that they consider the annual report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Company obtained in the course of performing our audit.
- The section of the annual report on pages 72 to 75 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The directors' statement relating to the Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Directors' Responsibility Statement set out on page 103 , the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 8 May 2017 to audit the financial statements for the year ended 31 December 2017 and subsequent financial periods. The period of total uninterrupted engagement is two years, covering the years ended 31 December 2017 to 31 December 2018.

Jonathan Hook (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors

London

6 March 2019

Consolidated Income Statement

Year ended 31 December

	Notes	2018 Underlying £m	2018 Other items £m	2018 Total £m	2017 (Restated) Underlying £m	2017 (Restated) Other items £m	2017 (Restated) Total £m
Continuing operations							
Revenue including share of revenue of joint ventures and associates	3	**1,489.3**	**–**	**1,489.3**	1,728.9	–	1,728.9
Less: Share of revenue of joint ventures and associates	13	**(25.6)**	**–**	**(25.6)**	(44.9)	–	(44.9)
Group revenue		**1,463.7**	**–**	**1,463.7**	1,684.0	–	1,684.0
Cost of sales		**(1,373.8)**	**–**	**(1,373.8)**	(1,595.8)	–	(1,595.8)
Gross profit		**89.9**	**–**	**89.9**	88.2	–	88.2
Administrative expenses before other items		**(37.4)**	**–**	**(37.4)**	(39.1)	–	(39.1)
Pension GMP equalisation charge	21	**–**	**(8.6)**	**(8.6)**	–	–	–
RDEC grant income	4	**–**	**2.6**	**2.6**	–	2.5	2.5
Amortisation of acquired intangible assets		**–**	**(3.0)**	**(3.0)**	–	(3.2)	(3.2)
Employment related and other deferred consideration		**–**	**(0.4)**	**(0.4)**	–	(1.2)	(1.2)
Administrative expenses		**(37.4)**	**(9.4)**	**(46.8)**	(39.1)	(1.9)	(41.0)
Group operating profit		**52.5**	**(9.4)**	**43.1**	49.1	(1.9)	47.2
Share of results of joint ventures and associates	13	**0.3**	**–**	**0.3**	0.3	–	0.3
Profit from operations	3	**52.8**	**(9.4)**	**43.4**	49.4	(1.9)	47.5
Finance income	7	**0.4**	**–**	**0.4**	0.4	–	0.4
Finance expense	7	**(3.5)**	**(0.1)**	**(3.6)**	(6.0)	(0.1)	(6.1)
Net finance expense		**(3.1)**	**(0.1)**	**(3.2)**	(5.6)	(0.1)	(5.7)
Profit before tax	3/4	**49.7**	**(9.5)**	**40.2**	43.8	(2.0)	41.8
Taxation	8	**(9.1)**	**1.7**	**(7.4)**	(9.3)	0.1	(9.2)
Profit for the year attributable to equity holders of the parent		**40.6**	**(7.8)**	**32.8**	34.5	(1.9)	32.6
Earnings per share							
Basic	9	**38.2p**	**(7.2)p**	**30.9p**	32.9p	(1.8)p	31.1p
Diluted	9	**37.4p**	**(7.2)p**	**30.2p**	32.3p	(1.7)p	30.6p

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

	2018 £m	2017 (Restated) £m
Profit for the year	**32.8**	32.6
Items that may be reclassified subsequently to profit or loss:		
Exchange differences on translation of foreign operations	**0.2**	0.5
Net investment hedge:		
Effective portion of changes in fair value during year	**0.1**	(0.7)
Net changes in fair value transferred to the income statement	**–**	0.2
Cash flow hedges:		
Effective portion of changes in fair value during year	**(0.1)**	(1.4)
Net changes in fair value transferred to the income statement	**–**	0.3
Total items that may be reclassified subsequently to profit or loss	**0.2**	(1.1)
Items that will not be reclassified to profit or loss:		
Remeasurement of defined benefit obligations	**13.3**	39.2
Tax recognised on remeasurement of defined benefit obligations	**(2.5)**	(7.4)
Total items that will not be reclassified to profit or loss	**10.8**	31.8
Other comprehensive income for the year	**11.0**	30.7
Total comprehensive income for the year attributable to equity holders of the parent	**43.8**	63.3

Consolidated Statement of Financial Position

As at 31 December

	Notes	2018 £m	2017 (Restated) £m
Assets			
Non-current assets			
Intangible assets	11	**58.5**	62.5
Property, plant and equipment	12	**40.0**	43.0
Investments in equity accounted joint ventures	13	**0.4**	0.3
Investments in equity accounted associates	13	**0.5**	0.8
Loans to equity accounted associates	13	**1.6**	1.6
Other	14	**3.6**	4.9
Deferred tax	8	**2.7**	10.1
Total non-current assets		**107.3**	123.2
Current assets			
Inventories		**1.5**	1.4
Trade and other receivables	14	**276.5**	289.7
Cash and cash equivalents	15	**189.3**	248.7
Total current assets		**467.3**	539.8
Total assets		**574.6**	663.0
Equity			
Share capital	22	**53.5**	52.8
Share premium		**15.0**	12.1
Foreign currency translation reserve		**2.6**	2.3
Hedging reserve		**0.7**	0.8
Retained earnings		**110.5**	86.0
Total equity attributable to equity holders of the parent		**182.3**	154.0
Liabilities			
Non-current liabilities			
Retirement benefit obligations	21	**4.2**	23.9
Other payables	19	**0.9**	1.3
Interest-bearing loans and borrowings	16	**60.5**	60.6
Provisions for other liabilities and charges	20	**–**	–
Total non-current liabilities		**65.6**	85.8
Current liabilities			
Trade and other payables	19	**313.2**	402.5
Taxation	8	**2.6**	9.0
Interest-bearing loans and borrowings	16	**10.0**	10.4
Provisions for other liabilities and charges	20	**0.9**	1.3
Total current liabilities		**326.7**	423.2
Total liabilities		**392.3**	509.0
Total equity and liabilities		**574.6**	663.0

The financial statements were approved by the Board of directors on 6 March 2019 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	2018 £m	2017 £m
Assets			
Non-current assets			
Investments in subsidiaries	13	**140.5**	108.1
Total non-current assets		**140.5**	108.1
Current assets			
Trade and other receivables	14	**138.9**	139.3
Cash and cash equivalents	15	**–**	–
Total current assets		**138.9**	139.3
Total assets		**279.4**	247.4
Equity			
Share capital	22	**53.5**	52.8
Share premium		**15.0**	12.1
Other reserves		**25.1**	22.2
Hedging reserve		**0.2**	(0.2)
Retained earnings		**86.3**	59.3
Total equity attributable to equity holders of the parent		**180.1**	146.2
Liabilities			
Non-current liabilities			
Interest-bearing loans and borrowings	16	**60.0**	60.0
Provisions for other liabilities and charges	20	**0.9**	0.9
Total non-current liabilities		**60.9**	60.9
Current liabilities			
Trade and other payables	19	**27.0**	28.5
Taxation	8	**1.5**	1.5
Interest-bearing loans and borrowings	16	**9.8**	10.2
Provisions for other liabilities and charges	20	**0.1**	0.1
Total current liabilities		**38.4**	40.3
Total liabilities		**99.3**	101.2
Total equity and liabilities		**279.4**	247.4

The profit for the year was £42.5 million (2017: £13.3 million).

The financial statements were approved by the Board of directors on 6 March 2019 and were signed on its behalf by:

A Wyllie
Director

A O Bickerstaff
Director

Registered number: 1393773

Consolidated Statement of Changes in Equity

Year ended 31 December

	Share capital £m	Share premium £m	Translation reserve £m	Hedging reserve £m	Retained earnings £m	Total equity £m
At 1 January 2017	52.1	8.8	2.3	1.9	34.5	99.6
Profit for the year	–	–	–	–	32.6	32.6
Other comprehensive income/(expense)	–	–	–	(1.1)	31.8	30.7
Issue of ordinary shares under employee share option plans	0.6	1.6	–	–	–	2.2
Shares purchased to satisfy employee share schemes	–	–	–	–	(1.4)	(1.4)
Equity-settled share-based payments	–	–	–	–	2.2	2.2
Dividends paid	0.1	1.7	–	–	(13.7)	(11.9)
At 31 December 2017	52.8	12.1	2.3	0.8	86.0	154.0
At 1 January 2018	**52.8**	**12.1**	**2.3**	**0.8**	**86.0**	**154.0**
Adoption of IFRS 15 'Revenue from Contracts with Customers'	**–**	**–**	**–**	**–**	**(4.6)**	**(4.6)**
Restated total equity at the beginning of the financial year	**52.8**	**12.1**	**2.3**	**0.8**	**81.4**	**149.4**
Profit for the year	**–**	**–**	**–**	**–**	**32.8**	**32.8**
Other comprehensive income/(expense)	**–**	**–**	**0.3**	**(0.1)**	**10.8**	**11.0**
Issue of ordinary shares under employee share option plans	**0.5**	**1.6**	**–**	**–**	**(0.3)**	**1.8**
Shares purchased to satisfy employee share schemes	**–**	**–**	**–**	**–**	**(1.3)**	**(1.3)**
Equity-settled share-based payments	**–**	**–**	**–**	**–**	**2.3**	**2.3**
Dividends paid	**0.2**	**1.3**	**–**	**–**	**(15.2)**	**(13.7)**
At 31 December 2018	**53.5**	**15.0**	**2.6**	**0.7**	**110.5**	**182.3**

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

Translation reserve

The translation reserve comprises all foreign exchange differences arising after 1 January 2004, the date of adoption of IFRS, 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 foreign subsidiaries, including fair value movements on investment hedges.

Hedging reserve

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

Company Statement of Changes in Equity

Year ended 31 December

	Share capital £m	Share premium £m	Other reserve £m	Hedging reserve £m	Retained earnings £m	Total equity £m
At 1 January 2017	52.1	8.8	19.5	–	59.7	140.1
Comprehensive income/(expense)	–	–	–	(0.2)	13.3	13.1
Issue of ordinary shares under employee share option plans	0.6	1.6	–	–	–	2.2
Equity-settled share-based payments granted to employees of subsidiaries	–	–	2.7	–	–	2.7
Dividends paid	0.1	1.7	–	–	(13.7)	(11.9)
At 31 December 2017	52.8	12.1	22.2	(0.2)	59.3	146.2
At 1 January 2018	**52.8**	**12.1**	**22.2**	**(0.2)**	**59.3**	**146.2**
Comprehensive income	**–**	**–**	**–**	**0.4**	**42.5**	**42.9**
Issue of ordinary shares under employee share option plans	**0.5**	**1.6**	**–**	**–**	**(0.3)**	**1.8**
Equity-settled share-based payments granted to employees of subsidiaries	**–**	**–**	**2.9**	**–**	**–**	**2.9**
Dividends paid	**0.2**	**1.3**	**–**	**–**	**(15.2)**	**(13.7)**
At 31 December 2018	**53.5**	**15.0**	**25.1**	**0.2**	**86.3**	**180.1**

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

Other reserve

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

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.

Consolidated Cash Flow Statement

Year ended 31 December

	Notes	2018 £m	2017 (Restated) £m
Cash flows from/(used by) operating activities			
Profit for the year		**32.8**	32.6
Adjustments for:			
Share of results of joint ventures and associates	13	**(0.3)**	(0.3)
Finance income	7	**(0.4)**	(0.4)
Finance expense	7	**3.6**	6.1
Taxation	8	**7.4**	9.2
Depreciation of property, plant and equipment	4	**3.2**	3.9
Amortisation of intangible assets	4	**3.4**	3.7
Employment related and other deferred consideration		**0.4**	1.2
Pension GMP equalisation charge		**8.6**	–
Shares purchased to satisfy employee share schemes		**(1.3)**	(1.4)
Share-based payments expense	5	**2.9**	2.7
Cash from operations before changes in working capital and provisions		**60.3**	57.3
(Increase)/decrease in inventories		**(0.1)**	0.2
Decrease in receivables		**8.6**	11.3
(Decrease)/increase in payables		**(90.9)**	3.4
Movement in provisions and employee benefits		**(15.8)**	(12.4)
Cash (used by)/from operations		**(37.9)**	59.8
Interest received		**0.4**	0.3
Interest paid		**(2.4)**	(3.2)
Taxation paid		**(8.2)**	(5.3)
Net cash (used by)/from operating activities		**(48.1)**	51.6
Cash flows from/(used by) investing activities			
Dividends received from joint ventures and associates	13	**0.5**	0.1
Additions to property, plant and equipment	12	**(1.0)**	(1.8)
Additions to intangible assets	11	**(0.3)**	(0.3)
Proceeds of disposals of property, plant and equipment and intangible assets		**2.1**	0.2
Repayment of loans to joint ventures and associates	13	**–**	0.1
Acquisition related deferred consideration	18	**–**	(2.4)
Net cash from/(used by) investing activities		**1.3**	(4.1)
Cash flows from/(used by) financing activities			
Issue of ordinary share capital		**1.8**	2.2
Ordinary dividends paid	10	**(13.7)**	(11.9)
Drawdown of loans	16/17	**30.0**	70.7
Repayment of loans	16/17	**(30.5)**	(70.0)
Net cash used by financing activities		**(12.4)**	(9.0)
Net (decrease)/increase in cash, cash equivalents and overdrafts		**(59.2)**	38.5
Cash, cash equivalents and overdrafts at beginning of the year	15	**248.7**	210.2
Effect of foreign exchange rate changes		**(0.2)**	–
Cash, cash equivalents and overdrafts at end of the year	15	**189.3**	248.7

Company Cash Flow Statement

Year ended 31 December

	Notes	2018 £m	2017 £m
Cash flows from/(used by) operating activities			
Profit for the year		**42.5**	13.3
Adjustments for:			
Finance income		**(14.9)**	(14.9)
Finance expense		**3.1**	2.9
Taxation		**0.3**	(0.4)
Release of provision against investment		**(29.5)**	–
Cash from operations before changes in working capital and provisions		**1.5**	0.9
Decrease/(increase) in receivables		**0.2**	(4.9)
(Decrease)/increase in payables		**(1.5)**	1.4
Movement in provisions		**–**	(0.1)
Cash from/(used by) operations		**0.2**	(2.7)
Interest received		**0.9**	0.6
Interest paid		**(3.1)**	(2.9)
Taxation received		**0.3**	0.4
Net cash used by operating activities		**(1.7)**	(4.6)
Cash flows from investing activities			
Dividends received		**14.0**	14.3
Net cash from investing activities		**14.0**	14.3
Cash flows from/(used by) financing activities			
Issue of ordinary share capital		**1.8**	2.2
Ordinary dividends paid	10	**(13.7)**	(11.9)
Drawdown of revolving credit facility	16/17	**30.0**	70.0
Repayment of loans	16/17	**(30.4)**	(70.0)
Net cash used by financing activities		**(12.3)**	(9.7)
Net movement in cash and cash equivalents		**–**	–
Cash and cash equivalents at beginning of the year	15	**–**	–
Cash and cash equivalents at end of the year	15	**–**	–

Notes to the Financial Statements

1 General information

Costain Group PLC (the Company) is a public limited company incorporated in the UK. The address of its registered office and principal place of business is disclosed on page 175 of this annual report. The principal activities of the Company and its subsidiary undertakings (collectively referred to as the Group) are described in the Strategic Report.

The consolidated financial statements of the Company for the year ended 31 December 2018 comprise the Group and the Group's interests in associates, joint ventures and joint operations. The Parent Company financial statements present information about the Company as a separate entity and not about its Group.

The financial statements were authorised for issue by the directors on 6 March 2019.

2 Summary of significant accounting policies

Both the Company financial statements and the Group consolidated financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards as adopted by the EU (Adopted IFRS) and their related interpretations. On publishing the Parent Company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in Section 408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements.

Basis of preparation

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

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

Going concern

The Group's business activities and the factors likely to affect its future development, performance and position are set out in the Strategic Report. The financial position of the Group, its cash flows, liquidity position, borrowing and bonding facilities, use of financial instruments and hedging activities, exposure to credit risk and its objectives, policies and processes for managing its capital and financial risk are described in the Financial Review section of these financial statements and in note 18.

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

The directors have acknowledged the guidance in respect of going concern published by the Financial Reporting Council. 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. Accordingly, they continue to adopt the going concern basis in preparing these financial statements.

Accounting policies

The accounting policies set out below have been applied consistently by the Group and the Company to each period presented in these financial statements, except for the adoption of the new accounting standards noted below and the change to the policy on accounting for research and development expenditure credits (RDEC).

The following standards and interpretations are effective for the year ended 31 December 2018:

- the adoption of IFRS 15 'Revenue from Contracts with Customers' has required an adjustment to brought forward reserves.
- the Group has also adopted IFRS 9 'Financial Instruments' which did not have any quantitative impact on the financial results.

The impact of the adoption of these standards and the new accounting policies is discussed in note 27.

Basis of consolidation

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

(b) Associates are operations over which power exists to exercise significant influence but not control, generally accompanied by a share of between 20% and 50% of the voting rights. Associates are accounted for using the equity method.

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

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

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

(f) Intra-Group balances and transactions together with any unrealised gains arising from intra-Group transactions are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates, joint ventures and joint operations are eliminated to the extent of the interest in the entity or operation. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Notes to the Financial Statements continued

2 Summary of significant accounting policies continued

Currency translation

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

The assets and liabilities of foreign operations are translated to pounds sterling at exchange rates ruling at the statement of financial position date. The revenues and expenses of foreign operations are translated to pounds sterling at rates approximating to the exchange rates ruling at the dates of these transactions.

Exchange differences arising from the translation of the net investment in foreign operations and of related hedges, to the extent that the hedge is effective, are recognised directly in equity. Those exchange differences 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.

Revenue from contracts with customers

The Group recognises revenue when control over the service or product is transferred to the customer and revenue is measured at the fair value of the consideration received or receivable, net of value added tax. Where the consideration is variable, the amount recognised is highly probable not to suffer a significant reversal in future.

The principal source of revenue relates to work on the UK's infrastructure across transportation, water and energy. Over 95% arises under long-term contracts, which require delivery of a specified item to the customer, increasingly involve a technology element, with a large element of the works undertaken on the customer's land and perhaps taking a number of years to complete. The majority are structured in a cost reimbursement or target cost form, typically with incentive and penalty arrangements. Generally, the works specified within the contract are integrated and the customer procures the one complete package, which may incorporate design, engineering and advisory work into the scope. Where a contract comprises distinct performance obligations, each is accounted separately. The scope of the works will be often subject to change and in the majority of contracts, the terms specify that changes are handled through compensation events. These are considered on a case by case basis to determine whether they are a new separate performance obligation and accounted as such, or part of the original works and dealt with on a cumulative catch-up basis. On the majority of contracts, the compensation events relate to clarifications or revisions of the original works. Other design, advisory and consulting contracts requiring production of a specified scope or provision of other services, some of which may lead to the construction of the designed product, can be structured as inter-dependant or standalone contracts and the resulting performance obligations depends on how the customer procures the contract.

Group revenue includes the Group's share of revenue of joint operations.

(a) Long-term contracts

Revenue arises from the increase in the value of work performed and the value of services provided during the year. Where the outcome of an individual 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. Contract costs are recognised as expenses in the period in which they are incurred.

Compensation events, variations and claims, gain from pain/gain arrangements and other bonus assessments are included in revenue where it is highly probable that the amount, which can be measured reliably, will be recovered from the customer and will not reverse. Pain from pain/gain arrangements is included where incurred or expected to be incurred. Revenue in respect of these items is determined on the most likely outcome method. When the outcome of a long-term contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred, where it is highly probable those costs will be recoverable and will not reverse. When it is probable that total contract costs will exceed total revenue, the expected loss is recognised as an expense immediately.

Contract work in progress is stated at cost plus profit recognised to date less a provision for foreseeable losses and less amounts billed and is included in contract assets. 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 contract liabilities.

(b) Other revenue

Revenue from other services contracts is recognised when the service is provided and revenue from the sale of land is recognised when title has been transferred to the buyer. The revenue recognised is the amount that can be measured reliably and is highly probable to flow to the Group and not reverse. Rental income is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives are recognised as an integral part of the total rental income on a straight-line basis over the term of the lease.

Income statement presentation – Other items

In order to aid understanding of the underlying and overall performance of the Group, certain amounts are shown in the consolidated income statement in a separate column headed 'Other items'. Items are included under this heading where the Board considers them to be of a one-off and unusual nature or related to the accounting treatment of acquisitions, this includes amortisation of acquired intangibles and employment related deferred consideration, the adjustments to the estimates of the prior year RDEC grant income because of changes to the methodology adopted (notes 4 and 27) and, in 2018, the pension GMP equalisation charge (note 21). These are adjusted because they are not long-term in nature and, hence, will not reflect the long-term performance of the Group.

Pre-contract costs

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

Research and development

Research and development activities are usually directly attributable to a project and accounted within project costs. In 2018, in line with common practice, the Group has adopted the research and development expenditure credit (RDEC) regime as these credits have characteristics similar to government grants and has changed its accounting policy to offset the credit against the relevant expenditure rather than reflect them in the tax charge. See also note 27.

Goodwill and other intangible assets

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

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

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

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

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

Notes to the Financial Statements continued

2 Summary of significant accounting policies continued

Property, plant and equipment

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

Freehold buildings	– 50 years
Leasehold buildings	– shorter of 50 years or lease term
Plant and equipment	– remaining useful life (generally 3 to 10 years)
Marina (Alcaidesa)	– concession period (19 years remaining)
Golf courses (Alcaidesa)	– 50 years

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

Investments – Company

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

Impairment of non-financial assets

For the purposes of impairment testing, goodwill is allocated to 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.

The carrying amounts of other assets, except inventories and deferred tax assets, are reviewed at each statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, the assets recoverable amount is estimated.

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

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

Provisions

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

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

Taxation

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

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

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

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

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

Leases

Leases principally comprise operating leases. Payments made under operating leases are recognised as an expense in the income statement on a straight-line basis over the lease term. Any incentives to enter into operating leases are recognised as a reduction of rental expense over the lease term on a straight-line basis.

Financial guarantee contracts

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

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Dividends

Dividends are recognised as distributions in the period in which they are declared. Dividends proposed but not declared are not recognised but are disclosed in note 10 to the financial statements.

Share-based payments

These comprise equity-settled 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. Fair value is measured by the use of a Black-Scholes option pricing model.

Notes to the Financial Statements continued

2 Summary of significant accounting policies continued

Share-based payments continued

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

Retirement benefit obligations

A defined benefit pension scheme is operated in the UK, which provides benefits based on pensionable salary. The details are included in note 21. The assets of the scheme are held separately from those of the Group.

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using a projected unit method and discounted at the current rate of return on a high-quality corporate bond of equivalent term and currency to the liability. The liability recognised in the statement of financial position in respect of the defined benefit pension scheme is the present value of the defined benefit obligations less the fair value of scheme assets at the statement of financial position date.

Administration costs of the scheme are recognised in the income statement and in 2018, a charge to reflect the impact of GMP equalisation is included in other items the income statement. The interest cost on the scheme's net liabilities is included in finance expense. Remeasurements of the net liability are recognised in the consolidated statement of comprehensive income.

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

Financial assets and liabilities

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

(a) Financial assets

Financial assets are classified as loans and receivables. The classification depends on the nature and purpose of the financial asset and is determined at the time of initial recognition.

A financial asset is derecognised only when the contractual rights to the cash flows from that asset expire, or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

Loans and receivables

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

Trade and other receivables

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

Impairment of financial assets

Impairment of financial assets is based on an expected credit loss model applying the simplified approach permitted under IFRS 9. The Group calculates an allowance for credit losses based on the nature of the customer, experience of collecting receivables from similar customers and modelling default scenarios and applying probabilities of such scenarios.

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.

(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 and interest rates and are measured at their fair value as explained in the cash flow hedges section of note 19.

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

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

Any gains or losses arising from changes in fair value of derivative financial instruments not designated as hedges are recognised in the income statement.

Fair value measurement

When measuring the fair value of a financial or non-financial asset or liability, the Group uses market observable data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (i.e. derived from prices).
- Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the hierarchy as the lowest level input that is significant to the entire measurement.

Notes to the Financial Statements continued

2 Summary of significant accounting policies continued

Significant areas of judgement and estimation

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

The most critical accounting policies and significant areas of estimation arise from the accounting for long-term contracts under IFRS 15 'Revenue from Contracts with Customers', the carrying value of goodwill and acquired intangible assets and the assumptions used in the accounting for defined benefit pension schemes under IAS 19 'Employee benefits'. There are no significant areas of judgement.

Long-term contracts

The majority of the Group's activities are undertaken via long-term contracts and IFRS 15 requires the identification and separation of individual, distinct performance obligations, which are then accounted individually. The most common type of contracts undertaken by the Group with multiple performance obligations are framework contracts. In most cases, the obligations are satisfied over time and estimates are made of the total contract costs and revenues. In many cases, these obligations span more than one financial period. Both cost and revenue forecasts may be affected by a number of uncertainties that depend on the outcome of future events and may need to be revised as events unfold and uncertainties are resolved. Cost forecasts take into account the expectations of work to be undertaken on the contract. Revenue forecasts take into account compensation events, variations and claims and assessments of the impact of pain/gain arrangements to the extent that the amounts the Group expects to recover or incur can be reliably estimated and are highly probable not to reverse based on most likely outcome.

Management bases its estimates of costs and revenues and its assessment of the expected outcome of each long-term contractual obligation on the latest available information, this includes detailed contract valuations, progress on discussions over compensation events, variations and claims with customers, progress against the latest programme for completing the works, forecasts of the costs to complete and, in certain limited cases, assessments of recoveries from insurers. Revenue is recognised to the extent that amounts forecast from compensation events, variations and claims are agreed or considered highly probable to be agreed. 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 both positive and negative is then reflected in the financial statements.

Management believes it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year could require material adjustment. Given the pervasive impact of judgements and estimates on revenue, cost of sales and related balance sheet amounts, it is difficult to quantify the impact of taking alternative assessments on each of the judgements above.

Carrying value of goodwill and intangible assets

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

The Company carries investments in some subsidiaries at above net asset value. In reviewing the recoverability of these carrying values and of intercompany loans to these subsidiaries, estimates are required about their values.

Defined benefit pension schemes

Defined benefit pension schemes require significant estimates 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 21.

IFRSs not applied

The following IFRSs having been endorsed, will be applicable as stated below:

- IFRS 16 'Leases' was issued in January 2016. It will result in almost all leases being recognised on the balance sheet, as the distinction between operating and financial leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exceptions are short term and low value leases.

  The standard will primarily affect the accounting for the Group's operating leases and hire charges and is mandatory for reporting periods beginning on or after 1 January 2019. The Group is adopting the modified retrospective approach including an exemption for leases with terms ending inside one year of the date of initial application and will not be restating comparative information. The impact of implementing the standard on 1 January 2019, will be an increase in right-to-use assets of approximately £36.1 million and similar increase in liabilities (approximately £14.4 million current liabilities).

- Except for IFRS 16, the directors do not currently anticipate that the adoption of any other standard or interpretation that has been issued but is not yet effective will have a material impact on the financial statements of the Group in future periods.

3 Operating segments

The Group has two core business segments: Natural Resources and Infrastructure plus the non-core business Alcaidesa in Spain. The core segments are strategic business units with separate management and have different core customers or offer different services. This information is provided to the chief executive who is the chief operating decision maker. The segments are discussed in the Strategic Report section of these financial statements.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. The Group evaluates segment performance on the basis of profit or loss from operations before interest and tax expense before and after other items. The segment results that are reported to the chief executive include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. The adjustments to the RDEC grant income for prior years and the pension GMP equalisation charge are viewed as Central items.

Intersegment sales and transfers are not material.

Notes to the Financial Statements continued

3 Operating segments continued

2018	Natural Resources £m	Infrastructure £m	Alcaidesa £m	Central costs £m	Total £m
Segment revenue					
External revenue	383.2	1,075.1	5.4	–	1,463.7
Share of revenue of joint ventures and associates	7.1	18.5	–	–	25.6
Total segment revenue	390.3	1,093.6	5.4	–	1,489.3
Segment profit/(loss)					
Operating profit/(loss)	14.1	46.0	(0.7)	(6.9)	52.5
Share of results of joint ventures and associates	0.3	–	–	–	0.3
Profit/(loss) from operations before other items	14.4	46.0	(0.7)	(6.9)	52.8
Other items:					
Pension GMP equalisation charge	–	–	–	(8.6)	(8.6)
RDEC grant income	–	–	–	2.6	2.6
Amortisation of acquired intangible assets	(1.4)	(1.6)	–	–	(3.0)
Employment related and other deferred consideration	(0.4)	–	–	–	(0.4)
Profit/(loss) from operations	12.6	44.4	(0.7)	(12.9)	43.4
Net finance expense					(3.2)
Profit before tax					40.2
Segment profit/(loss) is stated after charging the following:					
Depreciation	0.9	1.0	1.3	–	3.2
Amortisation (including acquired intangible assets)	1.7	1.7	–	–	3.4
Segment assets					
Reportable segment assets	104.9	238.9	32.1	6.7	382.6
Unallocated assets:					
Deferred tax					2.7
Cash and cash equivalents					189.3
Total assets					574.6
Expenditure on non-current assets					
Property, plant and equipment	0.2	0.6	0.2	–	1.0
Intangible assets	0.1	0.2	–	–	0.3
Segment liabilities					
Reportable segment liabilities	96.8	194.7	2.3	21.2	315.0
Unallocated liabilities:					
Retirement benefit obligations					4.2
Borrowings					70.5
Taxation					2.6
Total liabilities					392.3

2017 (Restated)	Natural Resources £m	Infrastructure £m	Alcaidesa £m	Central costs £m	Total £m
Segment revenue					
External revenue	333.5	1,345.2	5.3	–	1,684.0
Share of revenue of joint ventures and associates	10.4	34.5	–	–	44.9
Total segment revenue	343.9	1,379.7	5.3	–	1,728.9
Segment profit/(loss)					
Operating profit/(loss)	5.0	52.4	(1.4)	(6.9)	49.1
Share of results of joint ventures and associates	0.3	–	–	–	0.3
Profit/(loss) from operations before other items	5.3	52.4	(1.4)	(6.9)	49.4
Other items:					
RDEC grant income	–	–	–	2.5	2.5
Amortisation of acquired intangible assets	(1.5)	(1.7)	–	–	(3.2)
Employment related and other deferred consideration	(1.2)	–	–	–	(1.2)
Profit/(loss) from operations	2.6	50.7	(1.4)	(4.4)	47.5
Net finance expense					(5.7)
Profit before tax					41.8
Segment profit/(loss) is stated after charging the following:					
Depreciation	2.8	–	1.1	–	3.9
Amortisation (including acquired intangible assets)	1.9	1.7	0.1	–	3.7
Segment assets					
Reportable segment assets	117.6	248.0	35.1	3.5	404.2
Unallocated assets:					
Deferred tax					10.1
Cash and cash equivalents					248.7
Total assets					663.0
Expenditure on non-current assets					
Property, plant and equipment	0.4	0.6	0.8	–	1.8
Intangible assets	0.1	0.2	–	–	0.3
Segment liabilities					
Reportable segment liabilities	93.2	284.0	3.6	24.3	405.1
Unallocated liabilities:					
Retirement benefit obligations					23.9
Borrowings					71.0
Taxation					9.0
Total liabilities					509.0

Notes to the Financial Statements continued

3 Operating segments continued

Geographical information

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets and exclude deferred tax assets.

2018	External revenue £m	Share of revenue of JVs and assoc's £m	Total segment revenue £m	Non-current assets £m
UK	**1,458.3**	**25.6**	**1,483.9**	**73.0**
Spain	**5.4**	**–**	**5.4**	**31.6**
	1,463.7	**25.6**	**1,489.3**	**104.6**

2017	External revenue £m	Share of revenue of JVs and assoc's £m	Total segment revenue £m	Non-current assets £m
UK	1,674.7	44.9	1,719.6	78.9
Spain	5.3	–	5.3	34.1
Rest of the world	4.0	–	4.0	0.1
	1,684.0	44.9	1,728.9	113.1

Customers accounting for more than 10% of revenue

Three customers (2017: three) in the Infrastructure segment accounted for revenue of £758.1 million (2017: £1,005.7 million).

4 Other operating expenses and income

	2018 £m	2017 £m
Profit before tax is stated after charging:		
Amortisation of intangible assets (note 11)	**3.4**	3.7
Depreciation of property, plant and equipment (note 12)	**3.2**	3.9
Pension GMP equalisation charge (note 21)	**8.6**	–
Hire of plant and machinery	**31.6**	46.9
Rent of land and buildings	**4.3**	4.6
and after crediting:		
Income from sub-leases of land and buildings	**0.2**	0.1
RDEC grant income	**1.7**	0.4
RDEC grant income – prior year	**2.6**	2.5

As explained in note 27, the accounting policy for research and development expenditure credits has been changed during the year. The Group also changed its methodology for calculating these grants and as a result has shown current year changes to estimates of credits for prior years separately within other items.

Auditor's remuneration

	2018 £m	2017 £m
Fees payable to the Group's auditor for the audit of the annual financial statements	**0.1**	0.1
Fees payable to the Group's auditor and its associates in respect of:		
Audit of financial statements of subsidiaries of the Company	**0.4**	0.4
	0.5	0.5

An amount of less than £0.1 million was paid to the Group's auditor in 2018 (2017: less than £0.1 million) with regards to the independent review of the interim results and other non-audit services.

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	2018 £m	2017 £m
Wages and salaries	**219.5**	222.0
Social security costs	**24.4**	24.5
Pension costs – defined contribution schemes (note 21)	**9.8**	8.9
Share-based payments expense (note 21)	**2.9**	2.7
	256.6	258.1

	2018 Number	2017 Number
Average number of persons employed		
Natural Resources	**1,165**	1,205
Infrastructure	**2,709**	2,825
Alcaidesa	**70**	67
Central	**18**	21
	3,962	4,118

Of the above employees 72 were employed overseas (2017: 93).

Company

The Company does not employ any personnel, except for the directors considered in note 6.

6 Remuneration of directors

Details of the directors' remuneration, pension entitlements, interest in the Long-Term Incentive Plans, Annual Incentive Plans, Deferred Share Bonus Plans and share options are included in the Directors' Remuneration Report.

For the purpose of the disclosure required by Schedule 5 to the Companies Act 2006, the total aggregate emoluments of the directors in respect of 2018 and 2017 are detailed below.

	2018 £m	2017 £m
Remuneration	**1.7**	1.8
Post-employment benefits	**0.2**	0.2
Gains made on the exercise of share-based plans	**1.1**	1.2
	3.0	3.2

Notes to the Financial Statements continued

7 Net finance expense

	2018 £m	2017 £m
Interest income from bank deposits	**0.3**	0.2
Interest income on loans to related parties	**0.1**	0.2
Finance income	**0.4**	0.4
Interest payable on bank overdrafts, interest-bearing loans, borrowings and other similar charges	**(3.1)**	(4.2)
Unwind of discount on deferred consideration	**(0.1)**	(0.1)
Interest cost on the net liabilities of the defined benefit pension scheme (note 21)	**(0.4)**	(1.8)
Finance expense	**(3.6)**	(6.1)
Net finance expense	**(3.2)**	(5.7)

Other similar charges includes arrangement and commitment fees payable. Interest income on loans to related parties relates to shareholder loan interest receivable from investments in equity accounted joint ventures and associates.

8 Taxation

	2018 £m	2017 £m
On profit for the year		
UK corporation tax at 19% (2017: 19.25%)	**(6.6)**	(11.0)
Adjustment in respect of prior years	**3.7**	(0.8)
Current tax expense for the year	**(2.9)**	(11.8)
Deferred tax expense for the current year	**(0.8)**	2.5
Adjustment in respect of prior years	**(3.7)**	0.1
Deferred tax (expense)/credit for the year	**(4.5)**	2.6
Tax expense in the consolidated income statement	**(7.4)**	(9.2)

	2018 £m	2017 £m
Tax reconciliation		
Profit before tax	**40.2**	41.8
Taxation at 19% (2017: 19.25%)	**(7.6)**	(8.0)
Share of results of joint ventures and associates	**0.1**	0.1
Amounts qualifying for tax relief and disallowed expenses	**0.1**	(1.3)
Utilisation of previously unrecognised temporary differences	**–**	0.9
Rate adjustment relating to deferred taxation and overseas profits and losses	**–**	(0.2)
Adjustments in respect of prior years	**–**	(0.7)
Tax expense in the consolidated income statement	**(7.4)**	(9.2)
Effective rate of tax	**18.4%**	22.0%

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

The current tax liabilities of £2.6 million (2017: £9.0 million) for the Group and £1.5 million (2017: £1.5 million) for the Company represent the amount of tax in respect of all outstanding periods and include the Group's best estimate of any liabilities, where appropriate.

Accumulated trading tax losses carried forward in the UK were £0.1 million (2017: £0.1 million).

Accumulated tax losses carried forward in Spain were £60.5 million (2017: £58.8 million).

	2018 £m	2017 £m
Deferred tax asset recognised		
Accelerated capital allowances	**1.3**	1.6
Short-term temporary differences	**0.6**	0.6
Retirement benefit obligations	**0.8**	4.5
Tax losses	**–**	3.4
Deferred tax asset	**2.7**	10.1

UK deferred tax assets have been recognised at 19% or 17% as applicable (2017: 19% or 17%) and Spanish tax losses have not been recognised (2017: recognised at 25%).

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

	2018 £m	2017 £m
Analysis of deferred tax movements		
At 1 January	**10.1**	14.9
Deferred tax in consolidated income statement		
Accelerated capital allowances	**(0.3)**	(0.4)
Short-term temporary differences	**0.4**	4.7
Retirement benefit obligations	**(1.2)**	(2.1)
Tax losses	**(3.4)**	0.4
	(4.5)	2.6
Deferred tax in other comprehensive income and expense statement		
Retirement benefit obligations	**(2.5)**	(7.4)
Short-term temporary differences	**–**	0.5
	(2.5)	(6.9)
Deferred tax recognised directly in the consolidated statement of changes in equity		
Short-term temporary differences	**(0.4)**	(0.5)
At 31 December	**2.7**	10.1

Notes to the Financial Statements continued

8 Taxation continued

Factors that may affect future tax charges

The rate of UK corporation tax reduces to 17% with effect from 1 April 2020. The deferred tax assets are reflected at the 17% rate or at 19% where the asset will unwind prior to April 2020.

The Group and Company have deferred tax assets in their UK operations that have not been recognised at the year-end on the basis that their future economic benefits were not assured at the statement of financial position date.

The following gross assets are available to be recognised as deferred tax assets:

	Group		Company	
	2018 £m	**2017 £m**	**2018 £m**	**2017 £m**
Accelerated capital allowances	**2.2**	1.9	**–**	–
Short-term temporary differences	**6.3**	25.4	**–**	–
Trading tax losses	**0.1**	0.1	**–**	–
Total	**8.6**	27.4	**–**	–
In addition to the above temporary differences, the following gross value items are available as deferred tax assets:				
Management expenses and charges incurred by Parent Company	**54.7**	54.7	**54.7**	54.7
Spanish tax losses carried forward	**60.5**	40.7	**–**	–
Capital losses	**270.6**	270.6	**241.0**	241.0

The current year tax effect, at 19%, of claiming short-term temporary differences and trading tax losses was £nil (2017: £0.9 million) as shown in the tax reconciliation above.

There are no expiry dates associated with the deferred tax assets, recognised and not recognised, other than in Spain where a significant proportion of the losses expire between 2023 and 2028. Tax relief will be obtained if suitable profits arise in the future.

9 Earnings per share

The calculation of earnings per share is based on profit of £32.8 million (2017: £32.6 million) and the number of shares set out below.

	2018 Number (millions)	**2017 Number (millions)**
Weighted average number of ordinary shares in issue for basic earnings per share calculation	**106.3**	104.7
Dilutive potential ordinary shares arising from employee share schemes	**2.3**	2.0
Weighted average number of ordinary shares in issue for diluted earnings per share calculation	**108.6**	106.7

At 31 December 2018, no options were excluded from the weighted average number of ordinary shares calculation because they were anti-dilutive (2017: no options were excluded).

10 Dividends

	Dividend per share pence	2018 £m	2017 £m
Final dividend for the year ended 31 December 2016	8.40	–	8.7
Interim dividend for the year ended 31 December 2017	4.75	–	5.0
Final dividend for the year ended 31 December 2017	9.25	**9.8**	–
Interim dividend for the year ended 31 December 2018	5.15	**5.4**	–
Amount recognised as distributions to equity holders in the year		**15.2**	13.7
Dividends settled in shares		**(1.5)**	(1.8)
Dividends settled in cash		**13.7**	11.9

A final dividend in respect of the year ended 31 December 2018 of 10.0 pence per share, amounting to a dividend of £10.7 million, is to be proposed at the Annual General Meeting. If approved, the dividend is expected to be paid on 17 May 2019 to shareholders on the register as at 12 April 2019 and a scrip dividend alternative will be offered. These financial statements do not reflect the final dividend payable.

11 Intangible assets

Group	Goodwill £m	Customer relationships £m	Other acquired intangibles £m	Other intangibles £m	Total £m
Cost					
At 1 January 2017	54.1	15.4	9.7	8.1	87.3
Additions	–	–	–	0.3	0.3
At 31 December 2017	54.1	15.4	9.7	8.4	87.6
At 1 January 2018	**54.1**	**15.4**	**9.7**	**8.4**	**87.6**
Additions	**–**	**–**	**–**	**0.3**	**0.3**
Disposals	**–**	**–**	**–**	**(1.0)**	**(1.0)**
At 31 December 2018	**54.1**	**15.4**	**9.7**	**7.7**	**86.9**
Amortisation					
At 1 January 2017	–	7.9	7.3	6.2	21.4
Charge in year	–	2.3	0.9	0.5	3.7
At 31 December 2017	–	10.2	8.2	6.7	25.1
At 1 January 2018	**–**	**10.2**	**8.2**	**6.7**	**25.1**
Charge in year	**–**	**2.3**	**0.7**	**0.4**	**3.4**
Disposals	**–**	**–**	**–**	**(0.1)**	**(0.1)**
At 31 December 2018	**–**	**12.5**	**8.9**	**7.0**	**28.4**
Net book value					
At 31 December 2018	**54.1**	**2.9**	**0.8**	**0.7**	**58.5**
At 31 December 2017	54.1	5.2	1.5	1.7	62.5
At 1 January 2017	54.1	7.5	2.4	1.9	65.9

Notes to the Financial Statements continued

11 Intangible assets continued

The net book value of other acquired intangible assets includes £0.6 million (2017: £0.9 million) relating to order book.

Goodwill has been allocated to the applicable cash generating units of the Infrastructure segment (£15.5 million) and the Natural Resources segment (£38.6 million).

As described in note 2, the Group reviews the value of goodwill and in the absence of any identified impairment risks, tests are based on internal value in use calculations of the cash generating unit (CGU). The key assumptions for these calculations are: discount rates, growth rates and expected changes to revenue and direct costs during the period.

Discount rates have been estimated based on pre-tax rates that reflect current market assessments of the Group's weighted average cost of capital and the risks specific to the CGU. The rate used to discount the forecast cash flows for the Infrastructure CGU was 10.7% and for the Natural Resources CGU was 9.3%.

The value in use calculations use the Group's three-year cash flow forecasts, which are based on the expected revenues of each CGU taking into account the current level of secured and anticipated orders, extrapolated for future years by the expected growth applicable to each CGU as follows:

Growth rates	Infrastructure %	Natural Resources %
Year 4	1.5	1.5
Year 5	1.5	1.5
Long-term average	1.5	1.5

At 31 December 2018, based on the internal value in use calculations, management concluded that the recoverable value of the cash generating units exceeded their carrying amount.

There is substantial headroom on goodwill for both CGUs. Sensitivity analysis has been performed on the goodwill in relation to each CGU by changing the key assumptions applicable to each CGU. In respect of the Natural Resources segment, which has the smaller headroom, the assumptions would have to change as follows for any single assumption change to bring headroom down to £nil:

- Discount rate – increase from 9.3% to 25.7%
- Growth rate – reduce from positive 1.5% to a negative value
- Underlying operating margin – reduce forecast margin by 2.0%.

12 Property, plant and equipment

Group	Land and buildings £m	Plant and equipment £m	Total £m
Cost			
At 1 January 2017	29.9	31.7	61.6
Reclassification from inventories	2.0	–	2.0
Currency movements	1.0	0.1	1.1
Additions	–	1.8	1.8
Disposals	–	(0.9)	(0.9)
At 31 December 2017	32.9	32.7	65.6
At 1 January 2018	**32.9**	**32.7**	**65.6**
Currency movements	**0.4**	**0.1**	**0.5**
Additions	**–**	**1.0**	**1.0**
Disposals	**(1.2)**	**(1.6)**	**(2.8)**
At 31 December 2018	**32.1**	**32.2**	**64.3**
Depreciation			
At 1 January 2017	2.0	17.4	19.4
Charge in year	0.9	3.0	3.9
Disposals	–	(0.7)	(0.7)
At 31 December 2017	2.9	19.7	22.6
At 1 January 2018	**2.9**	**19.7**	**22.6**
Currency movements	**0.1**	**–**	**0.1**
Charge in year	**0.8**	**2.4**	**3.2**
Disposals	**–**	**(1.6)**	**(1.6)**
At 31 December 2018	**3.8**	**20.5**	**24.3**
Net book value			
At 31 December 2018	**28.3**	**11.7**	**40.0**
At 31 December 2017	30.0	13.0	43.0
At 1 January 2017	27.9	14.3	42.2

A piece of land at Alcaidesa in Spain was reclassified from inventories to land and buildings in the prior year.

Notes to the Financial Statements continued

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

Group	Investments: Joint ventures £m	Investments: Associates £m	Loans: Associates £m	Total £m
Cost				
At 1 January 2017	14.4	0.1	1.7	16.2
Repayments	–	–	(0.1)	(0.1)
At 31 December 2017	14.4	0.1	1.6	16.1
At 1 January 2018	**14.4**	**0.1**	**1.6**	**16.1**
At 31 December 2018	**14.4**	**0.1**	**1.6**	**16.1**
Share of post-acquisition reserves				
At 1 January 2017	(14.1)	0.5		(13.6)
Dividends	–	(0.1)		(0.1)
Profit for the year	–	0.3		0.3
At 31 December 2017	(14.1)	0.7		(13.4)
At 1 January 2018	**(14.1)**	**0.7**		**(13.4)**
Dividends	**–**	**(0.5)**		**(0.5)**
Profit for the year	**0.1**	**0.2**		**0.3**
At 31 December 2018	**(14.0)**	**0.4**		**(13.6)**
Net book value				
At 31 December 2018	**0.4**	**0.5**	**1.6**	**2.5**
At 31 December 2017	0.3	0.8	1.6	2.7
At 1 January 2017	0.3	0.6	1.7	2.6

Analysis of Group share of joint ventures and associates revenue, income and assets and liabilities

	2018			2017		
	Joint ventures £m	**Associates £m**	**Total £m**	**Joint ventures £m**	**Associates £m**	**Total £m**
Revenue	**24.8**	**0.8**	**25.6**	44.0	0.9	44.9
Profit before tax	**0.1**	**0.2**	**0.3**	–	0.4	0.4
Taxation	**–**	**–**	**–**	–	(0.1)	(0.1)
Profit for the year	**0.1**	**0.2**	**0.3**	–	0.3	0.3
Non-current assets	**–**	**–**	**–**	0.1	–	0.1
Trade and other receivables	**6.7**	**1.5**	**8.2**	8.6	1.5	10.1
Cash and cash equivalents	**2.9**	**0.5**	**3.4**	2.7	0.9	3.6
Trade and other payables – current	**(9.2)**	**(0.3)**	**(9.5)**	(11.1)	(0.4)	(11.5)
Non-current liabilities	**–**	**(1.2)**	**(1.2)**	–	(1.2)	(1.2)
Investments in joint ventures and associates	**0.4**	**0.5**	**0.9**	0.3	0.8	1.1
Dividends received by Group	**–**	**0.5**	**0.5**	–	0.1	0.1

Net interest payable by joint ventures and associates in 2018 was £nil (2017: £nil). The applicable interest rates during the year are income of 0.2% to 13.6% per annum (2017: 0.2% to 13.6%) and expense of 10.7% to 13.6% per annum (2017: 10.7% to 13.6%).

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

	2018			2017		
	Joint ventures £m	**Associates £m**	**Total £m**	**Joint ventures £m**	**Associates £m**	**Total £m**
Revenue	**71.5**	**2.0**	**73.5**	127.4	2.2	129.6
Profit before tax	**0.1**	**0.7**	**0.8**	–	1.0	1.0
Taxation	**–**	**(0.1)**	**(0.1)**	–	(0.2)	(0.2)
Profit for the year	**0.1**	**0.6**	**0.7**	–	0.8	0.8
Non-current assets	**0.1**	**–**	**0.1**	0.2	–	0.2
Trade and other receivables	**18.3**	**3.7**	**22.0**	24.5	3.8	28.3
Cash and cash equivalents	**8.3**	**1.3**	**9.6**	6.9	2.3	9.2
Trade and other payables – current	**(25.7)**	**(0.7)**	**(26.4)**	(30.7)	(1.0)	(31.7)
Non-current liabilities	**–**	**(3.0)**	**(3.0)**	–	(3.2)	(3.2)
Equity	**1.0**	**1.3**	**2.3**	0.9	1.9	2.8

Details of subsidiary undertakings, joint ventures, joint operations and associates are shown in note 25.

There is no other comprehensive income/(expense) in respect of joint ventures and the associates.

Notes to the Financial Statements continued

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

Company

Investments in subsidiaries	£m
Cost	
At 1 January 2017	374.6
Additions	2.7
At 31 December 2017	377.3
At 1 January 2018	**377.3**
Additions	**2.9**
At 31 December 2018	**380.2**
Amounts written off	
At 1 January 2017	(269.2)
At 31 December 2017	(269.2)
At 1 January 2018	**(269.2)**
Release of provision	**29.5**
At 31 December 2018	**(239.7)**
Net book value	
At 31 December 2018	**140.5**
At 31 December 2017	108.1
At 1 January 2017	105.4

Additions relate to the increase in the cost of investments in subsidiaries by the equivalent amount of the equity-settled share-based payment charge in relation to employees of subsidiaries included in the income statement.

Details of the subsidiaries in which the Company has an interest are set out in note 25.

14 Trade and other receivables

	Group		Company	
	2018 £m	**2017 (Restated)** £m	**2018** £m	**2017** £m
Amounts included in current assets				
Trade receivables	**85.2**	108.3	**–**	–
Other receivables	**19.7**	17.5	**–**	–
Contract assets	**141.8**	140.8	**–**	–
Prepayments and accrued income	**28.3**	21.8	**0.3**	0.3
Amounts owed by joint ventures and associates	**1.5**	1.3	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**138.6**	139.0
	276.5	289.7	**138.9**	139.3
Amounts included in non-current assets				
Other	**3.6**	4.9	**–**	–

Restatement: £2.6 million previously included in trade receivables within current assets has been moved to prepayments and accrued income.

At 31 December 2018, contract assets falling due within one year include retentions of £5.2 million (2017: £8.2 million) relating to long-term contracts in progress. Other receivables falling due after more than one year include retentions of £3.0 million (2017: £4.3 million) relating to long-term contracts in progress.

The average credit period within trade receivables on amounts billed for contract work and on sales of goods is 33 days (2017: 33 days). The analysis of the due dates of the trade receivables was £72.6 million (2017: £93.5 million) due within 30 days, £6.7 million (2017: £16.7 million) due between 30 and 60 days and £5.9 million (2017: £0.7 million) due after 60 days. An analysis of trade receivables that are beyond their due dates is shown in note 18.

In respect of the Company, amounts due from subsidiary undertakings are repayable on demand and may be interest-bearing.

15 Cash and cash equivalents

Cash and cash equivalents are analysed below, and include the Group's share of cash held by joint operations of £84.5 million (2017: £87.8 million).

	Group		Company	
	2018 £m	**2017 £m**	**2018 £m**	**2017 £m**
Cash and cash equivalents	**189.3**	248.7	**–**	–
Cash and cash equivalents in the cash flow statement	**189.3**	248.7	**–**	–

16 Interest-bearing loans and borrowings

	Group		Company	
	2018 £m	**2017 £m**	**2018 £m**	**2017 £m**
Current				
Revolving Credit Facility	**9.8**	10.2	**9.8**	10.2
Other loans	**0.2**	0.2	**–**	–
	10.0	10.4	**9.8**	10.2
Non-current				
Term Loan	**60.0**	60.0	**60.0**	60.0
Other loans	**0.5**	0.6	**–**	–
	60.5	60.6	**60.0**	60.0

The Group's borrowings facilities are described in note 18.

Notes to the Financial Statements continued

17 Cash flow information

Net cash/(debt) reconciliation

This section sets out an analysis of net cash/(debt) and movements in net cash/(debt) during the year.

	Group		Company	
	2018 £m	**2017 £m**	**2018 £m**	**2017 £m**
Cash and cash equivalents (note 15)	**189.3**	248.7	**–**	–
Borrowings – current (note 16)	**(10.0)**	(10.4)	**(9.8)**	(10.2)
Borrowings – non-current (note 16)	**(60.5)**	(60.6)	**(60.0)**	(60.0)
Net cash/(debt)	**118.8**	177.7	**(69.8)**	(70.2)

Group	**Cash and cash equivalents £m**	**Borrowings – current £m**	**Borrowings – non-current £m**	**Total £m**
Net cash/(debt) at 1 January 2017	210.2	(39.9)	(30.1)	140.2
Cash flows	38.5	29.8	(30.5)	37.8
Effect of foreign exchange rate changes	–	(0.3)	–	(0.3)
Net cash/(debt) at 31 December 2017	248.7	(10.4)	(60.6)	177.7
Net cash/(debt) at 1 January 2018	**248.7**	**(10.4)**	**(60.6)**	**177.7**
Cash flows	**(59.2)**	**0.4**	**0.1**	**(58.7)**
Effect of foreign exchange rate changes	**(0.2)**	**–**	**–**	**(0.2)**
Net cash/(debt) at 31 December 2018	**189.3**	**(10.0)**	**(60.5)**	**118.8**

Company	**Cash and cash equivalents £m**	**Borrowings – current £m**	**Borrowings – non-current £m**	**Total £m**
Net cash/(debt) at 1 January 2017	–	(39.9)	(30.0)	(69.9)
Cash flows	–	30.0	(30.0)	–
Effect of foreign exchange rate changes	–	(0.3)	–	(0.3)
Net cash/(debt) at 31 December 2017	–	(10.2)	(60.0)	(70.2)
Net cash/(debt) at 1 January 2018	**–**	**(10.2)**	**(60.0)**	**(70.2)**
Cash flows	**–**	**0.4**	**–**	**0.4**
Net cash/(debt) at 31 December 2018	**–**	**(9.8)**	**(60.0)**	**(69.8)**

18 Financial instruments – Fair values and risk management

Risk management

The Group's centralised treasury function manages financial risk, principally arising from liquidity and funding risks and movements in foreign currency rates and interest rates, in accordance with policies agreed by the directors.

Neither the Company or the Group enters into speculative transactions.

a) Capital management

The Group's objectives when managing capital are to safeguard its ability to continue as a going concern and to provide resources to grow the business, in order to provide returns for shareholders and other stakeholders. The current capital base of the Group is driven by equity capital from shareholders and retained earnings. The Board of directors (Board) continues to seek to strengthen the Group by growing the business and improving profitability; the Strategic Report describes the Group's strategy and its operations. In respect of dividends paid to shareholders, the Board's current policy will target a dividend cover of around 2.5 times underlying earnings.

b) Liquidity and funding risk

Ultimate responsibility for liquidity and funding risk rests with the Board, which has put in place a monitoring and reporting framework to manage funding requirements.

Liquidity risk is managed by monitoring actual and forecast short and medium-term cash flows and the maturity profile of financial assets and liabilities and by maintaining adequate cash reserves and bank facilities. The nature and timing of the contract cash flows causes the cash balances to vary over the month with the balance usually highest at month end.

The average month end net cash balance during the year was £77.1 million (2017: £96.7 million).

Customers awarding long-term contracting work may, as a condition of the award, require the contractor to provide performance and other bonds. Consequently, the Group is reliant on its ability to secure bank and surety bonds. It has facilities in place to provide these bonds and monitors the usage and regularly updates the forecast usage of these facilities.

At 31 December 2018, the Group had banking and bonding facilities, including a £131.0 million (2017: £131.0 million) Revolving Credit Facility and a £60.0 million (2017: £60.0 million) Term Loan, extending to 25 June 2022. The facilities have financial covenants based on interest cover and leverage measured quarterly. The covenants are based on accounting standards already in force at the date of signing the facilities. The Group complied with all covenants in 2018. The unsecured bonding facilities are set out below:

	Group and Company	
	2018 £m	**2017 £m**
Expiring between one and five years	**320.0**	320.0
Element of above facilities available for borrowings	**2.5**	2.5

At 31 December 2018, the utilisation of these bonding facilities amounted to £99.9 million (2017: £97.0 million).

Notes to the Financial Statements continued

18 Financial instruments – Fair values and risk management continued

Risk management continued

c) Credit risk

The Group focuses on major blue-chip private sector and large public sector customers. In respect of contracts with other customers, 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.

To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due. Group 1 comprises major blue-chip private sector and large public sector customers. Group 2 includes smaller customers and receivables arising from various additional services undertaken as requirements of some of the maintenance contracts. Group revenue of £1,428.8 million was attributable to Group 1 customers in 2018 and £34.9 million attributable to Group 2 customers.

The contract assets relate to unbilled work in progress and have substantially the same credit risk characteristics as the trade receivables for the same types of contracts. The Group has concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets.

The loss rates will be adjusted to reflect current and forward-looking information on macroeconomic factors that might affect the ability of the customers to settle the receivables.

On this basis, the loss allowance as at 31 December 2018 and 1 January 2018 (on adoption of IFRS 9) was determined as follows for both trade receivables and contract assets:

	Current	Less than 60 days past due	60 to 120 days past due	More than 120 days past due	Total
31 December 2018					
Group 1					
Expected loss rate	**0.00%**	**0.10%**	**0.25%**	**0.50%**	
	£m	**£m**	**£m**	**£m**	**£m**
Trade receivables	**68.4**	**8.1**	**2.0**	**5.3**	**83.8**
Contract assets	**80.5**	**16.4**	**1.5**	**43.4**	**141.8**
Loss allowance	**–**	**–**	**–**	**0.2**	**0.2**
Group 2					
Expected loss rate	**1.0%**	**2.0%**	**15.0%**	**30.0%**	
	£m	**£m**	**£m**	**£m**	**£m**
Trade receivables	**0.4**	**0.5**	**–**	**0.5**	**1.4**
Contract assets	**–**	**–**	**–**	**–**	**–**
Loss allowance	**–**	**–**	**–**	**0.2**	**0.2**
1 January 2018					
Group 1					
Expected loss rate	0.00%	0.10%	0.25%	0.50%	
	£m	£m	£m	£m	£m
Trade receivables	95.1	6.1	2.0	3.1	106.3
Contract assets	88.1	21.4	16.9	14.4	140.8
Loss allowance	–	–	–	0.1	0.1
Group 2					
Expected loss rate	1.0%	2.0%	15.0%	30.0%	
	£m	£m	£m	£m	£m
Trade receivables	0.8	1.2	–	–	2.0
Contract assets	–	–	–	–	–
Loss allowance	–	–	–	–	–

Impairment losses on trade receivables and contract assets are included within operating profit. Subsequent recoveries of amounts previously written off are credited against the same line item. The total provision for impairment of trade and other receivables is £0.5 million (2017: £0.6 million). The credit risk in contract assets is not material.

Deposits in the UK are placed with the bank facility providers or, in joint operations, with banks agreed by the partners. Overseas deposits are placed with major banks operating in those countries. Transactions involving derivative financial instruments are with bank or insurance company counterparties with high credit ratings that are monitored regularly and with whom there are signed netting agreements. Given the high credit ratings of the banks and insurance companies used, management does not expect any counterparty will fail to meet its obligations.

At the year-end date, excluding UK Government bodies, 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 contract assets in the statement of financial position.

d) Interest rate risk

The Group has cash balances in the UK and overseas and bank borrowings in the UK and Spain. The largest constituents are UK balances denominated in pounds sterling.

During the prior year ending 31 December 2017, the Group entered into interest rate swap arrangements that fixed the effective LIBOR interest rate on £60.0 million of pounds sterling borrowings up to June 2021.

A 1% rise in interest rates would have increased the annual interest income on net cash balances by approximately £1.0 million (2017: approximately £1.2 million).

e) Foreign currency risk

Transactional currency exposures arise from sales or purchases by operating companies in currencies other than their functional currency. The current strategy is to hedge both committed and forecast foreign currency exposures, where applicable, and where the transaction timing and amount can be determined reliably and no natural hedge exists. The Group only enters into forward contracts when a contractual commitment exists in respect of the foreign currency transaction and the Group's policy is to negotiate the terms of the hedge derivative to match the terms of the hedged item to maximise hedge effectiveness. The Group's treasury function evaluates and hedges foreign currency risks, in close cooperation with the responsible operational management team.

The Group's subsidiary, Alcaidesa Holding SA, a company based in Spain is denominated in euro. At the year-end, the carrying value of the net assets was £25.5 million (2017: £26.2 million). The investment is hedged by forward contracts to sell euro, which mitigate the foreign currency risk arising from the subsidiary's net assets. The value of the forward sales contracts at 31 December 2018 was €28.0 million (£25.0 million) (2017: €28.0 million (£24.6 million)). The Group's investments in other subsidiaries are not hedged. A 10% strengthening in the euro would have adversely impacted the results by £0.1 million (2017: £0.1 million), but would have no impact on the statement of financial position (2017: £nil).

Effects of net investment hedge accounting on the financial position and performance

	2018 £m	**2017 £m**
Carrying amounts liability (Forwards)	**(0.2)**	(0.4)
EUR carrying amounts	**25.5**	26.2
Hedge ratio	**95%**	95%
Change in carrying amount of the Forwards as a result of currency movements since 1 January, recognised in OCI	**(0.2)**	(0.4)
Change in value of hedged item used to determine hedge effectiveness	**0.2**	0.4
Weighted average hedged rate for the year (including forward points)	**€1 – £0.879**	€1 – £0.894

Notes to the Financial Statements continued

18 Financial instruments – Fair values and risk management continued

Cash flow hedges

Forward currency contracts that hedge forecast transactions are classified as cash flow hedges and stated at fair value based on a Level 2 valuation method, using quoted forward exchange rates. The terms of the foreign currency contracts match the terms of the commitments.

Interest rate swaps are classified as cash flow hedges and stated at fair value based on a Level 2 valuation method using yield curves derived from prevailing market interest rates.

At 31 December 2018, the Group had cash flow hedges as summarised below. The carrying value represents the fair value of the contract; the contractual cash flows represent the pounds sterling commitments. There were no ineffective hedges at the year-end (2017: none).

	2018				2017			
	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**
Foreign exchange contracts:								
Purchases	**0.7**	**(18.1)**	**(17.2)**	**(0.9)**	1.3	(17.5)	(8.3)	(9.2)
Sales	**(0.1)**	**(2.6)**	**(2.6)**	**–**	(0.1)	(3.2)	(0.6)	(2.6)
	0.6	**(20.7)**	**(19.8)**	**(0.9)**	1.2	(20.7)	(8.9)	(11.8)
Interest rate swaps	**0.2**	**(1.5)**	**(0.6)**	**(0.9)**	(0.2)	(1.8)	(0.5)	(1.3)
	0.8	**(22.2)**	**(20.4)**	**(1.8)**	1.0	(22.5)	(9.4)	(13.1)

The carrying amount of hedge instruments is included in trade and other receivables. The expected impact on the income statement of the foreign exchange contracts is £0.6 million and of the interest rate swaps is £0.1 million in 2019.

The movements on the hedging reserve by classification are set out below.

	Spot component of currency forwards £m	**Interest rate swaps £m**	**Total hedge reserves £m**
At 1 January 2017	1.9	–	1.9
Change in fair value of hedging instrument recognised in OCI for the year	(1.5)	(0.2)	(1.7)
Reclassified from OCI to profit or loss	0.4	–	0.4
Deferred tax	0.2	–	0.2
At 31 December 2017	1.0	(0.2)	0.8
At 1 January 2018	**1.0**	**(0.2)**	**0.8**
Change in fair value of hedging instrument recognised in OCI for the year	**(0.6)**	**0.5**	**(0.1)**
Deferred tax	**0.1**	**(0.1)**	**–**
At 31 December 2018	**0.5**	**0.2**	**0.7**

Effects of hedge accounting on the financial position and performance

The effects of the foreign currency related hedging instruments on the Group's financial position and performance are as follows:

	2018 £m	2017 £m
Foreign currency forwards		
Carrying amounts – asset	**0.6**	1.2
Notional amounts	**20.7**	20.7
Maturity dates	**January 2019 – October 2021**	January 2018 – October 2019
Hedge ratio	**100%**	100%
Change in discounted spot value of outstanding hedging instruments since 1 January	**0.0**	0.2
Change in value of hedged item used to determine hedge effectiveness	**0.0**	(0.2)
Weighted average hedged rate for the year (including forward points)	**€1 – £0.870 US$1 – £0.755**	€1 – £0.842 CHF1 - £0.792
Interest rate swap		
Carrying amounts – asset/(liability)	**0.2**	(0.2)
Notional amounts	**60.0**	60.0
Maturity dates	**25 June 2021**	25 June 2021
Hedge ratio	**100%**	100%
Change in fair value of outstanding hedging instruments since 1 January	**0.4**	(0.2)
Change in value of hedged item used to determine hedge effectiveness	**(0.4)**	0.2
Weighted average hedged rate for the year	**0.4%**	0.3%

The Company is party to the interest rate swaps. It does not have any forward foreign currency contracts or other derivatives.

Notes to the Financial Statements continued

18 Financial instruments – Fair values and risk management continued

Financial assets and liabilities

The Group has grouped its financial instruments into 'classes'. Although IFRS 7 does not define 'classes', as a minimum instruments measured at amortised cost should be distinguished from instruments measured at fair value.

a) Currency and maturity of financial assets

Financial assets not measured at fair value

	2018				2017			
	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	**186.1**	**186.1**	**–**	**–**	241.9	241.9	–	–
other	**3.2**	**3.2**	**–**	**–**	6.8	6.8	–	–
	189.3	**189.3**	**–**	**–**	248.7	248.7	–	–
Loans to joint ventures and associates:								
pounds sterling	**1.6**	**0.1**	**0.4**	**1.1**	1.6	0.1	0.4	1.1
Trade, other receivables and amounts owed by joint ventures and associates:								
pounds sterling	**109.5**	**105.9**	**3.6**	**–**	130.8	125.9	4.9	–
other	**0.5**	**0.5**	**–**	**–**	1.2	1.2	–	–
	110.0	**106.4**	**3.6**	**–**	132.0	127.1	4.9	–
Total financial assets not measured at fair value	**300.9**	**295.8**	**4.0**	**1.1**	382.3	375.9	5.3	1.1

The Group has not disclosed the fair values for short-term trade receivables and amounts due from joint ventures and associates within financial assets, because their carrying amounts are a reasonable approximation of fair values. The fair values of loans carrying interest rates above 10% may be higher than their carrying values of £1.6 million (2017: £1.6 million), but not by a material amount.

Financial assets measured at fair value

The Group does not have any financial assets measured at fair value.

b) Currency and maturity of financial liabilities

Financial liabilities not measured at fair value

	2018			2017		
	Total £m	Within one year £m	Between one and five years £m	Total £m	Within one year £m	Between one and five years £m
Term Loan - pounds sterling	**60.0**	**–**	**60.0**	60.0	–	60.0
Revolving Credit Facility:						
pounds sterling	**–**	**–**	**–**	–	–	–
euro	**9.8**	**9.8**	**–**	10.2	10.2	–
Other loans – euro	**0.7**	**0.2**	**0.5**	0.8	0.2	0.6
	70.5	**10.0**	**60.5**	71.0	10.4	60.6
Trade and other payables:						
pounds sterling	**161.7**	**160.8**	**0.9**	194.9	194.3	0.6
other	**1.8**	**1.8**	**–**	3.0	3.0	–
	163.5	**162.6**	**0.9**	197.9	197.3	0.6
Total financial liabilities not measured at fair value	**234.0**	**172.6**	**61.4**	268.9	207.7	61.2

The Group has not disclosed the fair values for short-term trade and other payables and bank loans within financial liabilities, because their carrying amounts are a reasonable approximation of fair values.

Financial liabilities measured at fair value

	2018			2017		
	Total £m	Within one year £m	Between one and five years £m	Total £m	Within one year £m	Between one and five years £m
Deferred consideration – pounds sterling	**1.2**	**1.2**	**–**	0.7	–	0.7

The deferred consideration is valued at a Level 3 valuation method. The fair value is the same as the carrying value. See 'Measurement of fair value' below.

Notes to the Financial Statements continued

18 Financial instruments – Fair values and risk management continued

Financial assets and liabilities continued

c) Reconciliation of trade and other receivables and trade and other payables to the statement of financial position

	2018		2017	
	Current £m	Non-current £m	Current £m	Non-current £m
Trade and other receivables (as above)	**106.4**	**3.6**	127.1	4.9
Contract assets	**141.8**	**–**	140.8	–
Prepayments and accrued income	**28.3**	**–**	21.8	–
	276.5	**3.6**	289.7	4.9

	2018		2017	
	Current £m	Non-current £m	Current £m	Non-current £m
Trade and other payables (as above)	**162.6**	**0.9**	197.3	0.6
Deferred consideration (as above)	**1.2**	**–**	–	0.7
Contract liabilities	**13.7**	**–**	5.8	–
Accruals and deferred income	**135.7**	**–**	199.4	–
	313.2	**0.9**	402.5	1.3

d) Effective interest rates of financial assets and liabilities

	2018	2017
Financial assets		
Cash and cash equivalents	**0.0% to 0.6%**	0.0% to 0.4%
Loans to joint ventures and associates	**10.7% to 13.6%**	10.7% to 13.6%

Financial liabilities

The Group has a Term Loan, a Revolving Credit Facility (RCF), overdraft facilities and other loans. The £60.0 million (2017: £60.0 million) Term Loan and £9.8 million (2017: £10.2 million) of the RCF were drawn at the year-end, the overdrafts were undrawn. These loans are unsecured and carry interest at floating rates at a margin over LIBOR and the effective LIBOR cost to the Group on £60.0 million of borrowings was fixed by entering into interest rate swaps in 2017. Other loans totalled £0.7 million (2017: £0.8 million) and are secured on the assets acquired from the loan proceeds and carry interest at a margin over EURIBOR.

The Company's financial assets comprised cash at bank of £nil (2017: £nil) and trade and other receivables of £138.6 million (2017: £139.0 million) with £127.8 million (2017: £128.1 million) denominated in pounds sterling and £10.8 million (2017: £10.9 million) denominated in euros and all maturing within one year.

The Company's financial liabilities comprise trade and other payables of £26.4 million (2017: £27.9 million) denominated in pounds sterling, the £60.0 million (2017: £60.0 million) Term Loan denominated in pounds sterling and the £9.8 million (2017: £10.2 million) RCF denominated in euro. The Term Loan matures between one and five years, all other liabilities mature within one year.

Measurement of fair value

Valuation techniques and significant unobservable inputs

The following tables show the valuation techniques used in measuring Level 3 and Level 2 fair values, as well as the significant unobservable inputs used. There are no financial instruments whose value could be determined under Level 1.

Financial instruments measured at fair value

Type	Valuation technique	Significant unobservable inputs	Inter relationship between significant unobservable inputs and fair value measurement
Deferred consideration	Discounted cash flows: The valuation models consider the present value of the contractual payments, discounted using a risk-adjusted discount rate.	Risk-adjusted discount rate (12.5%)	The estimated fair value would increase (decrease) if the risk-adjusted discount rate were lower (higher).
Cash flow hedges	Market comparison technique: The fair values are based on broker quotes. Similar contracts are traded in an active market and quotes reflect the actual transactions in similar instruments. Interest rate swaps are measured by discounting the related cash flows using yield curves derived from prevailing market interest rates.	Not applicable.	Not applicable.

Financial instruments not measured at fair value

Type	Valuation technique	Significant unobservable inputs
Other financial liabilities (as above)	Discounted cash flow.	Not applicable.
Revolving Credit Facility	Discounted cash flow.	Not applicable.
Term Loan	Discounted cash flow.	Not applicable.

Level 3 fair values

The following table shows a reconciliation from the opening to closing balances for Level 3 fair values:

	Deferred consideration £m
At 1 January 2017	1.8
Addition charged to income statement (including unwind of discount)	1.3
Payments	(2.4)
At 31 December 2017	0.7
At 1 January 2018	**0.7**
Addition charged to income statement (including unwind of discount)	**0.5**
At 31 December 2018	**1.2**

There were no transfers out of Level 3 during the year.

Sensitivity analysis

The deferred consideration is payable in 2019 and would not be adjusted significantly by a change in discount rate. The amount payable is contractual and not dependent on performance.

Notes to the Financial Statements continued

19 Trade and other payables

	Group		Company	
	2018 £m	**2017 £m**	**2018 £m**	**2017 £m**
Current liabilities				
Trade payables	**125.6**	161.9	**–**	–
Other payables	**29.2**	27.3	**0.1**	–
Social security	**7.4**	7.8	**–**	–
Contract liabilities	**13.7**	5.8	**–**	–
Accruals and deferred income	**135.7**	199.4	**0.6**	0.6
Deferred consideration	**1.2**	–	**–**	–
Amounts owed to joint ventures and associates	**0.4**	0.3	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**26.3**	27.9
	313.2	402.5	**27.0**	28.5
Non-current liabilities				
Other payables	**0.9**	0.6	**–**	–
Deferred consideration	**–**	0.7	**–**	–
	0.9	1.3	**–**	–

Accruals and deferred income include subcontract liabilities (not yet payable), subcontract retentions and other accruals and deferred income.

The amounts included in contract liabilities and in deferred income at 31 December 2017 have all been recognised as revenue in the year.

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.

20 Provisions for other liabilities and charges

Group	Property £m	Other £m	Total £m
Current			
At 1 January 2017	0.4	0.7	1.1
Provided	–	0.4	0.4
Utilised	(0.3)	(0.3)	(0.6)
Reclassified from non-current	0.3	0.1	0.4
At 31 December 2017	0.4	0.9	1.3
At 1 January 2018	**0.4**	**0.9**	**1.3**
Provided	**–**	**0.5**	**0.5**
Utilised	**(0.2)**	**(0.5)**	**(0.7)**
Released	**(0.2)**	**–**	**(0.2)**
At 31 December 2018	**–**	**0.9**	**0.9**
Non-current			
At 1 January 2017	0.3	0.1	0.4
Reclassified to current	(0.3)	(0.1)	(0.4)
At 31 December 2017	–	–	–
At 1 January 2018	**–**	**–**	**–**
At 31 December 2018	**–**	**–**	**–**

Company	Funding obligations £m
Current	
At 1 January 2017	–
Reclassified from non-current	0.2
Utilised	(0.1)
At 31 December 2017	0.1
At 1 January 2018	**0.1**
Reclassified from non-current	**0.1**
Utilised	**(0.1)**
At 31 December 2018	**0.1**
Non-current	
At 1 January 2017	1.1
Reclassified to current	(0.2)
At 31 December 2017	0.9
At 1 January 2018	**0.9**
Provided	**0.1**
Reclassified to current	**(0.1)**
At 31 December 2018	**0.9**

Notes to the Financial Statements continued

20 Provisions for other liabilities and charges continued

Group

Property provisions related to costs of vacant properties and were utilised or released during the year.

Other provisions, mainly comprise a provision for staff benefits payable to the staff of an overseas subsidiary, insurance provisions and remedial costs, most of which are expected to 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.

21 Employee benefits

Pensions

A defined benefit pension scheme is operated in the UK and a number of defined contribution pension schemes are in place in the UK and overseas. Contributions are paid by subsidiary undertakings and, to the defined contribution schemes, by employees. The total pension charge in the income statement was £20.8 million comprising £20.4 million included in operating costs plus £0.4 million included in net finance expense (2017: £12.9 million, comprising £11.1 million in operating costs plus £1.8 million in net finance expense).

The Company does not operate a pension scheme.

Defined benefit scheme

The defined benefit scheme was closed to new members on 31 May 2005 and from 1 April 2006 future benefits were calculated on a Career Average Revalued Earnings basis. The scheme was closed to future accrual of benefits to members on 30 September 2009. A full actuarial valuation of the scheme was carried out as at 31 March 2016 and this was updated to 31 December 2018 by a qualified independent actuary. At 31 December 2018, there were 2,858 retirees and 2,962 deferred members. The weighted average duration of the obligations is 16.6 years.

	2018 £m	2017 £m	2016 £m
Present value of defined benefit obligations	**(752.7)**	(803.4)	(827.5)
Fair value of scheme assets	**748.5**	779.5	754.0
Recognised liability for defined benefit obligations	**(4.2)**	(23.9)	(73.5)

Movements in present value of defined benefit obligations

	2018 £m	2017 £m
At 1 January	**803.4**	827.5
Past service cost – GMP equalisation charge	**8.6**	–
Interest cost	**19.6**	21.9
Remeasurements – demographic assumptions	**(25.9)**	16.8
Remeasurements – financial assumptions	**(20.7)**	6.9
Remeasurements – experience adjustments	**3.9**	(34.5)
Benefits paid	**(36.2)**	(35.2)
At 31 December	**752.7**	803.4

Movements in fair value of scheme assets

	2018 £m	2017 £m
At 1 January	**779.5**	754.0
Interest income	**19.2**	20.1
Remeasurements – return on assets	**(29.4)**	28.4
Contributions by employer	**15.7**	12.5
Administrative expenses	**(0.3)**	(0.3)
Benefits paid	**(36.2)**	(35.2)
At 31 December	**748.5**	779.5

Expense recognised in the income statement

	2018 £m	2017 £m
Administrative expenses paid by the pension scheme	**(0.3)**	(0.3)
Administrative expenses paid directly by the Group	**(1.7)**	(1.9)
GMP equalisation charge	**(8.6)**	–
Interest cost on the net liabilities of the defined benefit pension scheme	**(0.4)**	(1.8)
	(11.0)	(4.0)

The GMP (Guaranteed Minimum Pension) equalisation charge results from a decision on 26 October 2018 when the High Court issued a judgement involving Lloyds Banking Group defined benefit pension schemes. The judgement concluded that the schemes should be amended to equalise pension benefits for men and women in relation to GMP benefits and has implications for the majority of defined benefit schemes with liabilities before 1997. The effect of GMP equalisation, which has been recorded as a past service cost, is an increase of £8.6 million on the reported pension liabilities.

Fair value of scheme assets	2018 £m	2017 £m
UK equities	**–**	128.5
Overseas equities	**80.7**	104.2
Global equities	**52.4**	–
Multi-asset growth funds	**140.7**	–
Multi-credit fund	**90.8**	90.7
LDI plus collateral	**276.6**	–
Index linked gilts	**–**	319.4
PFI investments	**51.6**	52.2
Property	**21.2**	22.1
Absolute return fund	**–**	52.8
Cash	**34.5**	9.6
	748.5	779.5

All equities are quoted securities. The multi-asset growth funds comprise portfolios of quoted and unquoted investments. The multi-credit fund invests in a portfolio of primarily floating rate debt of non-investment grade or unrated borrowers. The Liability Driven Investments (LDI) portfolio is designed to respond to changes in gilt yields in a similar way to a fixed proportion of the liabilities. It comprises gilts, repos and swaps and is supported by a liquid absolute return fund providing collateral. The PFI investments is the portfolio of interests in 10 PFI investments transferred by the Group to The Costain Pension Scheme between 2010 and 2014.

Notes to the Financial Statements continued

21 Employee benefits continued

Pensions continued

Quoted equities are valued at the prevailing bid, offer or middle market stock exchange or over-the-counter market prices. In the multi-asset growth funds, the fair values of the underlying unquoted assets are determined by the fund managers using quoted prices for similar assets or other valuation techniques where all the inputs are directly observable or indirectly observable from market data. The loans in the multi-credit fund may be priced either using quotes from a pricing vendor (if available), a broker or at a level determined by the investment manager that is agreed with the fund. The LDI fund is valued using a unit price calculated for the fund based on the net asset value of the underlying assets. The PFI investments are valued using a Level 3 valuation method based on the future cash flows of the individual investments. The property investment is held within a limited partnership and is valued by the general partner in accordance with RICS valuation standards.

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.

Principal actuarial assumptions (expressed as weighted averages)

	2018 %	2017 %	2016 %
Discount rate	**2.80**	2.50	2.70
Future pension increases	**3.00**	2.90	3.10
Inflation assumption	**3.20**	3.10	3.20

Weighted average life expectancy from age 65 as per mortality tables used to determine benefits at 31 December 2018 and 31 December 2017 is:

	2018		2017	
	Male (years)	Female (years)	Male (years)	Female (years)
Currently aged 65	**22.4**	**24.3**	22.8	24.8
Non-retirees currently aged 45	**23.8**	**25.9**	24.5	26.7

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

	Pension liability £m	Pension cost £m
Increase discount rate by 0.25%, decreases pension liability and reduces pension cost by	30.3	0.8
Decrease inflation, pension increases by 0.25%, decreases pension liability and reduces pension cost by	26.3	0.7
Increase life expectancy by one year, increases pension liability and increases pension cost by	27.8	0.8

As highlighted above, the defined benefit scheme exposes the Group to actuarial risks such as longevity, interest rate, inflation and investment risks. Following consultation with the Company, the Trustee reviewed the investment strategy during the year and has made a number of changes in investments including the introduction of a LDI portfolio that is designed to respond to changes in gilt yields in a similar way to a fixed proportion of the liabilities.

With the LDI portfolio, if gilt yields fall, the value of the investments will rise to help partially match the increase in the trustee valuation of the liabilities arising from a fall in the gilt yield based discount rate. Similarly, if gilt yields rise, the value of the matching asset portfolio will fall, as will the valuation of the liabilities because of an increase in the discount rate.

In accordance with the pension regulations, a triennial actuarial review of the Costain defined benefit pension scheme was carried out as at 31 March 2016. In February 2017, the valuation and an updated deficit recovery plan were agreed with the scheme Trustee resulting in cash contributions of £10.0 million for the 12 months to 31 March 2017 and then £9.6 million per annum (increasing annually with inflation) until the deficit is cleared, which would be in 2031 on the basis of the assumptions made in the valuation and agreed recovery plan. The next triennial actuarial review will be carried out as at 31 March 2019.

In addition, as previously implemented, the Group will continue to make an additional contribution so that the total deficit contributions match the total dividend amount paid by the Company each year. Any additional payments in this regard would have the effect of reducing the recovery period in the agreed plan. The Group will also pay the expenses of administration in the next financial year.

Any surplus of deficit contributions to the Costain Pension Scheme would be recoverable by way of a refund, as the Group has the unconditional right to any surplus once all the obligations of the Scheme have been settled. Accordingly, the Group does not expect to have to make provision for these additional contributions arising from this agreement in future accounts.

Defined contribution schemes

Several defined contribution pensions are operated. The total expense relating to these plans was £9.8 million (2017: £8.9 million).

Share-based payments

The Company operates a number of share-based payment plans as described below.

Long-Term Incentive Plans (LTIP)

Shareholders approved Long-Term Incentive Plan at the 2014 AGM that allows for conditional awards with a maximum face value of up to 100% of base salary to be awarded. Performance conditions, such as those based on earnings per share, are determined by the Remuneration Committee of the Board at the time of grant.

Annual Incentive Plan (AIP)

Executive directors and other senior management are eligible to participate in the Company's Annual Incentive Plan, under which one third of the award is payable in shares. The total AIP award of up to 150% of base salary has performance conditions based on adjusted EBIT (Earnings before interest, tax and other items) (at least 50% of the award) and other measures. The share award element vests on the second anniversary of the date of grant and will be satisfied by shares purchased by a trust on behalf of the Group. It will not lead to any dilution of shareholder interest. Participants must be in employment with the Company and not under notice of termination (either given or received) on the date of vesting.

Deferred Share Bonus Plan (DSBP)

Prior to 2014, executive directors and other senior management were eligible to participate in the Company's Deferred Share Bonus Plan which allowed for conditional awards with a face value of up to 50% of base salary with a performance condition based on adjusted EBIT (Earnings before interest, tax and other items). The deferred bonus award was satisfied by shares purchased by a trust on behalf of the Group, so did not dilute shareholder interests. The last grant under the DSBP was made in 2014 and vested on 31 March 2016.

Notes to the Financial Statements continued

21 Employee benefits continued

Share-based payments continued

Save As You Earn Scheme (SAYE)

The Company operates a SAYE scheme that is open to all eligible employees who pay a fixed amount from salary into a savings account each month and elect to save over three years. At the end of the savings period, employees have six months in which to exercise their options (after which the options expire) using the funds saved. If employees decide not to exercise their options, they may withdraw the funds saved. Exercise of options is subject to continued employment within the Group (except where permitted by the rules of the scheme).

Share-based payment expense

The amounts recognised in the income statement, before tax, for share-based payment transactions with employees was £2.9 million (2017: £2.7 million); the entire charge relates to subsidiaries.

Options outstanding at the end of the year

The outstanding LTIPs (exercise price £1 per individual grant), AIP (nil-cost option) and DSBPs (nil-cost option), which arrange for the grant of shares to executive directors and senior management, and the outstanding SAYE schemes are shown below.

	LTIP	DSBP	AIP	SAYE	
	Number (m)	Number (m)	Number (m)	Number (m)	Weighted average exercise price (p)
Outstanding at 1 January 2017	2.0	0.1	1.2	3.1	271.9
Forfeited during the year	(0.8)	–	–	(0.3)	275.1
Exercised during the year	(0.1)	–	(0.3)	(0.9)	231.6
Granted during the year	0.5	–	–	1.1	357.4
Outstanding at 31 December 2017	1.6	0.1	0.9	3.0	315.5
Outstanding at 1 January 2018	**1.6**	**0.1**	**0.9**	**3.0**	**315.5**
Adjusted during the year	**–**	**–**	**0.1**	**–**	**–**
Forfeited during the year	**(0.3)**	**–**	**–**	**(0.3)**	**313.5**
Exercised during the year	**(0.4)**	**–**	**(0.3)**	**(0.7)**	**302.9**
Granted during the year	**0.4**	**–**	**0.3**	**1.1**	**336.8**
Outstanding at 31 December 2018	**1.3**	**0.1**	**1.0**	**3.1**	**326.1**
Exercisable at the end of the period	**0.1**	**–**	**–**	**0.2**	**196.0**

Share options outstanding at the end of the year had a weighted average remaining contractual life of 5.5 years (2017: 5.5 years).

The fair value of options granted is calculated using the Black-Scholes option pricing model. The aggregate fair value of options granted during the year was £3.6 million (2017: £3.3 million). The assumptions used in valuing the grants were:

	2018	2017
Expected volatility	**20%**	20%
Expected life (years)	**3.0**	2.7–5.0
Risk-free interest rate	**1.8%**	1.9%
Expected dividend yield	**3.0%**	2.7%

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.

22 Share capital

	2018		2017	
	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	**105.5**	**52.8**	104.2	52.1
Issued in year (see below)	**1.5**	**0.7**	1.3	0.7
Shares in issue at end of year – ordinary shares of 50p each, fully paid	**107.0**	**53.5**	105.5	52.8

The Company's issued share capital comprised 107,013,848 ordinary shares of 50 pence each as at 31 December 2018.

On 18 May 2018, pursuant to the Scrip Dividend Scheme, shareholders elected to receive 266,271 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 2017, and shareholders elected to receive a further 65,892 ordinary shares on 19 October 2018 in lieu of cash in respect of all or part of their interim dividend for the year ended 31 December 2018.

During 2018, the Company issued 86,814 shares on exercise of options granted under the 2014 3-year SAYE scheme.

During 2018, the Company issued 541,548 shares on exercise of options granted under the 2015 3-year SAYE scheme.

During 2018, the Company issued 500,000 shares on 9 March 2018 to the Employee Benefit Trust to satisfy outstanding awards under the LTIP.

All shares rank pari passu regarding entitlement to capital and dividends.

The share options outstanding at the year-end are detailed in note 21. Details of the performance conditions and the options granted to executive directors are given in the Directors' Remuneration Report.

Notes to the Financial Statements continued

23 Contingent liabilities

Group

Group bank borrowing facilities and bank and surety bonding facilities are supported by cross-guarantees given by the Company and participating companies in the Group.

There are contingent liabilities in respect of:

- performance bonds and other undertakings entered into in the ordinary course of business and
- 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.

Company

The Company has guaranteed the obligations of the subsidiary companies that are participating employers of The Costain Pension Scheme, the defined benefit pension scheme in the UK. At 31 December 2018, the potential liability was £4.2 million (2017: £23.9 million) on an IAS 19 basis and is included in these financial statements as disclosed in note 21.

24 Other financial commitments

Group

Operating lease commitments

	2018		2017	
Leases as lessee	**Land and buildings £m**	**Other operating leases £m**	**Land and buildings £m**	**Other operating leases £m**
Future aggregate minimum lease payments under non-cancellable leases:				
Within one year	**4.2**	**4.8**	4.8	5.0
Between one and five years	**11.4**	**4.2**	13.4	5.6
Later than five years	**2.5**	**–**	2.9	–
	18.1	**9.0**	21.1	10.6

	Land and buildings	
Leases as lessor	**2018 £m**	**2017 £m**
Future aggregate minimum lease income under non-cancellable leases:		
Within one year	**0.1**	0.1
Between one and five years	**0.4**	0.4
	0.5	0.5

The Group has various offices under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Group also leases vehicles and computers under non-cancellable operating leases. None of the leases include contingent rents.

Company

The Company does not have any other financial commitments (2017: £nil).

25 Subsidiary undertakings, joint ventures, associates and joint operations

	Activity	Percentage of equity held	Registered office/ principal place of business
Principal subsidiary undertakings			
Alcaidesa Holding SA	Golf Course and Marina Operations	100	(5)
Costain Limited	Engineering, Construction and Maintenance	100	(1)
Costain Engineering & Construction Limited	Holding and Service Company	100	(1)
Costain Integrated Services Limited	Professional Services	100	(1)
Costain Integrated Technology Solutions Limited	Technology Integration	100	(1)
Costain Oil, Gas & Process Limited	Process Engineering	100	(1)
Costain Upstream Limited	Engineering and Design Services	100	(2)
Richard Costain Limited	Service Company	100	(1)

	Activity	Issued share capital £m	Percentage of equity held	Registered office/ principal place of business	Reporting date
Principal joint ventures					
ABC Electrification Ltd	Rail Electrification	–	33.3	(11)	31 March
4Delivery Limited	Civil Engineering	–	40	(3)	31 March

The equity capital of the above are held by subsidiary undertakings with the exception of Richard Costain Ltd and Costain Engineering & Construction Limited.

All undertakings operate mainly in the country of incorporation. See key to registered office/principal place of business at the bottom of this note.

All holdings are of ordinary shares except Richard Costain Limited, where Costain Group PLC holds 100% of the ordinary and preference shares.

Notes to the Financial Statements continued

25 Subsidiary undertakings, joint ventures, associates and joint operations continued

	Activity	Percentage interest	Country of business
Major joint operations			
Alstom-Babcock-Costain Joint Venture – Edinburgh to Glasgow Rail Improvement Programme	Rail Engineering	33.3	UK
Alstom-Costain C644 Joint Venture – Traction power – Crossrail	Rail Engineering	32.5	UK
Alstom-Costain C650 Joint Venture – HV power supply – Crossrail	Rail Engineering	32.5	UK
A-one+ Joint Venture – ASC area 12 – Highways England	Engineering and Maintenance	33.3	UK
A-one+ Joint Venture – ASC area 4 – Highways England	Engineering and Maintenance	33.3	UK
ATC Joint Venture – C610 – Crossrail	Rail Engineering	32.5	UK
Balfour Beatty-BmJV-Carillion-Costain Joint Venture – National Major Projects – Highways England	Civil Engineering	22	UK
CH2M-Costain Joint Venture – Area 14 M&R contract	Engineering and Maintenance	50	UK
Costain-CH2M UK – ESCC JV – East Sussex highway maintenance	Engineering and Maintenance	50	UK
Costain-Atkins-Black & Veatch Joint Venture – Thames Water AMP6	Engineering	70	UK
Costain-Galliford Try Joint Venture – M1 smart motorways	Civil Engineering	70	UK
Costain-Laing O'Rourke Joint Venture – Bond Street station	Civil Engineering	50	UK
Costain-MWH Joint Venture – Southern Water AMP6	Civil Engineering	50	UK
Costain-Skanska C360 Joint Venture – Eleanor Street – Crossrail	Civil Engineering	50	UK
Costain-Skanska C405 Joint Venture – Paddington – Crossrail	Civil Engineering	50	UK
Costain-Skanska C412 Joint Venture – Bond Street – Crossrail	Civil Engineering	50	UK
Costain-Skanska – HS2 Enabling works	Civil Engineering	50	UK
Costain-Skanska Joint Venture – A14 Cambridge to Huntingdon Improvement Scheme	Civil Engineering	50	UK
Costain-Skanska Joint Venture – Balfour Beatty Joint Venture – A14	Civil Engineering	33.3	UK
Costain-Skanska Joint Venture – NGT Tunnels, London	Civil Engineering	52.6	UK
Costain-Skanska Joint Venture – Paddington Station Bakerloo Line Link Project	Civil Engineering	50	UK
Costain-Vinci Construction Joint Venture – Shieldhall	Civil Engineering	50	UK
Costain-Vinci Joint Venture – M4 corridor around Newport	Civil Engineering	50	UK
CVB Joint Venture – Thames Tideway Tunnel East	Civil Engineering	40	UK
Educo UK Joint Venture – Bradford Schools	Building	50	UK
Galliford-Costain-Atkins Joint Venture – United Utilities	Engineering	42.5	UK
Skanska-Costain-Strabag S1 Joint Venture – HS2 Main Works	Rail Engineering	34	UK
Skanska-Costain-Strabag S2 Joint Venture – HS2 Main Works	Rail Engineering	34	UK
The ASP Batch Joint Venture – Severn Trent – Large capital schemes outside AMP6	Engineering	33.3	UK

In accordance with Section 409 of the Companies Act 2006 a full list of subsidiaries, associates, joint ventures and joint arrangements is required:

	Status	Percentage of equity held	Registered office/ principal place of business
Other subsidiaries owned directly by Costain Group PLC			
Costain Civil Engineering Limited	Holding Company	100	(1)
Costain Investments Limited	Dormant	100	(13)
Costain USA Inc.	Holding Company	100	(6)
County & District Properties Limited	Trading	100	(1)
Renown Investments (Holdings) Limited	Trading	100	(1)
Lysander Services Limited	Trading	100	(1)
Other subsidiaries owned indirectly by Costain Group PLC			
AB Rhead & Associates Limited	Dormant	100	(1)
Alcaidesa Golf SL	Trading	100	(5)
Alcaidesa Servicios SA	Trading	100	(5)
Alway Associates (London) Limited	Dormant	100	(1)
Brunswick Infrastructure Services Limited	Trading	100	(1)
Calvert & Russell Limited	Trading	100	(1)
C-in-A Limited	Dormant	100	(1)
CLM Engineering (Overseas) Limited	Dormant	100	(1)
COGAP (Middle East) Limited	Holding Company	100	(1)
Construction Study Centre Limited	Trading	100	(1)
Costain Abu Dhabi Co WLL	Trading	49	(14)
Costain Alcaidesa Limited	Holding Company	100	(1)
Costain America Inc	Holding Company	100	(6)
Costain Building & Civil Engineering Limited	Holding Company	100	(1)
Costain Construction (Botswana) (Pty) Limited	Dormant	100	(7)
Costain Construction Limited	Dormant	100	(1)
Costain de Venezuela CA	Dormant	100	(22)
Costain Energy Solutions Limited	Trading	100	(1)
Costain Engineering & Construction (Overseas) Limited	Holding Company	100	(1)
Costain Engineering Services Inc	Dormant	100	(6)
Costain Holdings (Botswana) (Pty) Limited	Holding Company	100	(7)
Costain Holdings (Malaysia) Sdn Bhd	Dormant	100	(8)
Costain International Limited	Dormant	100	(1)
Costain (Malaysia) Sdn Bhd	Dormant	100	(8)
Costain Management Design Limited	Dormant	100	(1)
Costain Minerals Inc.	Dormant	100	(6)
Costain Mining Services Inc.	Dormant	100	(6)
Costain Oil, Gas & Process (Malaysia) Sdn Bhd	Dormant	100	(8)
Costain Oil, Gas & Process (Nigeria) Limited	Dormant	95	(23)

Notes to the Financial Statements continued

25 Subsidiary undertakings, joint ventures, associates and joint operations continued

	Status	Percentage of equity held	Registered office/ principal place of business
Costain Oil, Gas & Process (Overseas) Limited	Dormant	100	(1)
Costain Process Construction Limited	Dormant	100	(1)
EPC Offshore Limited	Dormant	100	(2)
International Commercial and Project Solutions Pty Limited	Dissolved 2018	100	(19)
JBCC Rhead PTE Limited	Trading	100	(17)
L.R.R. Holdings Limited	Holding Company	100	(1)
Promanex (Civils & Industrial Services) Limited	Dormant	100	(1)
Promanex (Construction & Maintenance Services) Limited	Dormant	100	(1)
Promanex Group Holdings Limited	Holding Company	100	(1)
Promanex Group Limited	Dormant	100	(1)
Promanex (Total FM & Environmental Services) Ltd	Trading	100	(1)
RG Bidco Limited	Trading	100	(1)
Rhead Group Holdings Limited	Holding Company	100	(1)
Rhead Group Holdings (Australia) Pty Limited	Dissolved 2018	100	(18)
Rhead Holdings Limited	Holding Company	100	(1)
Southview Holdings (Private) Limited	Trading	100	(24)
Southview Investments (Private) Limited	Trading	100	(24)
Sunland Mining Corporation (II)	Dormant	100	(6)
Westminster Plant Co. Limited	Dormant	100	(1)
Other joint ventures or associates owned indirectly by Costain Group PLC			
ACM Health Solutions Limited	Dormant	33.3	(4)
Brighton & Hove 4Delivery Limited	Trading	49	(3)
Budimex & Costain SP ZO.O	Dormant	50	(21)
China Harbour-Costain Mexico S de RL de CV	Dormant	50	(20)
Gravitas Offshore Limited	Dormant	45	(9)
Integrated Bradford LEP FIN Co One Limited	Trading	40	(10)
Integrated Bradford LEP Limited	Trading	40	(10)
Integrated Bradford PSP Limited	Holding Company	50	(10)
Jalal Costain WLL	Dormant	49	(15)
L21 Lewisham PSP Limited	Holding Company	50	(12)
Lewisham Schools for the Future LEP Limited	Trading	40	(12)
Nesma-Costain Process Co. Limited	Dormant	50	(16)

Costain Abu Dhabi Co WLL has been treated as a subsidiary undertaking due to Costain having power to influence and control the composition of the Board of directors and the beneficial right to all the net income. Dormant status means no or a very small number of transactions with activity winding down.

	Activity	Percentage interest	Country of business
Other joint operations, including completed			
ACTUS Joint Venture – Trawsfynydd nuclear power station active waste retrieval	Civil Engineering	25	UK
Amec-Costain-Jacobs Joint Venture – Magnox ILW Management Programme	Civil Engineering	33.3	UK
A-one+ Integrated Highway Services – MAC 7	Engineering and Maintenance	33.3	UK
A-one+ Integrated Highway Services – MAC 10	Engineering and Maintenance	25	UK
A-one+ Integrated Highway Services – MAC 12	Engineering and Maintenance	33.3	UK
A-one+ Integrated Highway Services – MAC 14	Engineering and Maintenance	33.3	UK
Bachy Soletanche-Costain-Skanska Joint Venture – CTRL 240 – Stratford Box	Civil Engineering	33.3	UK
Black & Veatch-Costain Joint Venture – Margate & Broadstairs UWWTD Scheme – Southern Water	Civil Engineering	50	UK
Costain-Carillion Joint Venture - M1 Widening and A5/M1 Link	Civil Engineering	100	UK
Costain-Dalekovod Joint Venture – National Grid HV Overhead Line System	Engineering	60	UK
Costain-Hochtief Joint Venture – Reading station	Civil Engineering	50	UK
Costain-John Mowlem-Skanska Joint Venture – A2/M2 widening (Cobham to Jct.2)	Civil Engineering	30	UK
Costain-Lafarge Joint Venture – East and South East Framework	Civil Engineering	50	UK
Costain-Lafarge Joint Venture – Midlands Framework	Civil Engineering	50	UK
Costain-Laing O'Rourke Joint Venture – Farringdon station	Civil Engineering	50	UK
Costain-Laing O'Rourke Joint Venture – King's Cross Eastern Range Refurbishment	Civil Engineering	50	UK
Costain-Skanska C411 Joint Venture – Bond Street – Crossrail	Civil Engineering	50	UK
Costain-Skanska Joint Venture – A14 Ellington to Fen Ditton	Civil Engineering	50	UK
Costain-Skanska Joint Venture – A43 Silverstone	Civil Engineering	50	UK
Costain-Skanska Joint Venture – Crossrail Civils Framework Enabling Works	Civil Engineering	50	UK
Costain-Skanska Joint Venture – Kings College Hospital, London	Building	50	UK
Costain-Skanska Joint Venture – Lower Precinct Shopping Centre, Coventry	Building	50	UK
Costain-Skanska Joint Venture – The new Met Office	Building	50	UK
Costain-Taylor Woodrow Joint Venture – King's Cross re-development & Phase II Northern works	Civil Engineering	50	UK
Costain-VWS Joint Venture – Mersey Valley Processing Centre (Shell Green) Extension Project Stage 2	Engineering	50	UK
Lagan-Ferrovial-Costain – A8	Civil Engineering	45	UK
The e5 Joint Alliance Severn Trent Framework	Engineering	25	UK
TSIF-ILW Joint Venture – Trawsfynydd nuclear power station decommissioning	Civil Engineering	33.3	UK

Notes to the Financial Statements continued

25 Subsidiary undertakings, joint ventures, associates and joint operations continued

Key to registered office/principal place of business

(1)	Costain House, Vanwall Business Park, Maidenhead, Berkshire, SL6 4UB, England
(2)	56 Carden Place, Aberdeen, AB10 1UP, Scotland
(3)	210 Pentonville Road, London, N1 9JY, England
(4)	Carillion House, 84 Salop Street, Wolverhampton, West Midlands, WV3 0SR, England
(5)	Avda. Pablo Cerezo, s/n, Club de Golf Alcaidesa, 11360 – San Roque-Cádiz, Spain
(6)	The Corporation Trust Company, Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801 (New Castle County), USA
(7)	Plot 67978, Mokolwane House, First Floor, Fairgrounds Office Park, Gaborone, Botswana
(8)	Suite 16-10, Level 16, Wisma UOA II, No. 21 Jalan Pinang, 50450 Kuala Lumpur, Malaysia
(9)	Whitehill House, Windmill Hill Business Park, Whitehill Way, Swindon, SN5 6PE, England
(10)	The Sherard Building, Edmund Halley Road, Oxford, Oxfordshire, OX4 4DQ, England
(11)	8th Floor, The Place, High Holborn, London, WC1V 7AA, England
(12)	3 More London Riverside, London, SE1 2AQ, England
(13)	P.O.Box N-7768, Bank Lane, Nassau, Bahamas
(14)	Building 4F, Corniche Road, Ground floor, Office 1, Mussafah Industrial Area, 3069, Abu Dhabi, UAE
(15)	Flat 33, Building 232, Road 18, Block 321, Manama, Bahrain
(16)	P.O.Box 6967, 21452, Jeddah, Saudi Arabia
(17)	Peninsula Plaza #27-01, 111 North Bridge Road, 179098, Singapore
(18)	10–12 Laramie Road, Narre Warren South, City of Casey, Melbourne, Victoria 3805, Australia
(19)	BGC Centre, Mezzanine level, 28 The Esplanade, Perth, WA 6000, Australia
(20)	Calle Delfines No. 268 – 2, Frac. Playa Ensenada, Ensenada, B.C., CP. 22880, Mexico
(21)	Marszałkowska 82, Warsaw, Mazowieckie, 00-517, Poland
(22)	Dormant company – Venezuela, no record of address
(23)	Dormant company – Nigeria, no record of address
(24)	10th Floor, Club Chambers Building, Corner Nelson Mandela Avenue / 3rd Street, Harare, Zimbabwe

26 Related party transactions

Group

A related party relationship exists with its major shareholders, subsidiaries, joint ventures and associates, joint operations, The Costain Pension Scheme and with its directors and executive officers.

Sales of goods and services

	2018			2017		
	Joint ventures and associates £m	Joint operations £m	Total £m	Joint ventures and associates £m	Joint operations £m	Total £m
Services of Group employees	**7.2**	**204.6**	**211.8**	19.5	157.9	177.4
Construction services and materials	**–**	**43.5**	**43.5**	0.1	33.5	33.6
	7.2	**248.1**	**255.3**	19.6	191.4	211.0

Balances with joint ventures and associates are disclosed in notes 14 and 19. Balances with joint operations are eliminated on consolidation.

The Costain Pension Scheme

Details of transactions between the Group and The Costain Pension Scheme are included in note 21.

Transactions with key management personnel

Disclosures related to the remuneration of key personnel as defined in IAS 24 'Related Party Disclosures' are given in note 6. Key management personnel, as defined under IAS 24 'Related Party Disclosures', have been identified as the Board of directors as the controls operated by the Group ensure that all key decisions are reserved for the Board.

The directors of the Company and their immediate relatives control 782,730 ordinary shares in Costain Group PLC, which expressed as a percentage of the issued share capital is 0.73% (2017: 0.73%) of the voting shares of the Company.

In addition to their salaries, in respect of the executive directors and executive officers, the Group provides non-cash benefits and contributes to defined contribution pension plans. Executive directors and executive officers also participate in the Group's LTIP, AIP, DSBP and SAYE plans, which are detailed in note 21.

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

	Group	
	2018 £m	2017 £m
Directors' emoluments	**2.8**	3.0
Executive officers' emoluments	**2.2**	2.5
Post-employment benefits	**0.2**	0.2
Share-based payments	**1.3**	1.8
	6.5	7.5

The above amounts are included in employee benefit expense (note 5).

Louis Thompson, who until 5 July 2016 was a director of Simulation Systems Limited (now Costain Integrated Technology Solutions Limited), is a beneficiary of a pension scheme that owns and leases certain properties to a Costain subsidiary under three leases dated between 2007 and 2013. The lease terms are seven, 10 and 25 years. Notice was served during the year to terminate the 25 year lease on 28 June 2019. The aggregate rent is under £0.1 million per annum.

Notes to the Financial Statements continued

26 Related party transactions continued

Company

The Company has no transactions with related parties other than the charge in relation to share-based payments (note 21) (2017: none).

27 Impact of adoption of new accounting standards and change in accounting policy

This note explains the impact of the adoption of IFRS 9 'Financial Instruments' and IFRS 15 'Revenue from Contracts with Customers', and the change in accounting policy for research and development expenditure credits (RDEC) on the Group's financial statements.

IFRS 9 'Financial Instruments' – impact of adoption

IFRS 9 replaces the provisions of IAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting.

The adoption of IFRS 9 from 1 January 2018 did not result in adjustments to the amounts recognised in the consolidated financial statements. Financial assets are held by the Group predominantly to collect the contractual cash flows. There is no material impact of adopting an expected credit loss model for impairment of financial assets. Hedge transactions undertaken by the Group meet the requirements of IFRS 9 and are not impacted by adopting the new standard.

IFRS 15 'Revenue from Contracts with Customers' – impact of adoption

The Group has adopted IFRS 15 'Revenue from Contracts with Customers' from 1 January 2018, which resulted in some changes in accounting policies and adjustments to the amounts recognised in the financial statements. In accordance with the transition provisions in IFRS 15, the Group has adopted the modified retrospective approach and has restated the brought forward reserves as at 1 January 2018.

Under IFRS 15, revenue recognition is based on the satisfaction of individual performance obligations and where these obligations are satisfied over time revenue is based on the cost profile of each obligation rather than in line with the total contract costs profile. The main change resulting from adopting IFRS 15 is the separation of individual, distinct performance obligations within framework and multiple revenue stream type contracts. This change results in a reduction in revenue recognised in periods prior to 1 January 2018 and a corresponding decrease in amounts due from customers on contract work (now contract assets) in the statement of financial position of £5.7 million and a decrease in opening retained earnings as at 1 January 2018 of £4.6 million, net of current tax. It will reverse over the remaining periods of the contracts. During the year, the Group recognised additional revenue and operating profit of £2.3 million (£1.9 million net of tax) as a result of adopting IFRS 15.

There is no impact on the commercial activities, lifetime profitability or cash flows of the Group, as a result of adopting this accounting standard.

The following disclosures result from adopting IFRS 15.

Assets and liabilities related to contracts with customers

The Group has recognised the following assets and liabilities related to contracts with customers, in addition to amounts included in trade receivables:

	2018 £m	2017 £m
Contract assets	**141.8**	140.8
Non-current assets recognised relating to client retentions	**3.0**	4.3
Contract liabilities	**(13.7)**	(5.8)

Contract assets is made up of a portfolio of contracts and represents unbilled amounts and includes amounts arising from changes to the scope of works that have been recognised as revenue but not yet billed to the customer. As shown in note 18, the contract assets value is similar to last year because of an increase in the amount of longer standing changes to contracts still to be billed that has offset the reduction that would be expected from lower revenue. There are no significant one-off factors outside of normal trading.

Contract liabilities result when cumulative cash received exceeds cumulative revenue on any particular contract. On contracts undertaken by the Group, this typically results from work being undertaken, or on framework contracts awarded, in a different order to the programme envisaged in the contractual payments schedule.

Revenue recognised in 2018 from performance obligations satisfied in previous periods was immaterial.

The aggregate amount of costs incurred plus recognised profits, less recognised losses, for all contracts in progress at the statement of financial position date was £3,894.6 million (2017: £4,459.7 million). Progress billings, including retentions, and advances received from customers on those contracts amounted to £3,771.7 million (2017: £4,332.9 million).

Unsatisfied long-term contracts

The following table shows unsatisfied performance obligations resulting from long-term contracts:

	2018 £m	2017 £m
Aggregate amount of the transaction price allocated to long-term contracts that are partially or fully unsatisfied as at 31 December	**1,653.8**	–

Management expects that approximately 50% of the transaction price allocated to the unsatisfied contracts as of 31 December 2018 will be recognised as revenue during the next reporting period (£820 million). The remaining 50% will be recognised in the period up to and including 2024. The 2017 comparative number has not been disclosed as permitted by the transitional provisions of IFRS 15.

Mobilisation costs and costs incurred to obtain a contract

The Group does not have any assets relating to mobilisation costs or costs incurred to obtain a contract.

Notes to the Financial Statements continued

27 Impact of adoption of new accounting standards and change in accounting policy continued

Research and development expenditure credits (RDEC)

The Group has changed its accounting policy for research and development expenditure credits for 2018 because these credits have characteristics similar to government grants and it is considered more appropriate to offset the income against the relevant expenditure rather than reflect them in the tax charge.

The Group has changed its process for collating this data during the year and this has enabled collection of more current data rather than the lag previously experienced. This will reduce the size of balancing adjustments in respect of prior period grants included in the current year. As a consequence, as part of the policy change the Group has included the prior year amounts in other items.

In the statement of financial position, grants receivable are now included in other debtors and not as a reduction to tax payable and in the cash flow, grants received are part of cash from operations not tax paid. The 2017 figures have been restated for the policy change. The effect on the closing 2016 position was immaterial.

Transition table

The impact of changing the Group's accounting policy for research and development expenditure credits and adopting IFRS 15 on the 2017 income statement, statement of financial position and cash flow statement and the 2018 opening position is set out below. Adopting IFRS 9 had no impact on the Group.

	2017 (As published) £m	RDEC £m	2017 (Restated) £m	IFRS 15 £m	At 1 January 2018 £m
Consolidated income statement					
Underlying profit before tax (included in cost of sales)	43.4	0.4	43.8		
Other items	(4.5)	2.5	(2.0)		
Profit before tax	38.9	2.9	41.8		
Taxation	(6.3)	(2.9)	(9.2)		
Profit after tax	32.6	–	32.6		
Consolidated statement of financial position					
Trade and other receivables	287.8	1.9	289.7	(5.7)	284.0
Taxation liability	7.1	1.9	9.0	(1.1)	7.9
Equity	154.0	–	154.0	(4.6)	149.4
Consolidated cash flow statement					
Adjustments to profit for year: Taxation	6.3	2.9	9.2		
Decrease in receivables	14.2	(2.9)	11.3		
Cash from operations	51.6	–	51.6		

Five-Year Financial Summary

	2018 £m	2017 (Restated) £m	2016 £m	2015 £m	2014 £m
Revenue and profit					
Revenue (Group and share of joint ventures and associates)	**1,489.3**	1,728.9	1,658.0	1,316.5	1,122.5
Less: Share of joint ventures and associates	**(25.6)**	(44.9)	(84.3)	(52.9)	(50.7)
Group revenue	**1,463.7**	1,684.0	1,573.7	1,263.6	1,071.8
Group operating profit before other items	**52.5**	49.1	41.1	33.2	28.7
Other items:					
Pension GMP equalisation charge	**(8.6)**	–	–	–	–
RDEC grant income	**2.6**	2.5	–	–	–
Amortisation of acquired intangible assets	**(3.0)**	(3.2)	(4.6)	(3.2)	(3.0)
Employment related and other deferred consideration	**(0.4)**	(1.2)	(1.6)	(0.4)	(2.2)
Group operating profit	**43.1**	47.2	34.9	29.6	23.5
Profit on sales of interests in joint ventures and associates	**–**	–	–	–	4.0
Share of results of joint ventures and associates	**0.3**	0.3	0.2	(0.1)	(1.3)
Profit from operations	**43.4**	47.5	35.1	29.5	26.2
Finance income	**0.4**	0.4	0.6	0.8	0.7
Finance expense	**(3.6)**	(6.1)	(4.8)	(4.3)	(4.3)
Net finance expense	**(3.2)**	(5.7)	(4.2)	(3.5)	(3.6)
Profit before tax	**40.2**	41.8	30.9	26.0	22.6
Taxation	**(7.4)**	(9.2)	(4.5)	(3.8)	(1.6)
Profit for the year attributable to equity holders of the parent	**32.8**	32.6	26.4	22.2	21.0
Earnings per share – basic	**30.9p**	31.1p	25.7p	21.8p	22.2p
Earnings per share – diluted	**30.2p**	30.6p	25.0p	21.2p	21.7p
Dividends per ordinary share					
Final	**10.00p**	9.25p	8.40p	7.25p	6.25p
Interim	**5.15p**	4.75p	4.30p	3.75p	3.25p
Summarised consolidated statement of financial position					
Intangible assets	**58.5**	62.5	65.9	52.3	31.0
Property, plant and equipment	**40.0**	43.0	42.2	37.3	10.0
Investments in equity accounted joint ventures and associates	**2.5**	2.7	2.6	2.6	27.5
Other non-current assets	**6.3**	15.0	22.6	18.8	41.0
Total non-current assets	**107.3**	123.2	133.3	111.0	109.5
Current assets	**467.3**	539.8	512.9	421.4	346.9
Total assets	**574.6**	663.0	646.2	532.4	456.4
Current liabilities	**326.7**	423.2	441.6	372.2	299.3
Retirement benefit obligations	**4.2**	23.9	73.5	36.7	41.7
Other non-current liabilities	**61.4**	61.9	31.5	2.9	4.6
Total liabilities	**392.3**	509.0	546.6	411.8	345.6
Equity attributable to equity holders of the parent	**182.3**	154.0	99.6	120.6	110.8

Financial Calendar and Other Shareholder Information

Financial calendar[1]

Full year results	6 March 2019
Annual report mailing	22 March 2019
Ex-dividend date for final dividend	11 April 2019
Final dividend record date	12 April 2019
Annual General Meeting	7 May 2019
Final dividend payment date[2]	17 May 2019
Half-year end	30 June 2019
Half-year results 2019	21 August 2019
Ex-dividend date for interim dividend	12 September 2019
Interim dividend record date	13 September 2019
Interim dividend payment date	18 October 2019
Financial year-end	31 December 2019

1 The financial calendar may be updated from time to time throughout the year. Please refer to the Investors section of our website at www.costain.com for up-to-date details.

2 Subject to shareholder approval at the Annual General Meeting to be held on 7 May 2019.

Scrip dividend scheme

Subject to shareholder approval at the forthcoming 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 25 April 2019. 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 0371 384 2268* or +44 (0) 121 415 7173 if calling from outside the UK.

Analysis of shareholders

as at 1 March 2019

	Total number of holdings	Total number of shares	Percentage issued capital
Shareholdings 100,000 and more	112	94,909,472	88.65%
Shareholdings 50,000–99,999	49	3,496,212	3.27%
Shareholdings 25,000–49,999	54	1,981,247	1.85%
Shareholdings 5,000–24,999	326	3,171,381	2.96%
Shareholdings 1–4,999	8,255	3,503,292	3.27%
Totals	8,796	107, 061,604	100.00%

Secretary

Tracey Wood

Registered Office

Costain House, Vanwall Business Park, Maidenhead, Berkshire SL6 4UB
Telephone 01628 842 444
costain.com
info@costain.com
Company Number 1393773

Registrar

Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA
Telephone 0371 384 2250* or +44 (0)121 415 7047 if calling from outside the UK.

Website

www.shareview.co.uk

Dividend mandate

Shareholders can arrange to have their dividends paid directly into their bank or building society account, by completing a bank mandate form. The advantages of using this service are:

- the payment is more secure as you can avoid the risk of cheques getting lost in the post
- it avoids the hassle of paying in a cheque and
- there is no risk of lost, stolen or out-of-date cheques.

A mandate form can be obtained from the Company's website, or by contacting Equiniti on 0371 384 2250* (+44 (0) 121 415 7047 if calling from outside the UK) 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 'dividend tax confirmation' of your last dividend payment. Overseas shareholders can arrange for their dividends to be paid in their local currency and more information can be obtained from www.shareview.com/overseas.

Shareview service

The Shareview service from our registrar, Equiniti, allows shareholders to manage their shareholding online, giving:

- direct access to data held on their behalf on the share register including recent share movements, indicative valuations 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, at www.shareview.co.uk, you can register your preferred format (post or email) for shareholder communications. If you select email as your mailing preference, you will be notified of various shareholder communications, such as annual results, by email instead of post.

If you have your dividends paid straight to your bank account, and you have selected email as your mailing preference, you can also collect your 'dividend tax confirmation' electronically. Instead of receiving the paper 'dividend tax confirmation', you will be notified by email with details of how to download your electronic version. Visit the website at www.shareview.co.uk for more details.

Details of software and equipment requirements are given on the website.

* Lines are open Monday to Friday 08.30am to 5.30pm, excluding public holidays in England and Wales.

Financial Calendar and Other Shareholder Information continued

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 at www.mpsonline.org.uk or on 0345 0700705*.

Further guidance can also be found on the Company's website at www.costain.com.

ShareGift

The Orr Mackintosh Foundation (ShareGift – Registered Charity No. 1052686) operates a charity share donation scheme for shareholders with small parcels of shares whose value makes it uneconomical 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 and the service is free of charge.

Website

The Company's website at www.costain.com provides information about the Group including its strategy and recent news. The 'Investors' section is a key source of information for shareholders, containing details of financial results, shareholder meetings and dividends. Current and past annual reports are also available to view and download.

* Lines are open Monday to Friday 08.30am to 5.30pm, excluding public holidays in England and Wales.

Contact Us

For shareholder information, please contact:

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info@costain.com

For investor relations, please contact:

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Corporate Development and Investor Relations Director

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For corporate communications, please contact:

Sara Lipscombe
Group Communications Director

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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.

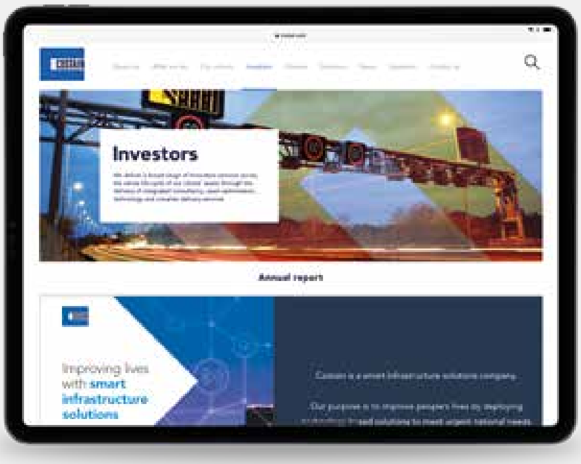
Useful links

costain.com

costain.com/investors

costain.com/our-culture

costain.com/news



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Visit us at **emperor.works**

COSTAIN

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