# Leading Edge Solutions

**Costain Group PLC**

Annual Report and Accounts

2019

# Costain is a smart infrastructure solutions company

**Our purpose is to improve people's lives. We deliver integrated leading edge smart infrastructure solutions to meet national needs across the UK's transportation, water, energy and defence markets.**

## Our services

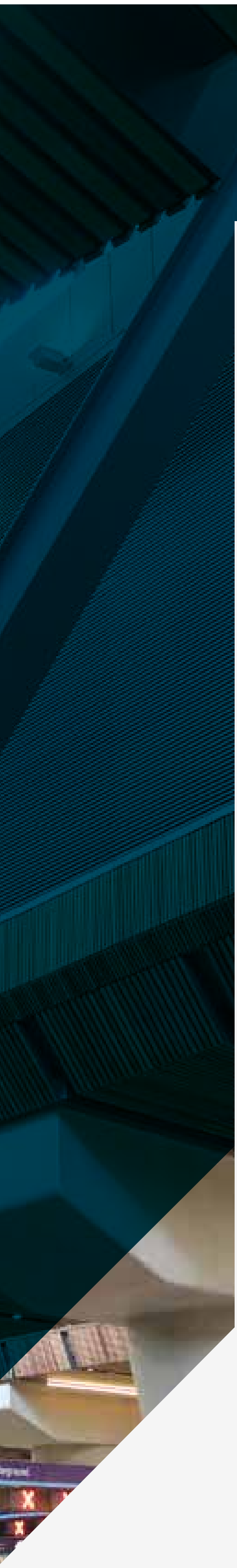
### Future shaping strategic consultancy
We work with our clients in their business and investment planning to develop new solutions to meet changing needs, leveraging our deep client insight, leading edge expertise and broad range of capabilities.

### Consultancy and advisory
We improve our clients' business performance by providing value adding consultancy and advisory services, leveraging our deep client insight, leading edge expertise and broad range of capabilities.

### Digital technology solutions
We transform business performance and infrastructure intelligence through the development and integration of leading edge digital technology solutions built on our deep client insight.

### Asset optimisation
We combine our deep client insight and leading edge expertise to increase capacity, improve resilience, minimise downtime and reduce our clients' operating costs.

### Complex programme delivery
Our complex programme delivery is safer, faster, better, smarter and costs less as a result of our pioneering working practices and collaborative behaviours.



# Highlights

## Aligning our integrated services to meet our clients' changing needs

2019 has been a year of transition for Costain as we began the implementation of our Leading Edge strategy to reshape and focus our business. Our underlying financial performance was impacted by delays to certain contract start dates and new awards, together with a contract cancellation and the loss resulting from the A465 arbitration. However, we are pleased that the Group has continued to secure significant new work during the year.

Our Leading Edge strategy aligns our activities to meet our clients' changing needs, supporting a step change in our programme delivery performance and an acceleration in the deployment of our higher margin activities.

The UK infrastructure markets are growing and developing rapidly, with increasing demand for innovative solutions to upgrade, enhance and decarbonise the nation's strategic infrastructure. This is a significant opportunity for our business and we are well placed, with our breadth of integrated services, to benefit from these market dynamics. Strengthening our balance sheet will enable us to capitalise on these opportunities and further enhance our capabilities.

£14.6m

**Underlying[1] profit before tax**

2018: £49.7m
2017: £43.8m

Reported[2]: £(6.6)m loss

£17.9m

**Underlying[1] operating profit**

2018: £52.5m
2017: £49.1m

Reported[2]: £(3.2)m loss

£1,162.9m

**Revenue***

2018: £1,489.3m
2017: £1,728.9m

Reported: £1,155.6m

13.5p

**Underlying[1] basic earnings per share**

2018: 38.2p
2017: 32.9p

Reported[2]: (2.7)p loss

3.8p

**Total dividend per share[3]**

2018: 15.15p
2017: 14.00p

£64.9m

**Net cash balance[4]**

2018: £118.8m
2017: £177.7m

## Highlights

- **Underlying operating profit of £17.9 million** in line with our revised expectations; the reduction in the year reflecting previously announced contract delays, a contract cancellation and the impact of the A465 contract arbitration outcome.
- **Continued momentum in securing new work:** £1.7 billion of new contract awards and extensions to existing contracts secured during the year, with the order book, as at 31 December 2019, standing at £4.2 billion.
- **New Leading Edge strategy in place:** accelerating the Group's deployment of higher margin services through leveraging our strong client relationships and reputation for complex programme delivery.
- **Strong market opportunities:** our markets have significant long-term committed investment programmes in place, with a focus on addressing the UK's strategic infrastructure needs and providing the Group with an annual c £23 billion addressable market.
- **Strengthening balance sheet:** planned equity raise, fully underwritten on a standby basis, to strengthen the balance sheet and enable the Group to capitalise on the growing infrastructure market opportunities.

* Including share of joint ventures and associates.

1 Before other items; amortisation of acquired intangible assets, employment related deferred consideration and other one-off costs as shown on the income statement.

2 2019 reported figures include the impact of the one-off cost of £9.7 million in respect of an arbitration award and a one-off aggregate charge of £8.9 million for the loss on disposal and asset impairment for the Group's non-core business assets in Spain as shown in the income statement.

3 This represents the interim dividend of 3.8 pence per share – the Company will pay no final dividend.

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

Company Overview

# We improve people's lives by delivering integrated smart infrastructure solutions

## What we do

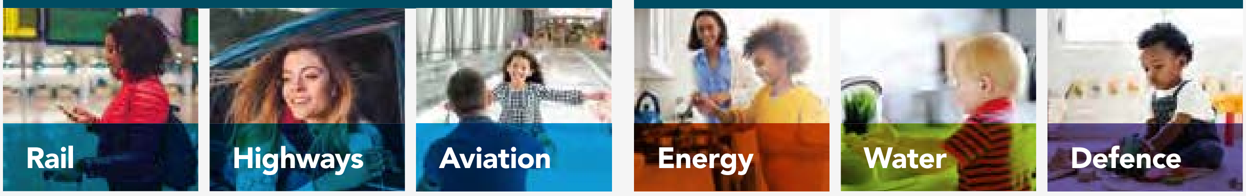
We offer our clients leading edge solutions that are digitally optimised across the whole life cycle of their assets by integrating five core services.

## Why we do it

Our purpose is to improve people's lives. We help our clients improve their business performance by increasing capacity, improving customer service, safeguarding security, enhancing resilience, decarbonising and delivering increased efficiency.

## Our divisions and sectors

**Transportation** | **Natural resources**




## How we do it

We deliver integrated leading edge smart infrastructure solutions to meet national needs across the UK's transportation, water, energy and defence markets.

## Our markets

**Transportation**
We connect and keep the nation moving

See more on pages 08 and 09

**Water**
We keep water clean and flowing

See more on pages 10 and 11

**Energy**
We power communities sustainably

See more on pages 12 and 13

**Defence**
We keep the nation safe

See more on pages 14 and 15

## Our Leading Edge strategy

In 2019 we launched our Leading Edge strategy which closely aligns our services to meet the changing needs of our blue-chip clients whose major spending plans are underpinned by strategic national needs, regulatory commitments, legislation or essential performance requirements. Our strategic priorities drive continued progress and differentiation and are linked directly to our Executive Board-sponsored implementation plan.

## Our strategic priorities

**Enhancing our performance**

**Developing our skills and capabilities**

**Delivering innovative solutions**

**Being a responsible business**

See our strategy on pages 26 to 30

## Our outstanding team, strong culture and embedded values underpin everything we do.

Commercial Consulting
ENVIRONMENTAL CONSULTING
Sustainability and Life Cycle engineering
Transportation Consultancy
Design Management
Construction Management
Risk Management Consulting
Project Management office and Project Controls
Electrical Engineering & Design
ENGINEERING CONSULTING SERVICES
Mechanical Engineering & Design
PROCESS ENGINEERING
PROGRAMME MANAGEMENT
Project Management
Commercial Management
Project Engineering Management
Mechanical Engineering
Civil & Structural Engineering & Design
Control & Instrumentation Engineering & Design
Quality Management
Geospatial services
Systems Engineering
Temporary Works
Strategic consulting
Design Safety
Portfolio, Programme & Project Management
HEALTH AND SAFETY
DESIGN MANAGEMENT
Digital
Engineering Services

All of which contribute to...
**Leading Edge insight and delivery**

**Our employees**
**c 3,400**
across the UK

# Why Invest in Costain?

**The long-term, strategic nature of our client relationships and the trust they place in us to deliver for them provides us with the strongest possible platform to accelerate the deployment of our higher margin services alongside our complex programme delivery. We are confident that our strategy, a stronger balance sheet and our differentiated proposition will best meet our clients' changing requirements and deliver significant value for our shareholders.**

**Addressable market spend**
c £23bn
per annum

## Aligned to growing market opportunities

- Focus on markets with increasing committed spend underpinned by regulation, legislation or strategic national needs.
- Sustainable market growth driven by technological, demographic and environmental change.
- Strategic, long-term relationships with blue-chip clients who trust us to deliver on our promises.

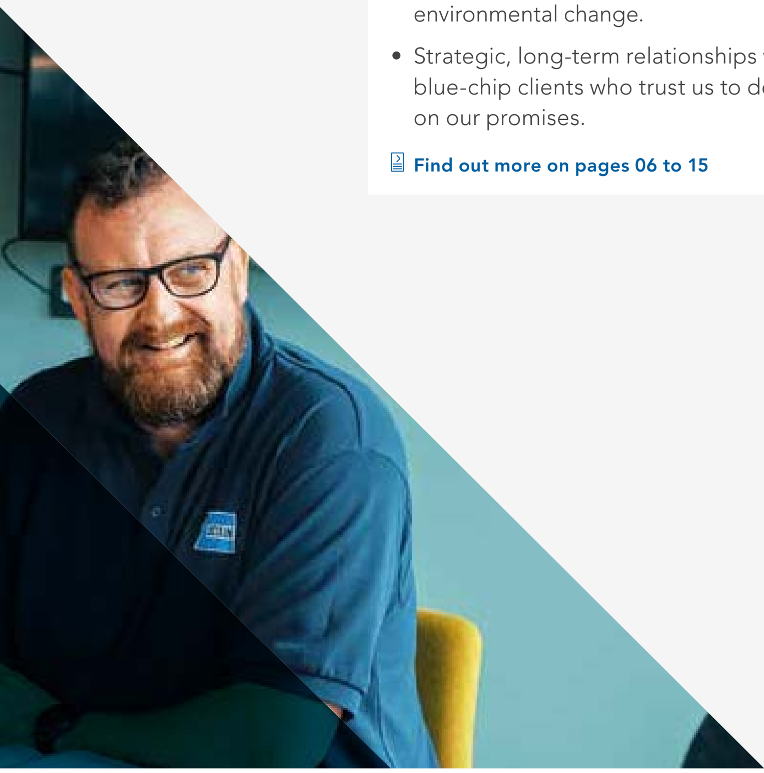
Find out more on pages 06 to 15

**Repeat business**
90%

## Positioned to meet our clients' needs

- Our Leading Edge strategy is driving close alignment of our services to meet changing client needs.
- Integrated range of innovative services across whole life cycle of infrastructure assets.
- Accelerated deployment of digitally enabled higher margin services.
- Investment in dedicated digital technology centre developing pioneering innovations.

Find out more on pages 26 to 30



Order book

£4.2bn

at 31 December 2019

c 3,400

employees across a broad mix of disciplines

Employer for women

The Times Top 50

## Our people

- Focused, experienced management team driving Leading Edge strategy implementation.
- Broadening mix of skills and diversity across our workforce, including 33 disciplines in consultancy and digital technology.
- Attracting and developing industry-leading talent, bringing a fresh perspective to our clients' challenges.
- 22 PhDs who collaborate with our projects to provide insight and innovation.

Find out more on pages 54 to 57

## Financial strength

- Positive net cash position.
- Positioned for growth with strong momentum in new orders and £4.2 billion order book.
- Strengthening the balance sheet with planned underwritten equity raise, enabling the Group to capitalise on the growing infrastructure market opportunities.

Find out more on pages 44 to 47

## Responsible business

- Responsible business priorities aligned to the United Nations Sustainable Development Goals.
- Committed to:
  - creating a greener future
  - ensuring Costain is a safe, inclusive and great place to work, where everyone can be at their best
  - enhancing the value that Costain contributes to society.
- Robust corporate governance and risk management processes.

Find out more on pages 32 to 37

Our purpose is to **improve people's lives**

Our vision is to be the **UK's leading smart infrastructure solutions company**

Our Leading Edge strategy **enables us to achieve our purpose and vision**

Market Overview

# A rapidly evolving market

## Mega-trends giving rise to urgent national needs and creating new opportunities

Our markets are rapidly evolving and are at an upward inflection point as population growth, climate change, customers' expectations of improved service and technology implementation, and public demand for action are resulting in the need for our clients to change their business strategies and investment priorities.

- Increasing capacity
- Enhancing resilience
- Safeguarding security
- Improving customer service
- Increasing efficiency
- Accelerating decarbonisation

### Market drivers

A revolution in technology use

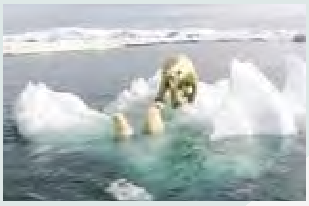
Population growth

New innovations


Demand for change

Decaying infrastructure assets

Interconnectivity



Climate change

Need for higher productivity

## The pace of change in our markets is accelerating, driven by demographic, technological and environmental developments

This is having an unprecedented impact on how and where our clients spend their money. Our opportunity is to position ourselves as a strategic, trusted partner to shape, advise on and deliver innovative solutions to create and improve critical national infrastructure assets.

The new UK Government has significantly increased its commitment to invest in long-term UK infrastructure projects, with its 2019 manifesto plan for national renewal underpinned by an additional £100 billion of infrastructure spend.

## Our markets

Transportation

Water

Energy

Defence

### Investment priorities in our markets

Digitisation | Decarbonisation | Decentralisation | Devolution

Asset optimisation | Improved customer service | Strategic connectivity

Systems thinking | Programme efficiency | Smart mobility

**Total market spend across our markets**

c £113.5bn per annum

**Addressable market spend across our markets**

c £23bn per annum

### Our opportunity: enabling new solutions to meet these demands

- Shaping new solutions as a leading innovation partner and thought leader
- Supporting clients' business improvement as a valued advisor and consultant
- Investing in technology and being an insightful technology integrator
- Optimising the performance of our clients' existing assets
- Delivering complex capital programmes

## CASE STUDY: THE PROGRESS WE HAVE MADE IN WATER

### Broadening our service offering in the water market

As we move through the final year of the AMP6 five-year programmes and into AMP7, we can see how our water sector has diversified its service offering and breadth of clients in line with our Leading Edge strategy; we are continually aligning our services to meet our clients' changing needs.

**AMP6 2015–2020**

- Capital delivery framework
- Capital delivery framework; incentivisation based

Severn Trent Water, Thames Water, Southern Water

**AMP7 2020–2025**

- Maintenance services
- Capital delivery
- Capital delivery and advisory
- Digital twin development
- Assurance consultancy and technical services
- Programme management/commercial consultancy
- Asset optimisation

Severn Trent Water, Thames Water, Southern Water, United Utilities, Yorkshire Water, South Staffs Water

Future shaping strategic consultancy | Consultancy and advisory | Digital technology solutions | Asset optimisation | Complex programme delivery

## Market Overview

### Transportation

# We connect and keep the nation moving

**In 2019 we have been at the forefront of developments in new transport technology across highways, rail and aviation; improving people's lives by making their journeys faster, better and healthier for them and our planet.**

As well as our role in delivering complex projects to increase transport network capacity, improve journey times and make them safer, we are a specialist advisor and integrator of smart transport digital technology, asset optimisation and decarbonisation solutions to regional and local transport operators. On the back of our award winning A2M2 project, we are working with leading car manufacturers as part of the connected digital roads project to provide leading edge vehicle-to-infrastructure technologies and expertise to enable connected and automated mobility on strategic and local roads.

## CLIENT NEED

Safe and seamless journeys; improving network capacity and air quality; decarbonisation; systems integration and information optimisation; lowering capital expenditure and maintenance costs

## Outcomes we deliver

- Helping our clients achieve their carbon reduction targets
- Making hydrogen fuel a reality for transport
- Ensuring net positive biodiversity gain using leading edge geospatial technology
- Developing, integrating and maintaining the next generation of digital road message signs
- Matching the pace of infrastructure-side technology to vehicle-side technology
- Forecasting and mitigating the risk of harm on major schemes
- Increasing productivity in complex programme delivery

Future shaping strategic consultancy | Consultancy and advisory | Digital technology solutions | Asset optimisation | Complex programme delivery

## Market Overview

## Water

# We keep water clean and flowing

**We continue to provide leading edge, technology-based solutions to UK water utility companies across the life cycle of their assets. In 2019 we have been at the front end of clients’ planning for AMP7, helping them to shape their strategies for the development of major future infrastructure projects. Our consultancy services provide strategic advice, engineering design, systems thinking and asset management support as well as guidance on their technology architecture, including digital twin strategies, to help them drive efficiencies.**

Our digital technology solutions are driving greater intelligent asset optimisation, data analytics and increasing connectivity between assets and control in the water sector. Our asset optimisation services continue to transform asset performance, enhance resilience and reduce risks. We have secured a first of a kind maintenance contract in the UK water sector, helping our client move from fix-on-fail to planned predictive maintenance.

### CLIENT NEED

Improved regulatory performance; lower water bills; increased asset resilience; improved customer service; protecting the environment

### Outcomes we deliver

- Delivering regulatory outcomes early
- Ensuring zero interruption to supply
- Delivering efficiencies through effective programme management and collaborative innovation
- Significantly reducing programme timeframes
- Minimising water usage and environmental impact
- Digitising existing assets to optimise performance

Future shaping strategic consultancy | Consultancy and advisory | Digital technology solutions | Asset optimisation | Complex programme delivery

Market Overview

## Energy

# We power communities sustainably

**We continue to work with industry, transport and energy utilities to shape the energy systems of the future, developing hydrogen and other low carbon solutions to support the UK's journey towards net zero carbon. In 2019 we helped industrial clusters set out their road map for carbon capture and storage (CCS) deployment and are currently providing strategic consultancy for a proposed CCS demonstration project in Scotland.**

In the year we grew our portfolio of consultancy services with major energy operators in support of their complex programmes. We also secured consultancy and design contracts to develop, maintain and optimise assets in the North Sea and onshore installations. We continue to support Sellafield in developing technologies that will reduce the cost of managing the UK's nuclear legacy. Alongside Scottish and Southern Electricity Networks and E.ON we are delivering a first of a kind digital solution that will provide a low carbon, cost-effective and secure electricity supply in rural areas.

### CLIENT NEED

Decarbonisation; decentralisation; enhancing efficiency and resilience; reducing cost of decommissioning

### Outcomes we deliver

- Improving network resilience of remote networks
- Enhancing energy efficiency of industrial processes and oil and gas infrastructure
- Ensuring there are robust and effective project controls on major asset optimisation or capital programmes
- Reducing capital expenditure and environmental impact of gas infrastructure
- Enabling cost effective, large-scale capture, transport and storage of $CO_2$
- Developing innovative hydrogen solutions to decarbonise the existing gas network

Future shaping strategic consultancy | Consultancy and advisory | Digital technology solutions | Asset optimisation | Complex programme delivery

Market Overview

## Defence

# We keep the nation safe

**We continue to provide strategic consultancy and advisory services to help clients such as BAE Systems, Rolls Royce and AWE enhance performance and their ability to deliver the most complex national strategic programmes. Achievements in 2019 include successful programme delivery for a key defence client and introducing additional value through our digital solutions services. Digital platforms, digitised design, digital twin, virtual reality and 3D scale model printing all contributed to enhanced outcomes.**

As strategic programme advisor to key defence clients, we have continued to provide programme, portfolio and project management (P3M) services, project controls design and implementation solutions improving programme control and delivery. We continue to expand our presence in this market with new consultancy services such as the successful programme and project controls transformation advisory services and in 2019 hit a milestone of training 1,000 client staff in P3M leadership and implementation.

### CLIENT NEED

Equipment and facilities upgrade; programme continuity and change control; improving performance and reducing through life costs of assets; digital and cyber resilience and security

### Outcomes we deliver

- Improving delivery confidence in strategic equipment programme
- Improving forecasting and resource planning capability for more efficient operations and maintenance
- Delivering mission critical, unique nuclear defence facility to schedule and cost
- Improving performance across Maritime, Air, Land and USA-led businesses in programme planning, monitoring and control
- Improving performance and reducing costs of business change programme
- Improving performance of middle and senior management through technical and behavioural coaching

Our Business Model

# Aligning our services

## Distinct business model

Five integrated services, digitally optimised leading edge solutions and blue-chip client base

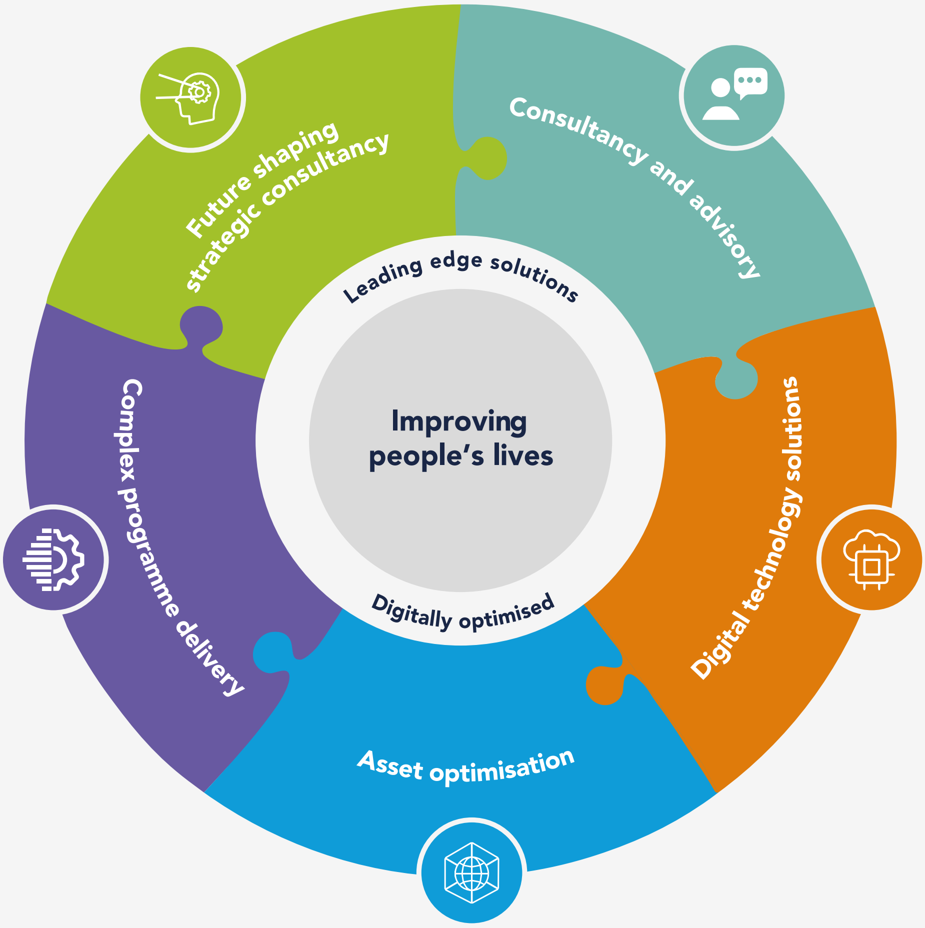
**Our markets**


Transportation


Water


Energy


Defence




## 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 all of our stakeholders.

### Embedded values and culture

Our strong culture and embedded values underpin everything we do.

# Our sources of competitive advantage

### Long-term, strategic relationships and client insight

We develop long-term relationships with our clients, collaborating strategically at all levels and understanding their individual needs to deliver optimal solutions.

### Benefits driven, leading edge services

We invest in research, innovation and technology to provide the leading edge solutions our clients need.

### Outstanding reputation and diverse team

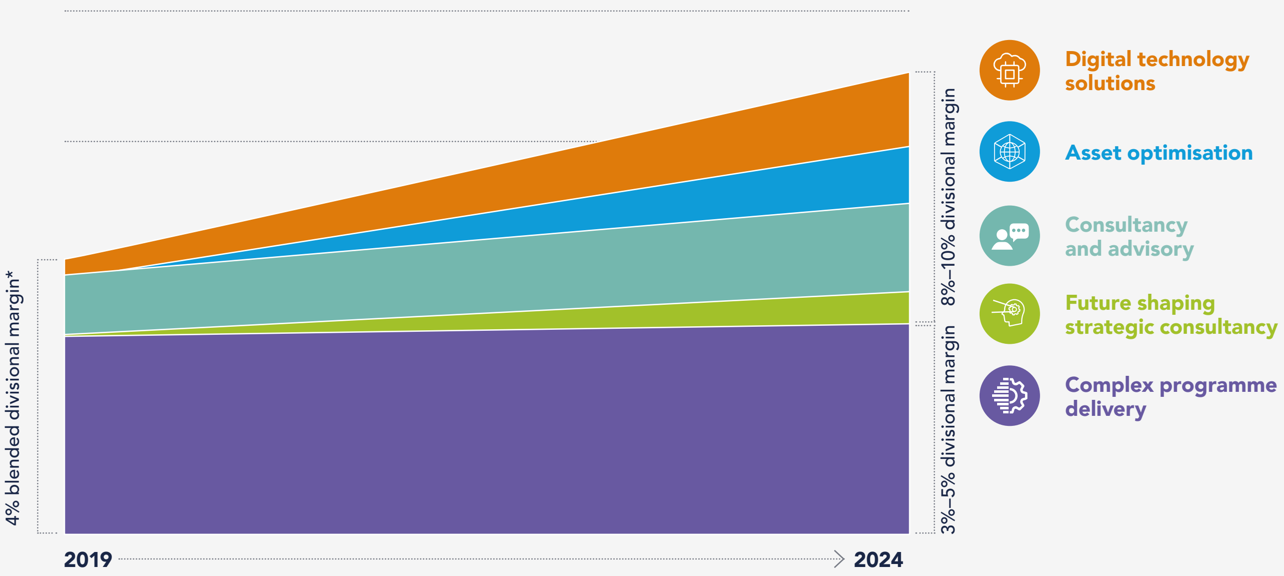
We are recognised for our outstanding delivery, technical excellence and our diverse, industry leading team.

### Delivery pedigree

Our clients trust us to consistently deliver innovative solutions on time and on budget, achieving measurable outcomes which improve their business performance.

## The future shape of Costain

### Increasing profit from higher margin services




* Excluding impact of A465 arbitration.

### Broadening our services | Increasing profit | Increasing margins | Increasing revenue

Through our Leading Edge strategy, our ambition is to derive over half of our operating profit from higher margin services, targeting a blended divisional margin range of 6% to 7% over the medium term. In 2019 our business mix reflects approximately one third of operating profit from higher margin services and two thirds from complex programme delivery activities. Over the medium term we are targeting a change in this mix to 55% of operating profit from higher margin services.

### Robust corporate governance

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

### Effective risk management

We have robust risk management processes which identify, manage and mitigate potential risks to protect the performance of the Group.

Chair's Statement

# A year of transition

*"The positive market outlook is driving our Leading Edge strategy"*

**Dr Paul Golby CBE**
Chair

It has been a year of change for Costain as we began to implement our Leading Edge strategy, more closely aligning our integrated services with our clients' changing, long-term infrastructure needs, and further position Costain as the smart infrastructure solutions partner of choice.

From a profit perspective, 2019 was disappointing for our Group and while much positive progress has been made, our financial performance was impacted by certain contract delays, a contract cancellation, and the loss resulting from the outcome of the A465 arbitration.

We have been encouraged by the level of new work which has been secured from across our blue-chip client base, adding a further £1.7 billion to our order book and demonstrating the continued demand for our integrated offer.

The positive infrastructure market outlook has been a driving force for our Leading Edge strategy, and we are pleased with the progress that is being made under Alex Vaughan's leadership and confident that it will support our ambition to achieve Group operating margins in the range of 6 to 7 per cent over the medium term.

A more stable political backdrop since the turn of the year gives greater certainty for our clients to commit to significant infrastructure investment and this is providing increasing opportunities for the Group.

The recent commitment to the strategically important HS2 programme, for example, demonstrates the Government's commitment to long term infrastructure investment as part of the answer to rebalancing economic prosperity and growth around the UK.

To ensure we capitalise on these opportunities and further enhance our capabilities we are strengthening our balance sheet through our proposed underwritten equity raise.

## Board and people

Alex Vaughan was appointed the Group's chief executive officer in May last year and he has since laid out the Leading Edge strategy, aligning the Group's services to meet the changing needs of our clients. He has set a clear vision for the business, which will drive long term shareholder value, and has also made a number of organisational and leadership changes to support the delivery of this strategy.

David McManus, non-executive director, has informed the Company that he intends to step down from the Board with effect from the conclusion of Costain's Annual General Meeting to be held on 7 May 2020. David will therefore not be standing for re-election at this year's AGM. We thank David for what will be six years of dedicated service to Costain, during which time he has made a very significant contribution to the Board.

Costain has a highly skilled and committed employee base of c 3,400 individuals who are the lifeblood of our business and critical to our success. I would like to thank them for their hard work and contribution during the year.

**Significant progress in implementing our Leading Edge strategy**

See our Strategy in action on pages 26 to 30

**Experienced management team with a far reaching skill set**

See our Board of Directors on pages 54 to 57

**A Board committed to the highest standards of governance**

See our Governance section on pages 54 to 121

## Environmental, social purpose and governance

We deliver on our purpose to improve people's lives by making positive contributions to society, helping us to build a sustainable future. We have integrated the United Nations Sustainable Development Goals into our responsible business commitments, recognising the role that Costain plays in working together with other organisations to address the global priorities by 2030 and to lead the decarbonisation of the UK's infrastructure.

Operating as a socially responsible business is integral to everything we do. To be leading edge, we need to be resilient to change and we are committed to working with our employees, clients, supply chain and all other stakeholders to ensure that we are sustainable for the future. Our Group-wide policies and processes support our responsible business matters. Our audit and training programmes ensure that these policies establish best practice for our employees and partners.

The Board maintains its commitments to the highest standards of governance and has taken steps during the year to consider and strengthen our approach to align with the UK Corporate Governance Code 2018. Further details of our approach to the 2018 Code are set out in the Governance Report.

## Dividend

Recognising the importance to the Group of maintaining a strong and growing capital base, following the proposed equity raise, Costain will target a dividend cover of around three times underlying earnings, taking into account the free cash flow generated in the period.

Consistent with the rationale for the proposed equity raise, the Company will pay no final dividend in respect of the year ended 31 December 2019, therefore resulting in a total dividend paid for the year, including the interim dividend, of 3.8 pence per share (2018: 15.15 pence). The first dividend to be paid under the new policy is expected to be an interim dividend for the six months ending 30 June 2020, payable in October 2020.

## Outlook

The market for complex infrastructure continues to evolve rapidly with increasing urgency to deliver innovative solutions as part of upgrading or enhancing the UK's strategic infrastructure. The long-term nature of our client relationships and the trust they place in us to deliver for them provides us with the strongest possible platform to accelerate the deployment of our higher margin services alongside our complex programme delivery.

We are confident that our strategy, a stronger balance sheet and our differentiated proposition will best meet our clients' changing requirements and deliver significant value for our shareholders.

**Dr Paul Golby CBE**
Chair

11 March 2020

Chief Executive Officer's Statement

# Strategically positioned for future growth

*"Our Leading Edge strategy aligns our integrated services with our clients' changing needs"*

**Alex Vaughan**
Chief Executive Officer

During the year we made significant progress in the strategic development of the Group to shape and re-focus our business and to capitalise on the attractive opportunities in our markets.

As outlined, financial performance in the year was impacted by several factors which resulted in a reduction in underlying operating profit and earnings per share. In June 2019, the Group experienced delays to the timing of a number of contract start dates and new awards, and a significant contract was cancelled, impacting expected profitability by c £16.0 million. In December 2019, the Group's profit was reduced by a further £20.0 million following the assessment of the impact of an arbitration decision on the A465 road contract.

This year we launched our new Leading Edge strategy, which places greater emphasis on leveraging our strong blue-chip client relationships, and reputation for complex programme delivery, through an accelerated deployment of higher margin services including future-shaping strategic consultancy, consultancy and advisory services, asset optimisation and digital technology solutions. The strategy ensures the alignment of our services with the changing investment priorities of our clients.

Through a continued effort to drive growth, our ambition is to derive over half of our operating profit from higher margin services, targeting a blended divisional margin range of 6 to 7 per cent over the medium term. In 2019 the Group's business mix reflects approximately two thirds of underlying operating profit from complex programme delivery activities and one third derived from higher margin services delivering, excluding the A465 impact, a combined 3.9% underlying divisional margin (before other items, Alcaidesa and central costs) overall. Our ambition, over the medium term, is to increase the proportion of operating profit from higher margin services to 55%, with divisional margins in our new target range.

Over the course of last year, we secured £1.7 billion of new work, demonstrating that our integrated services continue to be in high demand from our clients. Our order book as at 31 December 2019 was £4.2 billion (including £1.1 billion in respect of HS2) and we have a good level of secured revenue for 2020 at c £940 million (compared to c £900 million at HY2019), which is also higher margin business overall.

At Costain we are committed to conducting our business responsibly and have aligned our purpose of improving peoples' lives to the United Nations Sustainable Development Goals. Our three key areas of focus are creating a greener future, working towards being net zero carbon by 2035; ensuring Costain is a safe, inclusive and great place to work where everyone can be at their best; and enhancing the value that Costain contributes to society.

## Strengthening the balance sheet

The Board believes there is a significant opportunity for the Group to capitalise on the growing infrastructure market opportunities available to us, in line with our strategy. Also, having a strong balance sheet has become increasingly important to our clients and other stakeholders. For these reasons and to provide additional headroom in the current environment to effectively manage working capital flows in the business, the Board has concluded that it is in the best interests of the Group to raise up to £100 million of new equity to strengthen the Group's balance sheet.

Further details on the proposed capital raising, which has been fully underwritten on a standby basis, are contained in a separate announcement made made on 11 March 2020.

## Trading and financial performance

### Results

The term 'underlying' throughout this document excludes the following items: amortisation of acquired intangible assets and deferred consideration treated as an employment expense. In 2019 other items also include a one-off charge of £9.7 million in respect of an arbitration award in favour of Diamond Light Source Limited for the cost of remedial works deemed required to the roof at the National Synchrotron facility and a one-off aggregate non-cash charge of £8.9 million for the loss on disposal and fair value adjustment for the Group's non-core business assets in Spain.

Revenue, including the Group's share of joint ventures and associates, for the year was £1,162.9 million (2018: £1,489.3 million). The reduction in revenue resulted from a lower level of capital project activity, in line with the strategic change in mix of services, and the delay in contract starts and a contract cancellation. Underlying operating profit for the year was £17.9 million (2018: £52.5 million). As previously announced, this reflects a reduction of c £16.0 million for delayed contract starts and contract cancellation and a charge of £20.0 million following the A465 arbitration decision.

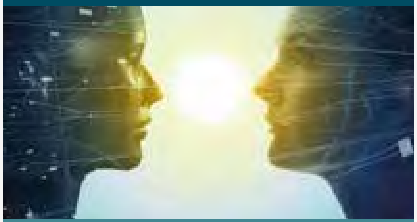
Underlying profit before tax was £14.6 million (2018: £49.7 million) and underlying basic earnings per share were 13.5 pence (2018: 38.2 pence). Reported loss before tax was £6.6 million (2018: £40.2 million profit before tax) and reported loss per share was 2.7 pence (2018: 30.9 pence earnings per share).

### Contract awards

The range of contracts we have secured reflects the progress being made in the transition in Costain's market positioning, the increasing breadth of our service offering and recognition as a leading and valued smart infrastructure solutions provider. Ongoing programmes and work within our order book include the following, demonstrating the breadth of our services:

- Formal contracts – construction delivery phase:
  - M1 smart motorway programme
  - A19 Testos scheme
  - Thames Tideway Tunnel – East
  - Peterborough and Huntingdon (National Grid).
- Early contract involvement (ECI phase):
  - HS2 Southern section main works
  - Highways England route to market
  - M6 smart motorway.
- Framework contracts:
  - Water AMP frameworks
  - Sellafield DDP framework.

**CASE STUDY**



## Creating the UK's national digital twin

In collaboration with the Centre for Digital Built Britain and other partners, we are shaping the future of the UK's national digital twin and leading the early market evolution for digital twins in infrastructure. Together we are creating a blueprint for collaboration between government, academia and industry that is critical to the successful delivery of a national digital twin. A national digital twin will transform the way infrastructure is developed across the UK and we are well positioned to advise infrastructure clients on shaping their digital twin ambitions. We are already helping clients in the water sector to transform their enterprise. Digital twins will:

- enable infrastructure owners and operators to run virtual scenarios to model the effects they could have on the real world and
- deliver whole life benefits, enabling actions that save time, money and minimise disruption to provide better outcomes for society at large.

# Chief Executive Officer's Statement continued

- Service based contracts:
  - United Utilities maintenance services
  - Highways England maintenance contracts, areas 4, 12 and 14
  - East Sussex highway services.
- Consultancy and technology contracts:
  - Smart motorway signage
  - Connected vehicle technology
  - EDF project controls
  - National Grid hydrogen blending study
  - INEOS Breagh compression feed

During the year we secured over 150 consultancy commissions across all sectors and in January 2020 we were for the first time recognised by the Financial Times as one of the UK's leading Management Consultancy companies.

## Capital structure and cash position

A key element in the successful implementation of the Group's Leading Edge strategy is the efficient allocation of capital. The Board regularly reviews the appropriate capital structure for the Group and capital allocation with regard to ensuring that the Group can deliver on its ongoing obligations including addressing the legacy pension contribution commitments and making regular returns to shareholders, and effectively exploit available growth opportunities.

In addition, maintaining a strong and flexible balance sheet is a key requirement of clients in tendering large long-term contracts, is necessary to manage the increasing move in the sector to delivery in joint operations and use of project bank accounts, and supports the investment needed to deliver our Leading Edge strategy.

The Group continues to have a positive net cash position, which as at 31 December 2019 was £64.9 million (2018: £118.8 million). Of this, c £35.0 million (2018: £30.0 million) reflects positive timing of receipts and payments around the year-end which reversed in the early part of 2020. Included within the Group's net cash position is £83.5 million of cash in joint operations (2018: £84.5 million). The average month-end net cash was £41.2 million for the period (2018: £77.1 million), of which £78.3 million was average month-end net cash in joint operations (2018: £83.4 million). Before taking the equity raise into account, the Group expects to maintain a positive average month-end net cash balance (including cash in joint operations) in 2020, increasing going forward.

The Group has total banking facilities in place of £187.0 million (which were £116.0 million drawn as at 31 December 2019 with month end average drawings during the year of £93.7 million), and £320.0 million of committed and uncommitted bonding facilities.

In 2019, the Group's net cash position was impacted by a number of market factors and performance on certain contracts:

- Market dynamics
  - The Group has implemented revised processes to ensure that suppliers are paid promptly, with the average time taken to pay invoices reduced to 34 days, moving into line with sector best practice, from 58 days in the same period in 2018, reducing cash held by £15 million and
  - Structural market changes, including the level of cash held in joint operations and project bank accounts, have increased the Group's general working capital requirements.
- Contract performance
  - A465 arbitration: £37.0 million cash outflow in the year
  - Diamond arbitration: cash cost of £9.7 million in the year
  - Delays to the start of new contracts and a contract cancellation, reducing the level of profit in the year by c £16 million.

The completion of the capital raising will reset the structural cash position of the Group to the appropriate level to capture the opportunities available in the market.

## Market overview

Costain is one of the UK's leading smart infrastructure solutions companies operating across the transportation, water, energy and defence markets supporting the delivery, enhancement and operation of the UK's critical strategic infrastructure.

These markets have significant long-term investment programmes underwritten by government policy, regulation, legislation and critical national need. They are evolving rapidly and positioned for accelerated growth responding to population increases, climate change, customers' expectations of improved service, ageing assets, and the need for greater efficiency and performance including a growing use of technology. All of these factors are causing our clients to change their business strategies and investment priorities.

The new UK Government has significantly increased its commitment to invest in long-term UK infrastructure projects, with its 2019 manifesto plan for national renewal underpinned by an additional £100 billion of infrastructure spend. Evidence of the scale of this developing investment programme includes:

- in Transportation: the UK Government is committed to investing in a fundamental upgrade of the UK's transport infrastructure. We expect that over the next five years more than £28.8 billion will be invested in England's strategic and local road network, £5.5 billion will be spent on capital investment and renewals by Transport for London, around £125 billion on other rail investment and c £7 billion on increasing airport capacity in the UK

**33 disciplines across our technology and consultancy capability**

c 3,400 people

**Chartered professionals across a wide range of disciplines**

370+

**25% of senior managers are female, up from 10% in 2014**

25%

- in Water: the regulator, Ofwat, is driving investment to improve water quality standards, supply resilience, decarbonisation and efficiency of operations. Water companies have pledged to spend more than £50 billion on improving services over the next five years
- in Energy: it is estimated that £138 billion will be invested by 2028 in new UK energy infrastructure to meet forecast energy demands and the UK Government has now committed to the very significant investment required to deliver a net zero carbon target by 2050, which will transform energy generation in the UK
- in Defence: the UK Government has committed £186 billion to a 10-year equipment and facilities upgrade programme.

We estimate that our addressable market in these sectors is c £23 billion per year, creating a significant growth opportunity for the Group. In addition, our major clients are changing the nature of their investment to meet and address these continuing challenges, with examples including:

- in a joined-up approach, UK Government, regulators and clients are demanding greater innovation to address these challenges, collectively spending in excess of £1 billion in the short and medium term with their suppliers to unlock new solutions
- investment to address the effects of the climate change crisis:
  - the water industry investing £13 billion to reduce carbon emissions and improve supply resilience
  - transport networks investing to overcome extreme weather events including heatwaves, storms and flooding that damaged infrastructure and halted thousands of services across the UK in 2019
- enhancing asset management practices, recognising that underlying infrastructure that will be used in 30 years' time already exists today, and it is therefore essential that these assets are most effectively and efficiently used, maintained and enhanced
- digital is widely seen as an all-encompassing solution for improved efficiency and enhanced performance and has led to increasing levels of investment in Highways England's 'Digital Roads' programme, Network Rail's 'Digital Rail' programme, water companies' 'Digital Water' programmes and the use of smart meters within the energy sector.

In response to these changing needs, our clients are continuing to consolidate their supply chains as they seek to derive business improvement and transformation by working in more strategic and collaborative relationships. We have taken the steps to be capable of providing a broad range of services to our clients across design, programme delivery and operational support to meet their increasingly complex needs.

As a result, Costain is now one of a limited number of companies with the integrated consulting, digital technology, complex programme delivery and asset management capability that we believe is required to meet the needs of major UK clients in the rapidly developing multi-billion pound transportation, water, energy and defence markets.

## Leading Edge strategy

Strategically we are well-positioned to benefit from these long-term positive market dynamics.

Our Leading Edge strategy, launched in 2019, closely aligns our services to meet the changing needs of our markets and clients and differentiates us through our long-term strategic client relationships, reputation for complex programme delivery and ability to meet their wider, evolving needs.

The ambition of our strategy is to broaden the services we provide to clients, step change our programme delivery performance, accelerate the deployment of higher margin activities and deliver a blended divisional operating profit margin of 6 to 7 per cent over the medium term.

The strategy positions our five key service offerings:

- Future-shaping strategic consultancy: shaping new solutions as a leading innovation partner and thought leader
- Consultancy and advisory: supporting clients' business improvement as a valued advisor and consultant
- Digital technology solutions: investing in technology and being an insightful digital technology integrator
- Asset optimisation: optimising the performance of clients' existing assets and
- Complex programme delivery: delivering complex capital programmes.

# Chief Executive Officer's Statement continued

We have re-organised our divisional structure to create greater client focus and align with growing market opportunities, consolidating our activities into two core divisions of 'transportation' (rail, highways and aviation) and 'natural resources' (water, energy and defence).

New appointments to strengthen and broaden the management team include Nathan Marsh, who joined as chief digital officer in October 2019, Catherine Warbrick, who was promoted to Group HR director in August 2019 and Sue Kershaw, who will take up the position of managing director, transportation on 23 March 2020.

We are implementing our strategy through a programme of focused workstreams including the development of new skills and capabilities, working increasingly as One Costain, and enhancing the client outcomes we deliver through our services.

In addition, to improve business competitiveness and returns, we have put in place a programme of robotic process automation, reduction in management layers and improved operational effectiveness. This programme is expected deliver £20.0 million per year in efficiency gains within three years to underpin investment in the business and support the implementation of our strategy.

Recognising the increasingly important role our digital technology capability has in meeting our clients' changing needs we have invested in a new technology centre in Somerset, strengthened our digital leadership and increased our involvement in leading research programmes. We will continue to invest in the development of solutions to help our clients improve their business performance and grow our business returns.

Having a strong pipeline of opportunities is important for the future of the business, but it is equally important to ensure that we agree contracts on terms which are acceptable from a profit and risk profile perspective for Costain and its shareholders. We have recently reviewed and updated our policies in this area to ensure that our new contracts reflect this. We have also improved our contract monitoring and administration procedures to better address scope of work changes and variations at an early stage.

## People

We have a highly skilled and experienced employee base of c 3,400 people, including over 370 chartered professionals with a diverse range of capabilities, c 110 graduates developing their skills and c 170 apprentices on a structured development programme. Our inclusion and wellbeing strategies ensure we support our teams to be at their best, and for the second year running we have been listed in the Times Top 50 Employers for Women and named as one of its 'Game Changers' for the actions we have taken on diversity.

Along with our engineering consultancy centre in Manchester where over 350 of our team are based, our technology centre in Somerset houses c 150 of our technology specialists. This enables us to work collaboratively with our clients to develop pioneering technology solutions.

**CASE STUDY**

Image courtesy of Highways England

### Digitally optimised complex programme delivery on the A14

Working as part of a joint venture with Balfour Beatty and Skanska on behalf of Highways England, Costain opened the 12-mile Huntingdon Bypass forming part of the UK's biggest road upgrade project a year ahead of schedule in December 2019.

Highlights of the scheme's delivery include:

- delivering £109 million in efficiency savings including £3.5 million from digital initiatives
- improving forecasting and mitigating the risk of harm
- winning Digital Initiative of the Year (Civils) and the coveted 'Overall Initiative of the Year' at the British Construction Industry Awards 2019
- integrating the next generation of digital road message signs
- incorporating the latest technological advances in drones and extended reality
- trialling self-driving dumper trucks to enhance safety and pace of delivery
- achieving 44001 collaborative accreditation, the first project ever to do so.

## Environment, social purpose and governance

In addition to providing leading edge solutions, operating responsibly and sustainably is a business imperative for Costain, and the safety of our people and the general public is our number one priority. Through the implementation of our WiiSE (wellbeing, safety and environment) strategy in 2019 we have maintained a world-leading safety performance, with only 19 reportable accidents occurring in over 41 million hours of work. This means our accident frequency rate (AFR) of 0.05 continues to lead the industry, with a 16% reduction in all accidents year-on-year and a 63% reduction over the past five years. I am also pleased to report that we had no major environmental incidents in 2019.

In 2019 we updated our Responsible Business Commitments and set the goals we aim to achieve. We will create a greener future and have published a detailed climate change action plan in which we commit to deliver low carbon whole life options for clients by 2023 and to be net zero carbon by 2035. We will also enhance the value that Costain contributes to society and ensure that Costain is a safe, inclusive and great place to work, where everyone can be at their best. Underpinning our commitments to responsible business are ten actions that all of our people, partners and suppliers must factor into their decision-making.

We are committed to building the best team at Costain and work hard to create a culture of inclusion where all employees are treated and valued equally. In 2019 our gender pay gap reduced for the third consecutive year to 23.65% (median) and we continue to work to address this further.

## Impact of Covid-19

We are closely monitoring the coronavirus situation, are following Government guidelines and sharing these with colleagues. We have robust business continuity procedures in place to cover all aspects of our operations in a scenario such as this which are regularly tested. We are prepared to take action to deal with this situation as it changes.

## Summary and outlook

2019 has been a year of transition for Costain as we began the implementation of our Leading Edge strategy to reshape and focus our business. Our underlying financial performance was impacted by delays to certain contract start dates and new awards, together with a contract cancellation and the loss resulting from the A465 arbitration. However, we are pleased that the Group has continued to secure significant new work during the year.

Our Leading Edge strategy aligns our activities to meet our clients' changing needs, supporting a step change in our programme delivery performance and an acceleration in the deployment of our higher margin activities.

The UK infrastructure markets are growing and developing rapidly, with increasing demand for innovative solutions to upgrade, enhance and decarbonise the nation's strategic infrastructure. This is a significant opportunity for our business and we are well placed, with our breadth of integrated services, to benefit from these market dynamics.

Strengthening our balance sheet will enable us to capitalise on these opportunities and further enhance our capabilities.

Alex Vaughan
Chief Executive Officer

11 March 2020

Our Strategy

# Implementing our Leading Edge strategy to align with our clients' changing needs

Our Executive Board-sponsored implementation plan is driving change in our business; increasing our efficiency, broadening our capabilities, investing in innovation and creating an environment where our team can be at their best, every day

### 2019 strategic priorities

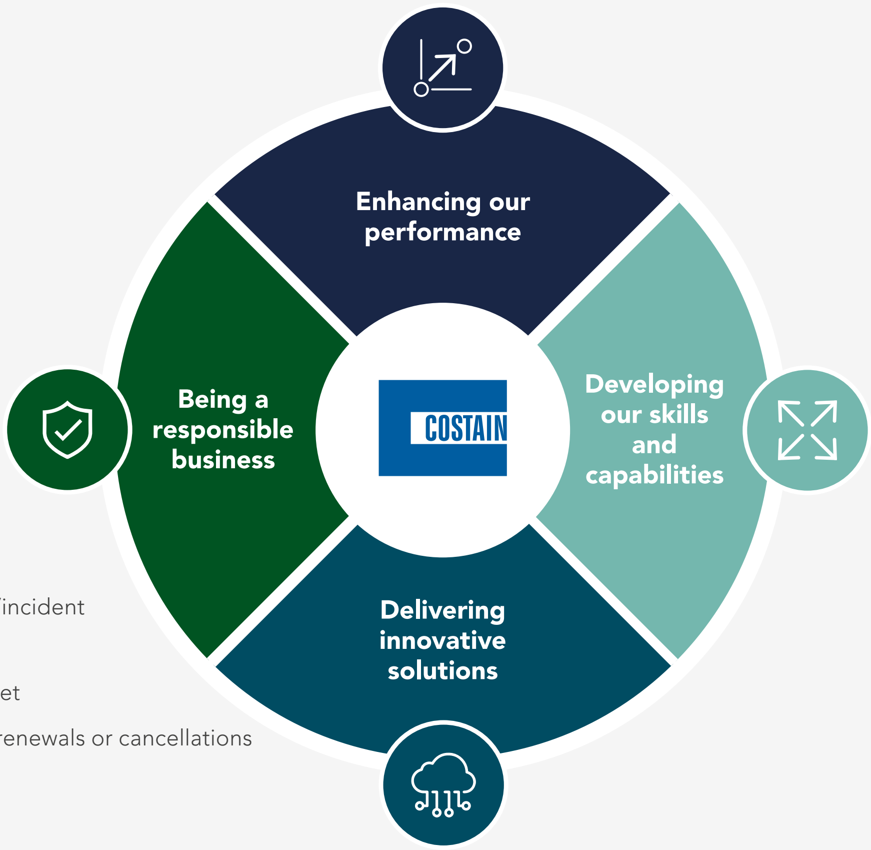
Our strategic priorities drive continued progress and differentiation and are linked directly to our Executive Board-sponsored implementation plan.

### Implementing our Leading Edge strategy

Each workstream of our strategic implementation plan is spearheaded by a member of our Executive Board. Implementing our Leading Edge strategy will see us further differentiate our business and maximise our opportunity.

### Implementation workstreams

- Leading Edge delivery
- Increased competitiveness
- Unlocking our capability
- Building a sales culture
- Becoming digital by default
- Positioned for greater shaping
- Turning reputation into value
- Being at our best




### Associated risks

1. Prevent a major accident/hazard/incident
2. Delivery of the business strategy
3. Maintaining a strong balance sheet
4. Securing new work and contract renewals or cancellations
5. Culture and people
6. Delivery of projects effectively
7. Management of our legacy defined benefit pension scheme
8. Ensure that our technology is robust, our systems are secure and our data protected
9. Anticipate and respond to changes in client circumstances

**See our Principal Risks and Uncertainties on pages 48 to 51**

**All strategic priorities contribute to Leading Edge Insight and Delivery**

*"Our Leading Edge strategy implementation plan will ensure we align our services to meet our clients' changing needs; evolve our service mix to increase divisional margins; work as One Costain to create an environment where our people are at their best every day and step change the value we bring to our industry through our integrated service delivery."*

**Alex Vaughan**
Chief Executive Officer

# Enhancing our performance

**Drive best in class productivity and enhance operational performance across our projects through our Operational Excellence Model (OEM). Continue to enhance and increase our own efficiency through automation and digitisation of our internal processes.**

**Driven by our implementation workstreams:**

**Leading Edge delivery**

Executive Board sponsor: **David Taylor**

**Increased competitiveness**

Executive Board sponsor: **Tony Bickerstaff**

**2019 progress:**

- launched OEM 1.0 to all live contracts, focusing on maximising productivity and operational effectiveness
- first robotics processes automation launch and automation academy held.

**2020 focus:**

- standardise our programme of continuous improvement across all projects through OEM 2.0
- improve our utilisation by automating and consolidating a variety of finance functions
- improve our supply chain management through an automated supplier relationship management system.

**Link to risks**

2 3 6 7 8

# Developing our skills and capabilities

**Develop our teams to create a culture where everyone searches for opportunity to broaden our service offering, achieving excellence through our capabilities and leveraging our full capability at every opportunity.**

**Driven by our implementation workstreams:**

**Unlocking our capability**

Executive Board sponsor: **Maxine Mayhew**

**Building a sales culture**

Executive Board sponsor: **Tracey Wood**

**2019 progress:**

- held our inaugural sales conference in September 2019
- comprehensive sales training completed by key personnel
- revised incentivisation in place linked to business development targets.

**2020 focus:**

- implement new CRM system to improve client and sales intelligence
- implement common sales operating model across the business.

**Link to risks**

2 4 5 9

# Our Strategy continued

## Delivering innovative solutions

**Become the UK's leading digitally enabled smart infrastructure solutions company by providing leading edge digital technology solutions across three core offerings: digital delivery, digital assets and digital systems integration. Promote and ensure transparency of our enhanced offering to the market and our internal and external stakeholders.**

### Driven by our implementation workstreams:

**Becoming digital by default**

Executive Board sponsor:
**Nathan Marsh**

**Positioned for greater shaping**

**Turning reputation into value**

Executive Board sponsor:
**Alex Vaughan**

See our spotlight on becoming digital by default on page 29

### 2019 progress:

- appointed chief digital officer
- opened our leading edge technology centre in Somerset
- implemented focused market campaigns.

### 2020 focus:

- embed our digital sales leads
- build our digital by default culture
- further integrate our PhD programme with our service lines, using their insight to shape and meet our clients' needs.

### Link to risks

2 4 8 9

## Being a responsible business

**Continue to prioritise safety, health and environment through our WiiSE (wellbeing, safety and environment) strategy, inclusion strategy and responsible business commitments, allowing our team to be at their best every day.**

### Driven by our implementation workstream:

**Being at our best**

Executive Board sponsor:
**Catherine Warbrick**

See our spotlight on being at our best on page 30

### 2019 progress:

- launched our inclusion strategy
- implemented our WiiSE strategy with a focus on wellbeing and eliminating SHE harm.

### 2020 focus:

- launch climate change action plan setting out our path to net-zero carbon by 2035
- launch responsible business commitments demonstrating our alignment with the UN Sustainable Development Goals.

### Link to risks

1 5

**All strategic priorities contribute to Leading Edge Insight and Delivery**

## Implementing Our Strategy

# Spotlight on becoming digital by default

**2019 saw the opening of our leading edge digital hub in Somerset and the appointment of Nathan Marsh as chief digital officer, demonstrating our commitment to and investment in this digital decade**

**"Costain is at a crucial point in its evolution. Building on the successes in 2019, we are embracing this new digital decade by digitally transforming our capabilities, services and our wider business, making it digital by default and fit for the future."**

**Nathan Marsh** Chief Digital Officer

In 2019, we further developed our digital technology capability, completing the full integration across both divisions and into our sectors. 2019 saw us organise our digital technology capabilities around our clients' most pressing issues to get ourselves and our sector ready for a true digital transformation in 2020.

Looking back at 2019, we are delighted to have been awarded Project of the Year for the A2/M2 Connected Corridor Testbed at the Intelligent Transport Systems (ITS) awards in October. This award is testament to both the development of our digital technology capability, and to our commitment to ensure the UK is at the leading edge of the connected autonomous mobility (CAM) revolution. There is still much to be done to secure the testing, trialling, adoption and normalisation of connected autonomous vehicles at scale and ready our infrastructure to support them. We are well-positioned to take a leading role in driving this forward with our partners in the CAM ecosystem.

Our A14 project also won digital transformation initiative of the year at the British Construction Industry Awards, a fantastic example of how we integrate our digital solutions for our customers into our core, complex delivery projects.

Digital twin, autonomy at scale, predictive data analytics, prolific connectivity, the Internet of Things (IoT) and quantum computing are further examples of how the industry is set to change in 2020 and we are excited to be leading the way in this digital decade.

We now have representatives on the TechUK Digital Ethics Board, the CBI Digital Leadership Advisory Board, the Zenzic CAM deployment and normalisation Advisory Board. Our IOT and Digital Twin Director, Kevin Reeves, was appointed on the national Digital Taskforce, the industry group who are developing leading edge solutions to create and maintain a digital twin of our critical national infrastructure.

Nathan Marsh
Chief Digital Officer

*"I'm incredibly proud and excited at the role we have as a digital leader in critical national infrastructure. I'm looking forward to us leading our industry to deliver a legacy of sustainable, connected and digitally enabled critical national infrastructure for generations to come"*

Implementing Our Strategy continued

# Spotlight on being at our best

**"Our people are our most important asset. Their physical health and general wellbeing is fundamental to maintaining a happy, effective and sustainable workforce. We want our people to be at their best and we recognise that good mental health is an essential element for success."**

**Catherine Warbrick** Group HR Director

The safety of our people and the general public is our number one priority. Through the implementation of our WiiSE (wellbeing, safety and environment) strategy in 2019, we have maintained a world leading safety performance, with only 19 reportable accidents occurring in over 41 million hours of work. This means our accident frequency rate (AFR) of 0.05 continues to lead the industry, with a 16% reduction in all accidents year-on-year and a 63% reduction over the past five years.

Gone are the days of chasing lagging indicators that tell us where we have been and what we did. We deliberately look forward, shaping the future, using leading indicators that measure engagement and behaviours. This is where the next step change in our safety performance will come from.

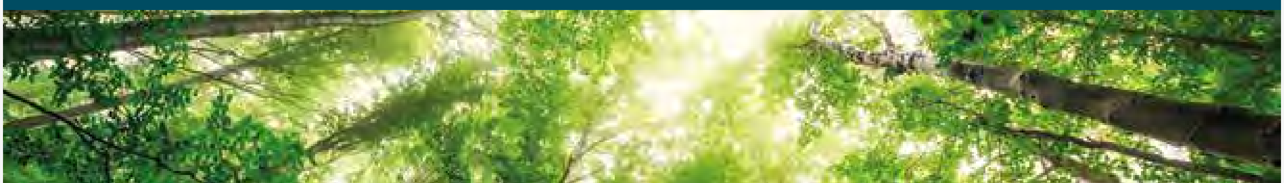
We continue to raise awareness of mental health, signing up to the 'Mental Health at Work Commitment' and training an additional 112 mental health first aiders in 2019. We were pleased to be highly commended by BITC in their health at work awards for our progress.

Protecting our natural environment remains a key priority and we are pleased to report that no major incidents occurred in 2019. Encouragingly we saw a 23% year-on-year reduction in environmental incidents, contributing to a 46% reduction over the past five years.

We are committed to building the best team at Costain. We work hard to create a culture of inclusion where all employees are treated and valued equally. In 2019 our gender pay gap reduced for the third consecutive year to 23.65% (median). While we clearly have more to do, our efforts on gender equality were publicly recognised and Costain was named a Times Top 50 Employer for Women for the second time.

Annually we set ourselves challenging targets as part of our WiiSE and inclusion strategies which are underpinned by our responsible business commitments. Our 2020 targets are ambitious and will ensure that we continue to provide a safe, inclusive and sustainable environment where everyone can be at their best.

**CASE STUDY**



### Taking action on climate change

During 2019 we undertook a series of stakeholder engagement activities, including engaging clients, suppliers and our people on climate change. Their feedback was used to shape our climate change action plan which was launched in February 2020 and sets out our commitment to be a net zero carbon business by 2035 at the latest.

We recognise that the response required to tackle climate change is more complex than carbon reduction alone and we have structured our plan to reflect this. It is our aim to be a clean growth leader and enabling the uptake of low carbon solutions such as hydrogen will be fundamental to meeting the UK's net zero target. See our case study on hydrogen and carbon capture storage on page 41 for an example of our activity in this space.

# Non-financial Information Statement

Our reporting is compliant with the 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 Carbon Disclosure Project and Global Reporting Initiative.

## Reporting requirement and risk management and additional information

### Environmental

- Our responsible business commitments pages 34 and 35
- Responsible Business Report

### Employees

- Our responsible business commitments pages 34 and 35
- Board composition and diversity pages 64 and 65
- Gender Pay Gap Report
- Inclusion Strategy

### Human rights

- Our approach page 32
- Responsible Business Report
- Modern Slavery Statement
- Supplier code of conduct

### Social matters

- Our responsible business commitments pages 34 and 35
- Responsible Business Report
- Gender Pay Gap Report
- Inclusion Strategy

### Anti-corruption and anti-bribery

- Responsible Business Report
- Supplier code of conduct

### Policy embedding, due diligence and outcomes

- Principal risks and uncertainties pages 48 to 51
- Our approach page 32
- Responsible Business Report

### Description of principal risk and impact on the business

- Principal Risks and Uncertainties pages 48 to 51

### Description of business model

- Business Model pages 16 and 17

### Non-financial KPIs

- Responsible Business pages 32 to 37
- Responsible Business Report

## Policy

**Board diversity**

This policy sets out the Chair and Board of directors' commitment to maintaining a diverse and inclusive Board. Leading by example and setting expectation that the Group operates inclusively and continues to invest in diversity. The owner of this policy is the chair.

**Business continuity management**

The principles which are to be adopted to ensure business continuity across the Group are set out in this policy. The Executive Board sponsor for this policy is the chief financial officer.

**Collaborative working**

This policy sets out the approach that Costain management shall take to ensure a collaborative working environment is maintained and relationships reflect the requirements of ISO44001:2017 Collaborative Business Relationships. The Executive Board sponsor for this policy is the Group commercial director.

**Customer service**

This policy is a declaration of the Board's intent in relation to achieving a positive impact on society. It sets out how Costain will meet the needs of clients, through professional, courteous and efficient service. The Executive Board sponsor for this policy is the chief executive officer.

**Drugs and Alcohol**

This policy is a declaration of the Board's intent to provide a safe and healthy working environment free from inappropriate use of alcohol and drugs in all Costain undertakings. The Executive Board sponsor for this policy is the chief operating officer.

**Environmental**

This policy sets out our approach to environmental management, going beyond minimising harm to the environment and sets out the proactive requirements of how our people must work to meet our objective to be net zero cawrbon by 2035 at the latest. The Executive Board sponsor for this policy is the chief operating officer.

**Ethical business conduct**

Bribery prevention, fair and open competition, insider dealing prevention, fraud prevention and whistleblowing are all covered by the Costain Ethical business conduct policy. The Executive Board sponsor for this policy is the company secretary and general counsel.

**Health and safety**

This policy protects all our stakeholders, including clients, colleagues and suppliers. Going beyond our statutory duties and responsibilities, it sets out our approach to achieving zero harm, both physically and mentally. The Executive Board sponsor for this policy is the chief operating officer.

**Modern slavery and human trafficking**

This policy specifies the mandatory conditions of employment and contractual conditions for our suppliers in respect of human rights. The Executive Board sponsor for this policy is the Group commercial director.

**People**

The Costain People policy encompasses recruitment, development, reward, equality and diversity, health and wellbeing, compliance with labour/employment and data protection laws and regulations wherever we work. The Executive Board sponsor for this policy is the Group human resources director.

**Responsible business**

This policy sets out the Board expectation for how the Company, its employees, partners and suppliers must conduct themselves, including three high level commitments to responsible business: ensure Costain is a safe, inclusive and great place to work where everyone can be at their best; create a greener future; and enhance the value Costain contributes to society. The Executive Board sponsor for this policy is the Group human resources director.

**Sustainable procurement and supply chain**

The Costain Sustainable procurement and supply chain policy stipulates the conditions of all procurement activity, aligning outcomes to our responsible business commitment and Leading Edge strategy. The Executive Board sponsor for this policy is the Group commercial director.

Responsible Business Report

# Working responsibly

**Being a responsible business is not just about looking at how we perform in the here and now. We deliver on our purpose to improve people's lives by making positive contributions to society, helping us to build a sustainable future.**

We have integrated the United Nations Sustainable Development Goals (UN SDGs) into our responsible business commitments, recognising the role that Costain plays in working together with other organisations to address these global priorities by 2030.

**See page 04 in our Responsible Business Report**


For more information on our policies, statements and how Costain is contributing to the UN Sustainable Development Goals, please visit our website www.costain.com

## Our approach

Operating as a socially responsible business is integral to everything that we do. To be leading edge, we need to be resilient to change and we are committed to working with our employees, clients, supply chain and stakeholders to ensure that we are sustainable for the future.

We have several Group-wide policies and processes to support key responsible business issues. These include:

- health and safety
- environmental
- customer service
- people
- responsible business
- ethical business conduct
- sustainable procurement
- modern slavery and human trafficking.

Our audit and training programmes ensure that these policies establish best practice for our employees and partners.

It is our policy to operate responsibly and with high ethical standards, particularly with regards to human rights issues. We take a zero tolerance approach to corruption and bribery, and we have an independent whistleblowing process in place to ensure we maintain exceptional standards in all areas. 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.

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. Our third Gender Pay Gap Report sets out the actions we are taking to reduce our gender pay gap.

## Governance

The Board and Executive Board of Costain have overall accountability for responsible business related 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 leadership groups that report our responsible business performance to the Board and hold direct responsibility for implementing and delivering policy across the organisation. Catherine Warbrick, Group HR director is the executive owner for responsible business and the 'Being at our best' strategy implementation workstream.

In addition to the annual report we publish a Responsible Business Report detailing the impact of our current responsible business activities and measuring performance against our long-term goals. The report is approved by the Board and produced in accordance with current Global Reporting Initiative (GRI) standards. Further detail regarding our 2019 corporate responsibility performance can be found in our full Responsible Business Report.

www.costain.com/our-culture/being-a-responsible-business/

## We are committed to identifying and addressing the material sustainability issues that affect Costain and our stakeholders

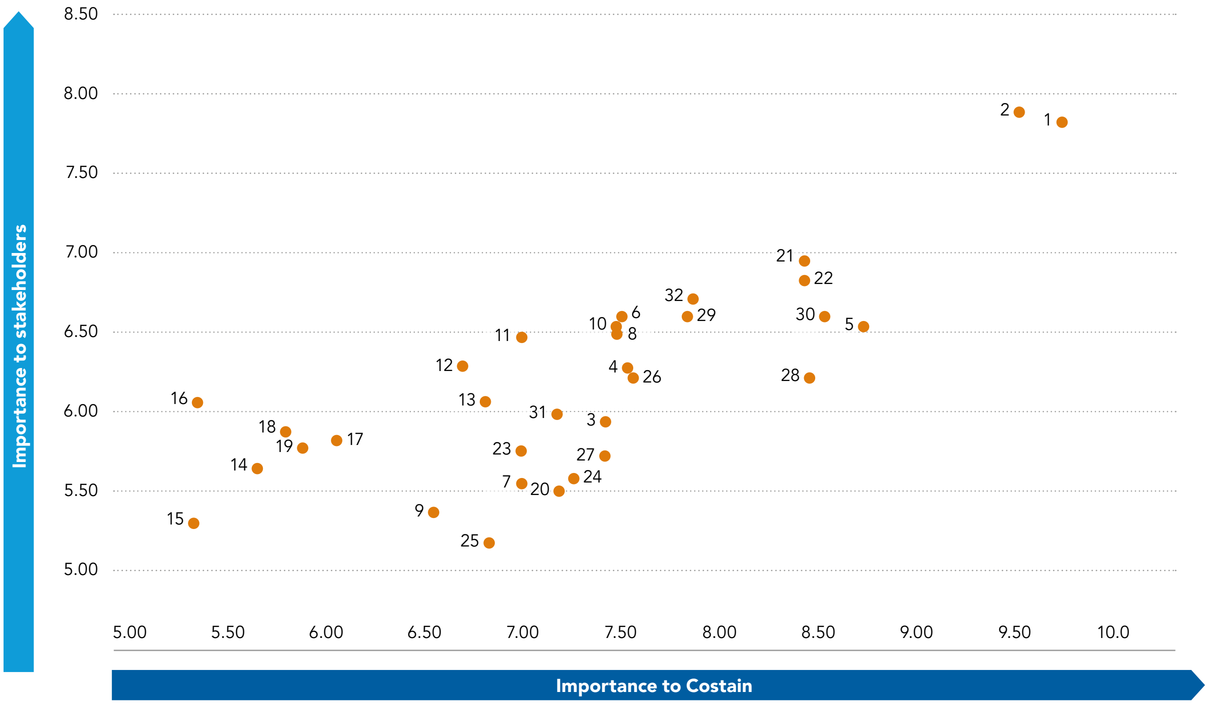
Our materiality assessment considers a wide range of issues that can be affected by our operations throughout our value chain. Many of these material issues align with the UN SDGs and all require Costain to be a responsible business.

## Process for identifying material issues

The Costain materiality assessment is aligned to GRI G4 guidelines. Our process involves a continual programme of stakeholder engagement (including clients, industry bodies, charities, suppliers, and employees) through face-to-face meetings, surveys and desktop studies to understand the issues they currently face and the risks they see in the future.

The intelligence we gathered through our 2019 engagements allowed us to rationalise a list of material issues. The commonly reported issues were then ranked in respect of their importance to Costain and our stakeholders. Safety (workforce and public) remains the highest ranked material issue, both with stakeholders and for Costain. Customer experience, business resilience and productivity/efficiency were included in this assessment and reflect a change in how businesses try to enhance value.

### Issues material to Costain and our stakeholders




1 Workforce safety
2 Public safety
3 Workforce diversity and gender pay gap
4 Inclusive culture
5 Employee health and wellbeing
6 Public health
7 Human rights (ethical labour/ modern slavery)
8 Carbon emissions
9 Embodied carbon in materials
10 Construction pollution (air quality, noise, dust, vibration...)
11 Asset/operational pollution (e.g. air quality from highway)
12 Construction waste
13 Sustainable materials (environmentally/ethically sourced)
14 Circular economy
15 Life cycle analysis of materials
16 Flooding risk
17 Water consumption
18 Biodiversity net gain
19 Biodiversity natural capital
20 Creating social value
21 Positive community relations
22 Customer experience (the end user, not the client)
23 Schools engagement
24 Creating skills and employment opportunities locally
25 Investing in local suppliers and/ or SMEs
26 Responsible data handling
27 Sustainable procurement
28 Ethical conduct
29 Business resilience (climate change/cyber attack)
30 Productivity/efficiency
31 Supply chain health
32 Asset optimisation

Responsible Business Report continued

# Our Responsible Business Commitments

In addition to providing leading edge solutions, operating responsibly and sustainably is a business imperative for Costain. Underpinning our commitments to responsible business are ten actions that all of our people, partners and suppliers must factor into their decision-making, helping us to achieve our 2030 ambitions and positively contribute to the UN SDGs. Our commitment is supported by Costain policies, procedures and enabling strategies and plans (wellbeing, safety and environment (WiiSE), climate change action plan and inclusion strategy).

| Commitments | Actions | 2030 Goals |
|---|---|---|
| Create a greener future | 1 Always a low or zero carbon solution<br>2 Eliminate waste through circular thinking<br>3 Enhance biodiversity value and natural capital | • Carbon net zero on or before 2035, for all operations<br>• Eliminate waste through an active role in the circular economy<br>• Net positive biodiversity impact and increased natural capital value |
| Ensure Costain is a safe, inclusive and great place to work, where everyone can be at their best | 4 Always prioritising the safety of our colleagues and members of the public<br>5 Inclusive and accessible to all<br>6 Enable people to be at their best everyday | • Eliminating all harm<br>• A gender pay gap of <5% and a reduction in our BAME pay gap of 50%<br>• Demonstrable improvement in employee wellbeing as a result of being at work |
| Enhance the value that Costain contributes to society | 7 Work smart and efficiently<br>8 Procure sustainable goods and services<br>9 Customer focused<br>10 Deliver value for our shareholders | • 40% reduction in time on site and 30% reduction in the cost of project delivery contracts<br>• Spend £1 billion with small businesses or voluntary, community and social enterprises (VCSE)<br>• Recognised as a champion for Human Rights<br>• Exceeding all relevant industry regulatory customer satisfaction measures<br>• By aligning Costain to the UN Sustainable Development Goals, we have delivered enhanced shareholder value |

## Improving environmental sustainability with GIS

Geographic Information System (GIS) technology is being used to support Costain contracts to improve environmental sustainability. Incorporating eco-understanding tools in both tendering and developed design we can be aware of potential impacts to the environment, providing clients with a more cost efficient solution. Our GIS models determine biodiversity value, allowing us to optimise design to ensure we are reaching our natural capital targets.

Improving lives and contributing to the UN SDGs:

## Our 2019 performance

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

**$CO_2$ data** $CO_2$ emissions ($tCO_2e$)

13,247 total

'19 13,247
'18 16,703

12,697 scope 1

'19 12,697
'18 15,921

Emissions intensity ($tCO_2e$/£m)

11.37

'19 11.37
'18 11.21

550 scope 2

'19 550
'18 782

**Environmental incident frequency rate** (EIFR)

0.12

'19 0.12
'18 0.13

- Environmental incident frequency rate (EIFR) is at its record lowest
- No major incidents or damage recorded

**Diversity and inclusion**
Equality, diversity and inclusion

2,566 male 834 female

'19 2,566 834
'18 2,845 891

- Year-on-year reduction in gender pay gap to 23.65%
- Named as a Times Top 50 Employer for Women for the second consecutive year

Board members

4 male 3 female

'19 4 3
'18 4 3

Senior Management

36 male 9 female

'19 36 9
'18 45 10

**Accident frequency rate** (AFR)

0.05

'19 0.05
'18 0.03

- Industry leading safety performance
- 16% year-on-year reduction in accidents

**Group charitable giving**

£225,100

'19 £225k
'18 £198k

- Raised over £5,500 supporting the Samaritans Your24 campaign
- Employees volunteered over 4,000 hours in the local community and for good causes

**Considerate Constructors Scheme (CCS) average score**

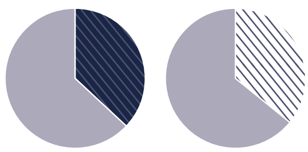
42.3 out of 50

'19 42
'18 43

- Over 20,000 young people engaged through Costain school initiatives
- A14 Cambridge to Huntingdon Improvement Scheme named CCS Ultra site of the year

**Spend with SMEs (small, medium enterprises)**

37% 2019 36% 2018



- 165th SME completed the Costain Supply Chain Academy
- 91% of relevant strategic suppliers have signed the GLAA construction protocol on slavery and trafficking

## Responsible Business

# Engaging with our stakeholders

### WORKFORCE/ COLLEAGUES/ OUR PEOPLE

Our people are our most valuable asset. We rely on their skills, experience, knowledge and diversity to deliver our purpose to improve people's lives.

**How did we engage with them?**

In 2019, we reviewed the way that we engage with our workforce and focused on three key methods of engagement: staff roadshows, monthly leadership briefings and site visits. In addition, we continued our biannual leadership impact days. These events require our senior directors to visit every live project for a half-day shutdown to discuss a key theme impacting our industry. This year's themes were "this year I would like to do more of…", which focused on different ways of working to achieve personal goals, and decarbonisation.

We have extended our employee networks and launched our new religion, ethnicity and cultural heritage (REACH) network, underpinning the four pillars of our inclusion strategy.

See pages 60 and 61 for more detail on how we gave our Board first-hand insight into the key concerns of our people.

### SHAREHOLDERS

Our shareholders' views inform our decision-making, and it is important that they understand our strategic priorities and ambition.

**How did we engage with them?**

In March and August, our chair, chief executive officer, chief financial officer and investor relations director met with potential and existing shareholders to discuss the financial performance of the business.

In July, we held a capital markets day to launch our Leading Edge strategy which was followed by a round of investor meetings to gather feedback on the strategy.

We held our Annual General Meeting in May and gained feedback from our smaller shareholders.

We wrote to our large shareholders in relation to the new remuneration policy (see Remuneration Report on pages 83 to 107).

### CLIENTS

Understanding our clients' changing requirements is fundamental to our success. We support our clients by offering solutions which help them meet their challenges, including in relation to the environment.

**How did we engage with them?**

We obtained regular feedback from our clients to ensure that we are consistently delivering high performance standards.

We hosted numerous site visits and conferences and extended invitations to our client teams to attend stand down days on our projects. We also attended client events and meetings and our representatives sit on numerous forums and boards.

We conducted a materiality assessment with clients and stakeholders to help us to align our sustainability priorities (see page 33).

See page 61 for more detail on how our Board engaged with one of our key clients, United Utilities, in a visit to their offices.

See page 34 for further information on our responsible business commitments.

### OUR SUPPLIERS

Our suppliers are key to our ability to deliver leading edge solutions for our clients. It is important for both us and them to understand each other's cultures and methods of business.

**How did we engage with them?**

Costain has a dedicated supply chain management team responsible for our supply chain relationships.

Throughout 2019 we continued to invest in relationships with our supply chain and complete regular 'business-to-business' meetings to create a platform to enhance our collaborative relationships.

Supplier performance reviews are completed quarterly on all contracts for all strategic and preferred supply chain partners with an average performance review score of 68% in 2019.

We have continued to run our supply chain academy, offering best practice guidance across a range of topics to our supply chain partners.

We have also provided webinars for our supply chain to engage with and understand our new supplier relationship management (SRM) system.

### COMMUNITIES AND ENVIRONMENT

We value the opportunity to engage with our local communities. We aim to make a positive contribution to our environment and generate social value as a result of our work in our local communities.

**How did we engage with them?**

All Costain contracts have an appointed community relations representative and many contracts have a dedicated engagement specialist to fulfil this important role. Our community/customer contacts are proactively managed using social media, public hotlines and through the production of written notifications.

We are a partner of the Considerate Constructors scheme and our projects sign up to their code of considerate practice, ensuring we maintain exceptional standards of community engagement.

Many of our projects have visitor centres that welcome members of the community to drop in to meet with members of the site team. We want to make a positive contribution to our local communities and create partnerships with external organisations to help maximise the impact that we can make. In 2019, we worked with The Prince's Trust, Centrepoint, STEM Learning, Career Ready, Samaritans and The Wildlife Trust.

## Our commitment to stakeholders

We set out below our key stakeholder groups and how and why we engage with them. Each stakeholder group requires a tailored engagement approach to foster effective relationships. By understanding our stakeholders and listening to their views and feedback, we can factor into Board discussions the potential impact of our decisions on each stakeholder group and consider their needs and concerns. The below and page 69 of the Corporate Governance Report on Principal Decisions show how the directors have performed their duty under Section 172 Companies Act 2006 to have regard to various stakeholder factors.

**Signed by the Board,** 11 March 2020

### What did we talk to them about?

- Our new Leading Edge strategy.
- Company results.
- Career ambition and progression.
- Safety, wellbeing and sustainability.
- The importance of having an inclusive culture, where all employees are valued equally, allowing everyone to reach their potential.
- Climate change and the impact of carbon emissions.

### Outcomes

- Launched our new wellbeing, safety and environment (WiiSE) and inclusion strategies and our climate change action plan.
- Focused on promoting flexible working across our business, encouraging all business operations to consider how their working patterns could be made more agile.
- Included in 2019 The Times Top 50 Employers for Women list for the second consecutive year.

### What did we talk to them about?

- Our new leadership team and Leading Edge strategy.
- Our five service lines, the organisation of our business and the market opportunities.
- Our financial results, which we presented to shareholders and provided opportunities for our shareholders to ask questions to better understand our business performance.
- Our new remuneration policy.

### Outcomes

- Shareholder feedback received twice per year via our brokers, which we review to ensure we are addressing shareholder concerns.
- Production of our annual report to help investors and other stakeholders understand our business and the performance in the year.
- Launched business strategies including WiiSE, inclusion, responsible business commitments and our climate change action plan to provide better understanding of our environmental, social and corporate governance.
- Submission of new remuneration policy to shareholders for approval at the 2020 AGM.

### What did we talk to them about?

- Our performance.
- Their strategy, business priorities, principal risks and opportunities with a view to ensuring we are aligned to meet their needs.
- Sustainability priorities.
- Sustainability risks and opportunities, such as climate change and social value.

### Outcomes

- Client satisfaction score of 87%, demonstrating a year-on-year improvement from 86% in 2018.
- Reviewed our 2025 sustainability strategy in line with outcomes of materiality assessment and have launched our new responsible business commitments as a result of this in early 2020.
- Engaged with our own carbon specialists to approve a climate change action plan, setting out how our business will decarbonise and become a net zero business by 2035 at the latest.

### What did we talk to them about?

- Modern slavery and ethical labour.
- Diversity and inclusion.
- Supporting our environmental goals and reducing carbon emissions.
- The roll out of our SRM system.
- Innovation and knowledge sharing.

### Outcomes

- Fifteen SMEs supported through our supply chain academy, completing 22 modules of free industry best practice training, including a dedicated module on slavery and human trafficking awareness. To date 165 SMEs have been through our academy.
- 91% of relevant strategic supply chain partners signed up to the GLAA Construction Protocol committing to action on modern slavery.
- Rolled-out our SRM system which digitises our supply chain management by bringing supplier registration, business assurance and performance reporting into one place and will improve two-way communications between us and our suppliers.

### What did we talk to them about?

- Changes to working conditions and provided updates on our progress.
- Matters that arise in relation to our operations that may affect our stakeholders, which we discussed in an open and honest way.
- STEM initiatives at a local level, to support the future generation of technologists and engineers. We also feature on the U-Explore careers platform 'Start'.
- The local environment, pollution and archaeology.

### Outcomes

- Attained the sixth highest company average score in the industry-wide Considerate Constructors Scheme.
- Implemented a new Legacy Action Plan process and database to maximise social value.
- Rolled out a system to help projects better manage interactions with local communities.
- Climate change action plan which you can read more about at www.costain.com

Operational Review

# Structured for growth with a focus on client and market alignment

## Under our 'One Costain' operating model we have reorganised our divisional structure into two core divisions of 'transportation' and 'natural resources'

### Transportation

The transportation division had revenue in the year (including joint ventures and associates) of £722.9 million (2018: £1,004.1 million) and an underlying operating profit of £9.7 million (2018: £41.4 million). The revenue reduction results from the lower level of large capital project delivery compared to the prior year. The profit in the division has been impacted by the lower revenue, increased investment in work winning and technology capability and a charge of £20.0 million following the assessment of the adverse impact of an arbitration decision on the A465 contract. The underlying operating margin in the year was 1.3% (2018: 4.1%), increasing to 4.1% excluding the impact of the A465 charge.

As at 31 December 2019, the division had a forward order book of £3.1 billion (2018: £3.3 billion) including a £1.1 billion share of the HS2 southern section main works contracts.

#### Highways

The Government, through Highways England, has made a substantial investment in the highways sector during its first Road Investment Strategy (RIS) cycle which ends in March 2020. During this period, well over 100 new highway projects have been introduced by Highways England to tackle the challenges of safety, congestion, connectivity and climate change. This investment is set to continue into RIS 2 (2020-2025) which provides good visibility of earnings in this sector.

Our services in the highways sector cover the full range of our integrated capabilities to achieve the outcomes of enhancing safety, increasing capacity and reducing congestion on the UK's roads. We deliver for both national highway infrastructure operators such as Highways England and the Welsh Government and sub-regional and local government organisations including Transport for London and local authorities.

Costain is known as one of the UK's most experienced providers of smart motorway solutions, working with Highways England to deliver the physical infrastructure and also develop the camera, radar and electronic signage technologies needed to enable such schemes in a safe, reliable and sustainable way.

The highways market is expected to evolve quickly in the coming years as the need for improved connectivity between vehicles and infrastructure, together with the switch to greener fuels, places new demands on the providers and operators of highway networks. We are already responding to these challenges, playing a leading role in the Midlands Future Mobility testbed project, and the A2/M2 Connected Corridor project, where specially-equipped vehicles can interact directly with roadside infrastructure.

We continue to deliver large capital investment programmes on critical sections of the road network, including the A14 Cambridge to Huntingdon Improvement scheme, which remains on-budget and on-time for completion in 2020. Part of the scheme opened one year early to traffic in December 2019 and is already delivering benefits to road users and the local community.

To support improvements in increasing local capacity and connectivity we have started work on two new large schemes. In the Northeast, construction work has started on the A19 Testo's junction improvement work and in the Northwest we have started the Preston Distributor Road contract.

Work is continuing to complete the A465 Heads of the Valleys road on the fringe of the Brecon Beacons National Park, a complex and environmentally sensitive project, that will radically improve East-West communications and help to unlock the economic potential of the region. As previously reported, the project has experienced significant additional scope and we continue to look to resolve the associated impact on the cost and schedule in accordance with the contractual process. During the year, a specific contractual matter was determined at arbitration, which partially reversed the decision of a previous adjudication and was contrary to the legal advice received by the Group concerning the relevant provisions of the contract. As a consequence, an assessment of the implications of this determination has been made and the appropriate allowance included in the results for the year. The Group is engaged in discussions with the Welsh Government to reach agreement on a financial settlement.

We are currently providing design, pre-construction and construction delivery services to Highways England through its Regional Delivery Partnerships in northern England and the East of England and have started work on a scheme to improve sections of the A1 in Northumberland.

We also have four long term asset maintenance contracts working with Highways England and East Sussex County Council, helping our clients to optimise the life and performance of their existing infrastructure.

Within the highways sector there is a high level of work winning activity, and we are playing a key role in leading a number of innovation and technology-led solutions contracts to meet the changing needs of road-users and the country.

## Rail

Network Rail, the operator of the mainline railway in the UK, has started its latest five-year Control Period (CP6) and in doing so has also been implementing a substantial change in its operating model, moving the business to one which puts its passengers first and is structured to complement having stronger aligned relationships with the train operating companies. This restructuring has had some impact on the market environment and the timing of the procurement of some services and schemes.

In 2019, we secured the delivery contract for Gatwick Station, a significant enhancement project in the Southeast of England, which is jointly funded by Network Rail, Gatwick Airport and the Department for Transport, and delivers improved capacity and connectivity for Gatwick Airport.

**CASE STUDY**

### Connected Digital Roads

We are working with Highways England and automotive industry partners to accelerate the UK's journey to naked, connected, digital roads. We are developing integrating technology to enhance the accuracy and reliability of information displayed in vehicles. This will help drivers adjust to road conditions, improving safety and traffic flow. This advances the UK's connected and automated mobility journey and paves the way for enabling vehicles to adjust automatically to road conditions, reducing the need and therefore the cost of installing and maintaining road signage and gantries and extending traffic smoothing benefits to the entire road network, reducing journey times, safety hazards and air pollution from stop start traffic.

Operational Review continued

# The integration of our transportation activities is already creating opportunities

In partnership with Jacobs Engineering, we have secured a place on one of Network Rail's three multi-disciplinary national design and consultancy frameworks which provides Costain the opportunity to support Network Rail in shaping a number of its future business solutions.

During the year we completed a number of strategically important contracts including London Bridge Station, a flagship redevelopment for Network Rail, which is already transforming the journeys of the 50 million passengers who travel through this station every year; and in Scotland, the electrification project to upgrade the railway lines between Stirling, Dunblane and Alloa is substantially complete with the new fleet of electric trains entering service on time and now providing both performance and environmental benefits on this route.

Our work on High Speed 2 has continued to progress. Our enabling works contract in joint venture with Skanska for the southern section of the route has involved the significant preparatory works for the new railway. Under our main works contract in joint venture with Skanska and Strabag we have substantially completed design services for the southern section of the route with an expectation to start construction in the first half of 2020.

Activities to complete Crossrail (the Elizabeth Line) have continued throughout the year at Bond Street and Paddington stations and on our extensive tunnel systems contract, in line with the supplemental agreements reached with the client.

We have continued to develop the 'Meerkat' system for unguarded level crossings in conjunction with Network Rail and expect to begin deploying the system in 2020. Meerkat is a technology developed by Costain that combines trackside radars, a photovoltaic charging system, and warning lights and sirens at pedestrian crossings. The aim of this system is to eliminate the accidental death or injury of those using unguarded crossings and represents a significant safety improvement for Network Rail, with potential to bring wider benefits to other rail clients.

### Aviation

Our activities in aviation are focused on working across the key regional airport network to support improvements to enhance capacity and efficiency of operations. We have recently secured a number of consultancy opportunities including a technical services framework, carbon management and programme management services.

## Natural resources

The natural resources division had revenue in the year (including share of joint ventures and associates) of £434.4 million (2018: £479.8 million), with an underlying operating profit of £15.4 million (2018: £18.7 million), a net margin of 3.5% (2018: 3.9%). The reduction in revenue and profit reflects the lower level of activity in energy following the completion of our Hinkley contract and in water as we move from AMP6 to AMP7.

As at 31 December 2019 the division had a forward order book of £1.1 billion (2018: £0.9 billion), reflecting wins of £0.6 billion in 2019 including some significant contract awards within the regulated AMP7 cycle in the water sector. This higher quality order book will enable sustainable growth in margins.

### Water

We are now in the final year 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, estimated through the life of the contract and finalised at the end of the programme. We are in constructive dialogue with the client to resolve this outstanding commercial matter.

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 started in 2019 with overall completion scheduled for 2024.

**Number of consultancy contracts won in the year**

150+

**Recognised by the Financial Times as one of the UK's leading Management Consultancy companies**

FT FINANCIAL TIMES

**Number of disciplines across our technology and consultancy capabilities**

33

Tender activity for AMP7 advisory, asset delivery programmes and capital maintenance programmes has continued through the year, with several key opportunities now secured. The focus has been to provide innovative solutions, exploiting our deep domain knowledge, expertise and digital technology solutions to optimise existing asset infrastructure. This has enabled us to secure long-term frameworks with new clients as well as continuing our trusted long-term relationships. As a result, the water sector has diversified its service offering and breadth of clients in line with our strategy:

- We were awarded a place on the capital delivery framework for AMP7 for Severn Trent Water and have now mobilised our design, construction and consultancy expertise to undertake renewal and refurbishment projects along with the detailed design and build of capital projects.
- We were also pleased to announce that we have been selected with our joint venture partner MWH to extend our relationship with Southern Water for the delivery of the AMP7 investment programme.
- Mobilisation started in June and delivery is now well underway for the management and delivery of asset maintenance services through our role as the sole Maintenance Service Provider for United Utilities.
- In line with our strategy we are delivering a broader range of consultancy services including an ECI contract with United Utilities to support its flagship Manchester and Pennines resilience project and specialist, targeted assurance for Yorkshire Water's AMP7 capital investment programme through our health and safety assurance consultancy framework contract in joint venture with Arup.

## CASE STUDY


### Hydrogen and carbon capture and storage

We are currently providing strategic consultancy support to Pale Blue Dot Energy in support of the Acorn carbon capture and storage (CCS) project in Scotland; this could be the UK's first CCS project. Costain is providing concept design and front-end engineering design support, including onshore processing, gas systems and offshore subsea systems design for the CCS hub at the existing St Fergus site, ultimately maximising delivery efficiency of the wider Acorn CCS project. This will not only enable the cost efficient carbon capture and storage of current carbon emissions from the onshore gas facilities at St Fergus, but is also a key enabler for the Acorn Hydrogen project where North Sea natural gas will be reformed into clean hydrogen and used in transport applications as well as blended into the gas grid to decarbonise heating in homes and industries throughout the UK.

Operational Review continued

# We have diversified our service offering in line with our Leading Edge strategy

## Energy

This year, we brought together our energy services and activity (previously reported as power, oil and gas and nuclear) to create an integrated energy team focused on supporting the decentralisation and decarbonisation of energy generation and transmission in the UK. The focus on our competitive positioning in the market has Costain targeting services to:

- increasingly shape the future energy solutions, including unlocking the future of hydrogen production and transmission, carbon capture, and enhanced production techniques
- exploit our process engineering, programme management and digital skills in supporting our clients to develop their new solutions and deliver programmes of work
- support clients to optimise the performance of their existing infrastructure
- deliver programmes of work through strategic frameworks.

This focus takes advantage of attractive market opportunities to grow our position, where we have a successful differentiated offer; and consequentially we are continuing to not pursue future EPC design and build contracts.

Throughout the year we continued to develop the hydrogen market in the UK. We secured several notable consultancy and advisory contracts, looking at carbon capture and storage as well as hydrogen blending, which is a pivotal enabler to unlocking the hydrogen economy.

We are working with Scottish and Southern Electricity Networks and E.ON to improve network resilience in rural parts of the UK by focusing on resilience as a service, in a first of its kind project in the UK. Following a successful bid into Ofgem's Network Innovation Competition (NIC), which provides funding of over £9.5 million, we are developing a leading-edge digital energy solution to maintain and improve reliability, providing customers with a low carbon, cost-effective and secure electricity supply.

Our contract for the upgrade of National Grid's Peterborough and Huntingdon compressor stations has experienced significant change and additional scope which has impacted on the forecast target cost and schedule for the completion of the works, expected in 2021. We, and the client, are working to an agreed project level escalation process that includes a requirement to demonstrate our entitlement regarding the compensation events. Costs on the project have doubled due to additional scope and at this stage only a limited proportion of the associated £90.0 million reforecast outturn cost has been formally agreed. Supported by external advice, we believe that we have strong entitlement to recover the costs to date and remaining costs to be incurred over the next 18 months.

In the period, we have continued to secure new consulting contracts for our gas process technology service offering and a number of strategic development consultancy services, with some £4.0 million of consultancy contracts for the energy market. This will see Costain shaping the future for sustainable operations and improved efficiencies at several UK onshore gas terminals by providing engineering design services. The contract awards also include topside modification projects for several subsea tie-backs in the North Sea, both at front-end engineering design (FEED) and pre-FEED phases as well as providing subsea engineering support to nuclear sector projects. Other work secured involves the pre-FEED for a carbon capture usage and storage project that includes the onshore and offshore dimensions.

We also continue to secure and provide a range of asset management, programme management, training, commercial, engineering and other advisory services for strategic contracts with National Grid and Cadent.

In the period, we have completed the marine jetty at Hinkley Point C and agreed the final account for the project. Our contract with EDF Energy to provide consulting and project controls services across their portfolio continues to grow and we continue to support the development of a programme management office in preparation for the defueling and decommissioning of the existing EDF nuclear reactor fleet. 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.

### Defence

Our focus in the defence market is to drive value for money outcomes and optimise delivery for our clients with improved ways of working across the defence equipment and infrastructure areas.

The development of the defence sector builds on work over recent years as a strategic advisor to clients such as DE&S, AWE, BAE Systems and Rolls Royce. This experience has provided us with a solid platform to grow in this market.

We continue to support our clients through improving complex programme management on major infrastructure schemes, project controls and delivery as well as providing vital assurance capability. For example, we continue to roll out programme, portfolio and project management (P3M) leadership training to key personnel at our clients' organisations and have introduced a digital enterprise platform for improved project controls on a major defence programme.

Our programme management contract for AWE continues to meet performance expectations, allowing us to secure further 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 contractor teams

## Alcaidesa

Revenue in this non-core division in the period was £5.6 million (2018: £5.4 million) with a £0.7 million operating loss (2018: £0.7 million operating loss).

In December 2019, the Group announced the sale of its ownership of two golf courses, land and a club house in Cadiz, Spain. The Group is also seeking a purchaser for its 624-Marina Concession. The disposal and potential sale will complete the Group's strategy to divest its non-core business assets in Spain.

### CASE STUDY

**Collaboratively transforming programme management at Rolls-Royce Submarines**

Jointly we worked with Rolls-Royce Submarines to help transform their programme controls capability. We provided strategic consultancy and advisory services to achieve:

- improved clarity of resource demand
- a robust project control system
- improved confidence of delivering to cost and schedule
- more effective workforce capability through better PM processes
- the ability to meet emerging requirements, such as Earned Value Management (EVM) reporting capability across all programmes.

Chief Financial Officer's Review

# Continued momentum in securing new work

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

*"The Group continues to have a positive net cash position"*

**Anthony Bickerstaff**
Chief Financial Officer

## Overview

In 2019, the Group's financial performance was impacted by several factors which resulted in a reduction in underlying operating profit and earnings per share. In June 2019, the Group experienced delays to the timing of a number of contract start dates and new awards and a significant contract was cancelled, impacting expected profitability by c £16.0 million. In December 2019, the Group's profit was reduced by a further £20.0 million following the assessment of the impact of an arbitration decision on the A465 contract.

Revenue, including share of joint ventures and associates, was £1,162.9 million for the year to 31 December 2019 (2018: £1,489.3 million). Reported revenue, excluding share of joint ventures and associates, was £1,155.6 million for the year (2018: £1,463.7 million). The reduction in revenue results from a lower level of capital project activity, in line with our strategic change in mix of activities, and the delay in contract starts and a contract cancellation.

The Group's underlying operating profit was £17.9 million (2018: £52.5 million) with the reduction in the period due to the factors set out in the opening paragraph. Reported operating loss for the year was £(3.2) million (2018: £43.1 million reported operating profit), with the significant reduction due to the lower underlying operating profit and the adverse impact of other items as set out below.

Underlying profit before tax for the year was £14.6 million (2018: £49.7 million). Underlying basic earnings per share amounted to 13.5 pence (2018: 38.2 pence).

Reported loss before tax for the year was £(6.6) million (2018: £40.2 million reported profit before tax). Reported basic loss per share was (2.7) pence (2018: 30.9 pence earning per share).

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. During the year, the Group's divisional structure has been reorganised to create greater client focus and align with growing market opportunities. The Group operates with two core divisions of 'transportation' (rail, highways and aviation) and 'natural resources' (water, energy and defence). The Group's segmental results are being presented on this new divisional basis, including a re-presentation of the 2018 divisional results.

## 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. 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 and deferred consideration treated as an employment expense. In 2019 other items also include a one-off charge of £9.7 million in respect of an arbitration award in favour of

**Strong order book**
£4.2bn

**Year-end net cash**
£64.9m

**Underlying operating profit**
£17.9m

Diamond Light Source Limited for the cost of remedial works deemed required to the roof at the National Synchrotron facility and a one-off aggregate charge of £8.9 million for the loss on disposal and an impairment adjustment for the Group's non-core business assets in Spain. In 2018, other items included an exceptional one-off pension charge in respect of a 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 £3.7 million (2018: £3.2 million). The interest payable on bank overdrafts, loans and other similar charges was £3.3 million (2018: £3.1 million) and the interest income from bank deposits and other loans and receivables amounted to £0.9 million (2018: £0.4 million). In addition, the net finance expense includes the interest income on the net assets/liabilities of the pension scheme of £0.1 million (2018: £0.4 million cost) and an unwind of discount on deferred consideration of £0.1 million (2018: £0.1 million). The net finance expense in the 2019 financial statements also includes the interest expense on lease liabilities of £1.3 million following the adoption of the new accounting standard IFRS 16.

## Tax

The Group has a tax credit of £3.7 million for 2019 (2018: £7.4 million charge). The tax credit arose due to the release of a provision against overseas tax liabilities that were concluded during 2019 (£1.5 million shown in Other Items) and reassessment of provisions held against deferred tax assets which management now consider to be recoverable, together with permanent items and other prior year adjustments. It is anticipated that the effective tax rate will return to a normalised basis from 2020.

In 2018, the accounting treatment of research and development expenditure credits was changed to include the credits as grant income in operating profit (previously these were included as a deduction from the tax expense). Changes to estimates of prior year research and development expenditure credits were disclosed in operating profit as 'other items', giving rise to a credit of £2.6 million in 2018.

## Dividend

Recognising the importance to the Group of maintaining a strong and growing capital base, following the proposed equity raise, Costain will target a dividend cover of around three times underlying earnings, taking into account the free cash flow generated in the period.

Consistent with the rationale for the proposed equity raise, the Company will pay no final dividend in respect of the year ended 31 December 2019, therefore resulting in a total dividend paid for the year, including the interim dividend, of 3.8 pence per share (2018: 15.15 pence). The first dividend to be paid under the new policy is expected to be an interim dividend for the six months ending 30 June 2020, payable in October 2020.

## Shareholders' equity

Shareholders' equity decreased in the year to £157.7 million (2018: £182.3 million). The movements are detailed in the consolidated statements of comprehensive income and expense and changes in equity in the financial statements. The decrease in the year includes the re-measurement of the Group's legacy pension scheme defined benefit obligations to reflect current market-based assumptions and the final dividend payment for 2018.

The Board has concluded that it is in the best interests of the Group to raise up to £100 million to strengthen the Group's balance sheet. Further details on the proposed equity raise, which has been fully underwritten on a standby basis, are contained in a separate announcement made on 11 March 2020.

## New accounting standard – IFRS 16

The new accounting standard, IFRS 16 leases, is applicable to Costain's financial statements in 2019 and full details of the impact of the new standard are included in a note to the financial statements.

# Chief Financial Officer's Review continued

## Pensions

As at 31 December 2019, the Group's pension scheme surplus in accordance with IAS 19, was £4.9 million (2018: £4.2 million deficit). The position of the scheme has improved in the year because the Company contributions and a liability reduction from using more recent mortality tables more than covered increases in net liabilities due to market movements and liabilities because of member experience over the year. The table below sets out the key details of the pension scheme deficit calculation.

In accordance with the pension regulations, a triennial actuarial review of the Costain defined benefit pension scheme was carried out as at 31 March 2019 and an updated deficit recovery plan has been agreed with the Scheme Trustee. Under the terms of the plan, from 1 April 2020 to 31 January 2029, the Group is required to make: (i) cash contributions of £10.2 million per annum (increasing annually with the Consumer Price Index) (the 'Shortfall Correction Contribution'); and (ii) if, in any year, the total dividend amount paid by Costain exceeds the 'Shortfall Correction Contribution', an additional contribution equal to such excess. Any additional payments in this regard would have the effect of reducing the recovery period in the agreed plan.

## 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 advisors the best estimate of GMP equalisation to the Group was an increase of £8.6 million on the reported pension liabilities at 31 December 2018. This increase in liabilities represents a past service cost and was recorded as a pre-tax exceptional expense in the 2018 income statement, shown within 'other items'. From 2019 any change in relation to this additional liability is included within the remeasurement of retired benefits within the consolidated statement of comprehensive income and expense.

## 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 of 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 directly to all suppliers, including the Group, that join the trust deed. 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 net cash balance of £64.9 million as at 31 December 2019 (2018: £118.8 million); comprised of a positive cash balance of £180.9 million (2018: £189.3 million), including cash held by joint operations of £83.5 million (2018: £84.5 million) and borrowings of £116.0 million (2018: £70.5 million). Approximately £35.0 million of the net cash balance (2018: £30.0 million) reflects positive timing of receipts at the year-end which reversed in the early part of 2020.

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

| | 2019 £m | 2018 £m |
|---|---|---|
| Present value of defined benefit obligations | (812.1) | (752.7) |
| Fair value of scheme assets | 817.0 | 748.5 |
| Recognised asset/(liability) for defined benefit obligations | 4.9 | (4.2) |
| **Principal actuarial assumptions (expressed as weighted averages)** | **%** | **%** |
| Discount rate | 2.05 | 2.80 |
| Future pension increases | 2.85 | 3.00 |
| Inflation assumption | 2.95 | 3.20 |

The cash outflow in the period reflects the positive cash flow from operations and asset sale offset by working capital movements, dividend payments and associated pension deficit contributions. The cash balance also reflects the impact of the one-off charge in respect of the arbitration award in favour of Diamond Light Source Limited for the cost of remedial works deemed required to the roof at the National Synchrotron facility.

During the year, the Group's average month-end net cash balance was £41.2 million (2018: £77.1 million).

The Group has implemented revised processes to ensure that suppliers are paid promptly, with the average time taken to pay invoices reduced to 34 days from 58 days in the same period in 2018, with the associated working capital requirement also impacting the cash position during the period.

## Order book

During the year, the Group secured several new contracts and extensions and the Group's order book was maintained at £4.2 billion (31 December 2018: £4.2 billion).

The 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 order book also includes the estimated value of the associated construction activities.

## Sale of non-core asset

In December 2019, the Group announced the sale of Alcaidesa Holding S.A.U. and its wholly owned subsidiary Alcaidesa Golf S.L.U. which own and operate two golf courses, land and a club house in Cadiz, Spain. The sale was made for a total consideration of €15.2 million and resulted in a loss on disposal of £3.0 million. The Group is also seeking a purchaser for its 624-Marina Concession and during the year has recorded an asset impairment of £5.9 million to reflect the estimated sale value. The disposal and potential sale will complete the Group's strategy to divest its non-core business assets in Spain.

## 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. The Group has banking facilities of £187.0 million with its relationship banks and has agreed that the maturity date will be extended to 24 September 2023, conditional on the completion of the proposed capital raising. These facilities are made up of a £131.0 million revolving credit facility and a £56.0 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 2019 was £122.0 million (31 December 2018: £102.7 million).

## Treasury

The Group's treasury and funding activities are undertaken by a centralised treasury function. Its primary activities are to manage 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 and 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.

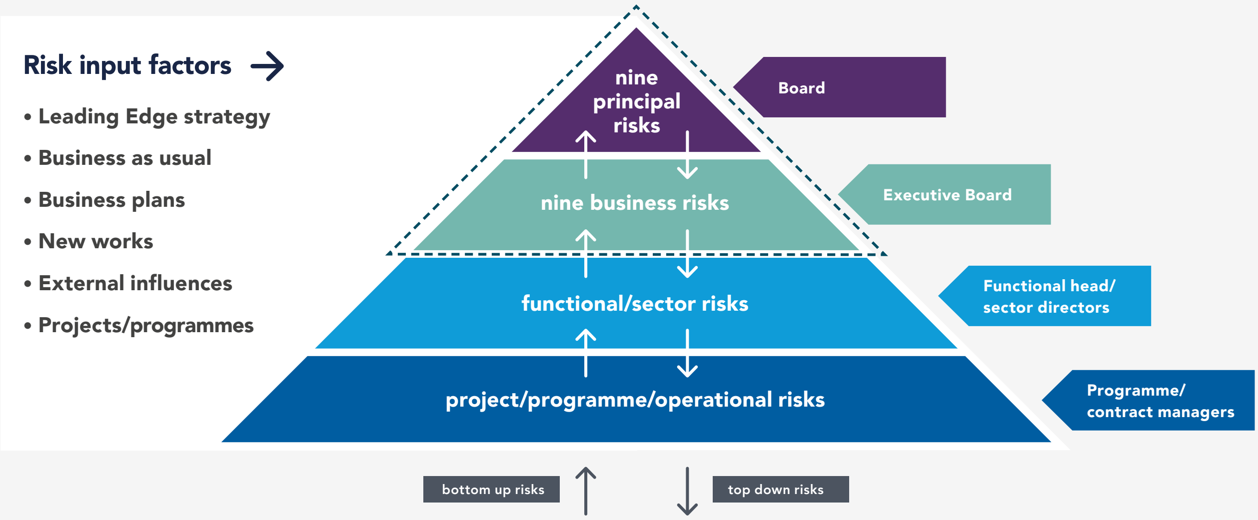
## Interest rate risks and exposure

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 part of which the Group holds the appropriate interest rate hedging arrangements.

Anthony Bickerstaff
**Chief Financial Officer**
11 March 2020

# Principal Risks and Uncertainties

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




### Approach to identifying our principal risks

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 management process.

Risks are identified both top down from the Group strategy and bottom up from the major projects, programmes, joint ventures and ongoing business as usual operational activities. These are then escalated or consolidated (as appropriate) and assessed based on a consistent methodology to identify and prioritise those that could threaten the achievement of the Group's strategic objectives.

### Top down review

All principal risks are integrated with our strategic objectives and these are reviewed by the Executive Board members at various times throughout the year, for example at executive strategy, work winning, finance, and health and safety meetings. A formal bi-annual review of risks by the Executive Board is aligned to half year and year-end reporting. Ongoing discussions are held with the key principal risk owners and their delegates to update the risk status and review progress of response actions together with any supporting metrics to review their effectiveness.

Emerging risks are reviewed and assessed by a Risk Sub-Committee with nominated members from the Executive Board and the Group risk management team.

### Bottom up review

Risk management is embedded at all levels of the business. Sectors, functions, major programmes, projects and operations ensure that their risks can be effectively managed within their boundaries. If they need any additional support or assistance, they can escalate the risk to the next management level right through to executive level where appropriate.

Risk dashboards are updated and reviewed at the various levels within Costain's business to determine the current risk position such as any changes in risk description, their causes, the impact statements and importantly to assess the progress of the mitigating activities.

The flow of risk within our risk management process is illustrated in the diagram above.

## Risk Appetite

Risk appetite which defines the level and types of risk Costain is willing to accept, is set in line with the overall strategy and approved by the Board.

## 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 76 to 79.

To undertake a robust assessment of the risks which could threaten the business objectives, performance, solvency or liquidity of Costain, the Board undertakes reviews of our principal risks and mitigation plans during the year to ensure they are well understood and actively managed to reduce the potential impact.

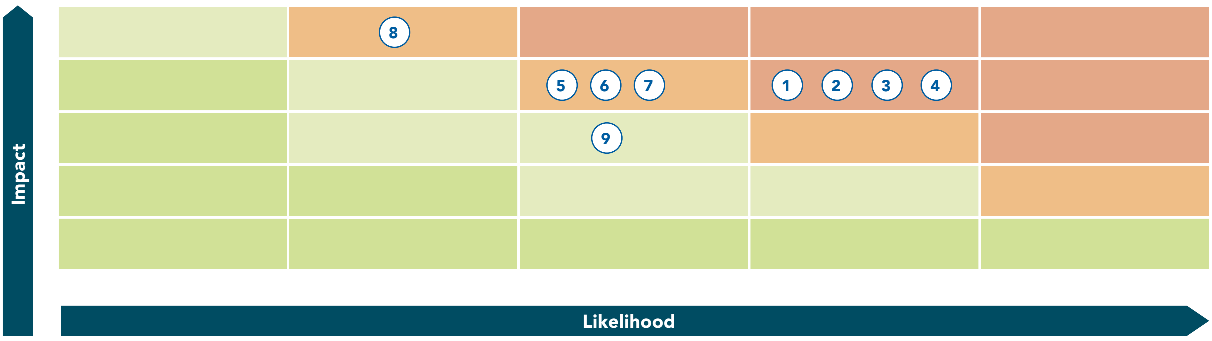
Additionally, our principal risks are formally reviewed and approved by the Executive Board twice-yearly in line with mid-year and year-end reporting.

## 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. Also, as the emerging risks are developed and agreed by the Executive Board they will be included in the principal risk register. This year a new risk manager has been appointed and a Risk Sub-Committee of the Executive Board has been established to provide enhanced senior management oversight of risk including emerging risks within the Group.

## 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 Prevent a major accident/hazard/incident
2 Delivery of the business strategy
3 Maintaining a strong balance sheet
4 Securing new work and contract renewals or cancellations
5 Culture and People
6 Delivery of projects effectively
7 Management of our legacy defined benefit pension scheme
8 Ensure that our technology is robust, our systems are secure and our data protected
9 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 and examples of relevant controls and mitigating factors. Further information on our strategic priorities can be found on pages 26 to 30.

| Principal Risk | Description and impact | Controls and key mitigations | Trend | Strategic link |
|---|---|---|---|---|
| 1 **Prevent a major accident/ hazard/ incident** | Costain operates in complex and hazardous environments. Failure to manage the inherent risks associated with those complex environments may result in a major accident, hazard or incident resulting in injury or loss of life to employees, sub-contractors, clients employees, members of the public and/or damage to the environment. | Safety, health and environment (SHE) management policies and procedures.<br>WiiSE strategy and plans.<br>The Costain behavioural safety programme.<br>Mandated accident and near miss reporting and embedding of lessons learned.<br>SHE governance, monitoring and assurance. | ⇔ | |
| 2 **Delivery of the business strategy** | Failure to deliver the new Leading Edge strategy could affect the Group's ability to develop and strengthen its brand in relation to higher margin services to new and existing clients. If the Group does not successfully implement the Leading Edge strategy or is required to spend more to achieve its strategic objectives, this could have a material adverse effect on its business, financial condition and operating results. | Clear strategy communicated throughout the business with an Executive Board sponsor of each workstream within the implementation plan.<br>Detailed divisional three year business plans setting out pinpointed campaigns and actions to deliver the strategy.<br>Appointment of chief digital officer to accelerate development of technology offering 'Becoming digital by default' allowing for increased competitiveness and accelerating digital growth. | ⇔ | |
| 3 **Maintaining a strong balance sheet** | Maintaining a strong balance sheet is fundamental to demonstrate to clients that the Group has the financial capacity to support any particular contract size and duration. In addition, the Group has a number of facility agreements in place. The continued availability of these facilities is dependent on the Group maintaining a robust balance sheet. | Treasury function experienced in the management and oversight of the bank and surety bonding facilities to deliver finance requirements.<br>A robust joint venture partner selection criteria; all partnerships and alliances signed off by the Board.<br>Work winning contract sign-off processes and project monitoring to manage delivery risk.<br>Monitoring and management of amounts receivable.<br>Effective balance sheet reconciliation process.<br>Continued focus on net asset growth, key areas for continuous development and sustainable pension management.<br>Disposal of non-core businesses. | ↑ | |
| 4 **Securing new work and contract renewals or cancellations** | The success and profitability of the Group is dependent on its ability to identify and secure new work in the energy, water, transportation and defence markets. These markets are highly competitive and as a result the Group may fail to win new contracts in these chosen growth markets. Even where the Group has been successful in winning work, there may be a risk that such contracts are cancelled and/or have changes relating to the scope which may affect the expected revenue to be generated from the order book. | Effective implementation of the Leading Edge strategy aligning our services to meet our clients' changing needs.<br>Evolve our service mix to increase divisional margins.<br>Work as 'One Costain'. | ↑ | |

## Link to strategic priority

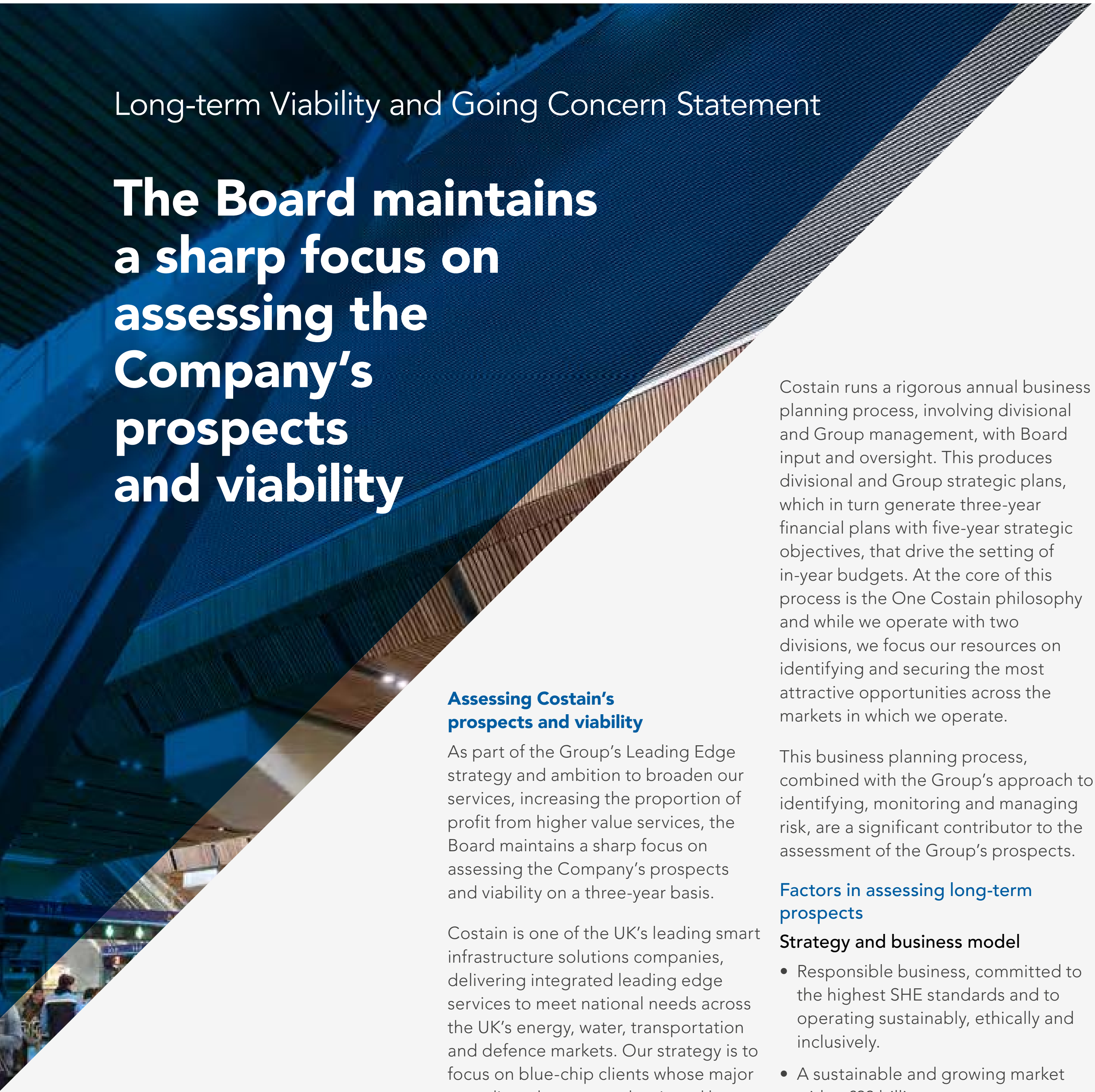
Enhancing our performance

Delivering our skills and capabilities

Delivering innovative solutions

Being a responsible business

| Principal Risk | Description and impact | Controls and key mitigations | Trend | Strategic link |
|---|---|---|---|---|
| 5 **Culture and people** | The development and motivation of our people and leaders are critical factors in the successful execution of our strategy. In addition, we require the right behaviours from our leaders and employees to deliver our business strategy in accordance with our culture and values. | People risk is monitored closely and a comprehensive workforce plan is in place to address the consultancy and technology resource requirements from the sectors and capabilities, building an external brand to attract these resources.<br>Effective succession planning and competency assessments including an annual talent review process undertaken across the business.<br>Learning and development spend aligned to the strategy eg consultancy, sales development programme.<br>Group inclusion strategy in place with targets to improve diversity. Wellbeing targets included in WiiSE strategy and wellbeing steering group, people strategy under review. | ↔ | |
| 6 **Delivery of projects effectively** | The Group bids for and enters into a variety of contracts that span a number of years. Failure to deliver these projects effectively could adversely affect the contract margins that the Group seeks to achieve and also the Group's reputation, business, results of operations and future revenue streams. This may be affected by unexpected operational issues or difficulties resulting in delivery failures, additional unbudgeted work required to complete the project, and failure in the performance of obligations by joint venture partners, sub-contractors and service providers. | Assessment of capabilities required for delivery and performance management of project delivery resources.<br>Weekly/monthly performance review process incorporating standard reporting at project, sector, division and Group levels using PMO oversight.<br>Divisional operating director accountability in addition to contract leaders.<br>Work winning tender gate process with set delegated authorities including Investments Committee approvals.<br>Risk/commercial assessments being undertaken prior to contract start.<br>Monitoring supply chain with strategic and preferred supplier status.<br>Central PMO established and used as a control process to target key and major programmes to improve programme delivery, confirm financial out-turns and identify any concerns affecting successful delivery.<br>Implementation of additional reporting systems to enhance the management of consultancy and technology development. | ↔ | |
| 7 **Management of our 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. | A third-party pensions expert provides independent advice.<br>Monitor the funding position of the scheme via quarterly funding updates provided by scheme's investment consultant.<br>Investment performance monitored and input to the scheme's investment strategy.<br>Regular monitoring in conjunction with the trustee of asset performance, pensions regulations, Company covenant and liability management. | ↔ | |
| 8 **Ensure that our technology is robust, our systems are secure and our data protected** | It is critical that our technology is robust, our systems are secure and our data protected. Effectiveness, availability, integrity and security of IT systems and data are essential for Costain's operations. | An information security strategy integrates information systems, personnel and physical aspects to prevent, detect and investigate information security threats and incidents.<br>Process in place to engage with key technology partners and suppliers to ensure potentially vulnerable systems are identified and updated.<br>Annual penetration tests and 24-hour threat monitoring.<br>Combining the ISO 27001:2013 accreditation to the annually reviewed Cyber Essentials Plus accreditation.<br>Deploy information classification model into production use, classifying data as public, internal communication, confidential or highly confidential. | ↔ | |
| 9 **Anticipate and respond to changes in client circumstances** | Failure to recognise or understand clients' changing buying behaviours and requirements, particularly in emerging sectors or where we have new clients. In 2019 we have seen an increasing focus on climate change, delivering to budget and digitisation. A failure to understand and respond may result in a loss of market share or reputational damage. | Monitoring of competitors and clients via Costain intelligence.<br>Implementation of focused marketing campaigns.<br>Identification of a shaping service offering supported by divisional strategies.<br>Use of external market advisors to maintain our situational awareness of changing market drivers.<br>Capture client perception and net promoter score via assessment of service quality reviews. | ↔ | |



Long-term Viability and Going Concern Statement

# The Board maintains a sharp focus on assessing the Company's prospects and viability

## Assessing Costain's prospects and viability

As part of the Group's Leading Edge strategy and ambition to broaden our services, increasing the proportion of profit from higher value services, the Board maintains a sharp focus on assessing the Company's prospects and viability on a three-year basis.

Costain is one of the UK's leading smart infrastructure solutions companies, delivering integrated leading edge services to meet national needs across the UK's energy, water, transportation and defence markets. Our strategy is to focus on blue-chip clients whose major spending plans are underpinned by strategic national needs, regulatory commitments, legislation or essential performance requirements. Our integrated services are aligned with our clients' changing needs, driven by rapidly changing markets which offer the potential for sustainable long-term growth. Our addressable market is c £23 billion per annum, with a stronger backdrop to UK infrastructure with the new majority Government.

Costain is strategically positioned for future growth with an established and trusted brand, long term strategic relationships with blue-chip clients, highly focused and experienced management team and a broadening mix of skills and diversity across our workforce.

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 with five-year strategic objectives, 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 in which we operate.

This business planning process, combined with the Group's approach to identifying, monitoring and managing risk, are a significant contributor to the assessment of the Group's prospects.

## Factors in assessing long-term prospects

### Strategy and business model

- Responsible business, committed to the highest SHE standards and to operating sustainably, ethically and inclusively.
- A sustainable and growing market with c £23 billion per annum addressable spend and a stronger backdrop to UK infrastructure with the new majority Government.
- Long-term strategic relationships with blue-chip clients leading to £4.2 billion order book encompassing a broader range of services and 90% repeat orders.
- Focused Leading Edge strategy which aligns our integrated services to our clients' changing spend patterns, targeting an increase in the proportion of higher value services to enhance margins over the medium term.

- Proposed new equity capital raising of up to £100 million fully underwritten by HSBC, Investec and Liberum on a standby basis, to strengthen the balance sheet and enable the Group to capitalise on the growing infrastructure market opportunities.
- A rigorous work winning gate process where we actively manage risk of client selection, opportunity and contract form, adopting the 'One Costain' philosophy.
- Robust financial management; fundamental to win work, invest and drive sustainable business growth.

### 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.

### Structured strategic and financial planning process

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

To create these plans, each division assesses external factors – market spend and emerging 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, with five-year strategic objectives including targets for key accounts and strategic campaigns, resourcing and skills planning 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 Group's principal risks and testing several severe but plausible scenarios that could impact the Group. These downside scenarios reflect a combination of circumstances, including the potential impact of a significant decline in activity resulting from an inability to secure new work, loss of reputation from a major safety incident or data breach and associated fines, the impact on working capital decline arising from a major dispute on contract delivery, the loss of key management and inability to recruit the right capabilities, and a change in Government sentiment impacting investment and procurement programmes. The Board undertook this assessment in the context of macroeconomic and political risks affecting the UK economy, including Brexit.

The base case projections prepared for going concern and viability show adequate headroom for the group, stress testing this with an aggregation of severe and prolonged scenarios creates a downside case where the headroom on the committed facilities is adequate, but on the leverage covenant becomes limited. Therefore in order to provide greater flexibility and headroom, and for the Company to take advantage of market opportunity, the Board has concluded
it would be prudent to take steps to conduct a capital raise to strengthen the balance sheet of the Group.

### Impact of Covid-19

We are closely monitoring the coronavirus situation, are following Government guidelines and sharing these with colleagues. We have robust business continuity procedures in place to cover all aspects of our operations in a scenario such as this which are regularly tested. We are prepared to take action to deal with this situation as it changes. We have considered the potential impact of Covid-19 in our scenario analysis.

### Viability statement

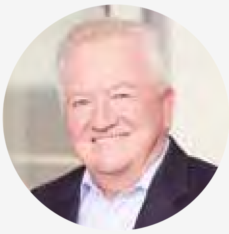
Under the UK Corporate Governance Code, the directors have assessed the prospects of the Group over a longer period than the 12 months required by the 'Going Concern' provisions. Based on the results of this analysis, the Board confirms that it has a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three-year period to 31 December 2022, and, subject to shareholder approval, will be conducting a capital raise to strengthen the balance sheet of the Group.

### Going Concern

The Group's going concern statement is detailed in note 2 of the consolidated financial statements on page 130.

## 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) and a member of the Prime Minister's Council for Science and Technology (2010–2019).

**External appointments**
Non-executive director and chair of the safety, environment and health committee of National Grid plc, board member of the ERA Foundation and chairman of the National Air Traffic Services (NATS Holdings Ltd).

C

### Alex Vaughan

BSc (Hons) FRICS,
Dip IoD, FIoD

Chief Executive Officer

**Appointment**
May 2019

**Skills and experience**
Alex Vaughan was appointed CEO in May 2019. Prior to this he was managing director of the natural resources division with responsibility for Costain's services to water, oil and gas and power clients as well as the development of client facing technology solutions across the Group. He held this position from 2013. Alex 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).

**External appointments**
Chair of the CBI regional council.

### 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.

C

## 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), Cobham plc (2011-2020) and e2v technologies plc (2013–2017) where she was senior independent director.

**External appointments**
Non-executive director and chair of the Remuneration Committee at TT Electronics plc and the British Standards Institute and non-executive director of Cairn Energy PLC.

C

## David McManus

BSc

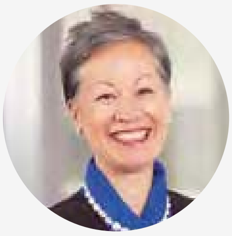
Independent Non-Executive Director

**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 a non-executive director of Cape plc (2004–2012), where he served as chairman from 2006 to 2008, a non-executive director of Rockhopper Exploration plc (2010–2019), where he served as chairman from 2016 to 2019 and a non-executive director of Caza Oil & Gas Inc. (2011–2015).

David will step down from the Board at the conclusion of the AGM on 7 May 2020.

**External appointments**
Non-executive chairman of FlexLNG and Genel Energy plc 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 AO World Plc and 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 FDM Group (Holdings) 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**
June 2011

**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 2011 and also has responsibility for 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 Alex Vaughan, focuses on running the business and delivering the Group strategy. The members are:**

### Darren James

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

Chief Operating Officer

**Appointment**
September 2008

**Skills and experience**
Darren James was appointed chief operating officer in May 2019. He previously 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 transportation and natural resources divisions. Additionally, he 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.

### Dr Maxine Mayhew

FioD, PhD

Managing Director – natural resources

**Appointment**
November 2018

**Skills and experience**
Maxine Mayhew was appointed managing director of the natural resources division in May 2019. She joined the business in 2017 and previously held the positions of water sector director and Group capability director, responsible for Costain's capability including technology, consultancy, complex delivery and asset optimisation. 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**
Non-executive director for Karbon Homes and 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.

**Board of Directors profiles**
See pages 54 and 55.

## Alex Vaughan

BSc (Hons) FRICS,
Dip IoD, FIoD

Chief Executive Officer

## Anthony Bickerstaff

FCCA

Chief Financial Officer

## Tracey Wood

LLB

General Counsel and Company Secretary

## David Taylor

FRICS, FIoD

Group Commercial Director

**Appointment**
January 2015

**Skills and experience**
David Taylor joined the Company in 2009 and was appointed to the Executive Board as 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 procurement functions. David is also executive sponsor for the delivery of operational excellence across the Group's portfolio of complex delivery projects.

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

David is a Fellow of the Institute of Directors and a Fellow of the Royal Institution of Chartered Surveyors.

## Catherine Warbrick

Group HR Director

**Appointment**
September 2019

**Skills and experience**
Catherine joined Costain in 2006 and has performed a number of roles, most recently as director of learning and development and corporate responsibility and prior to that as investor relations director. Highlights of her career with Costain include developing and implementing the Group's first Corporate Responsibility (CR) strategy, achieving Platinum status in Business in the Community's CR Index in 2013 and driving change to achieve the Group's recognition in the Times Top 50 Employers for Women 2018 and 2019, and being cited as a game changer in 2019 for Costain's work on gender parity in early careers recruitment. Catherine graduated with an honours degree in Environmental Science.

## Nathan Marsh

BSc Econ Hons

Chief Digital Officer

**Appointment**
October 2019

**Skills and experience**
Nathan Marsh was appointed chief digital officer in October 2019. He has over 20 years' experience working in digital transformation with a particular focus on shaping and enabling digital capabilities across the UK's critical national infrastructure. Nathan is experienced in leading client and consulting teams to design and deliver programmes and businesses with new commercial structures, leveraging technology and new operating models across sectors including government, digital infrastructure, future mobility, defence, capital markets and strategic risk transfer. He has helped author the Connected and Autonomous Mobility Sector Deal, Robotics and Artificial Intelligence Sector Deal and The Rail Sector Deal. His career history includes working with at SNC Lavalin & ATKINS, McKinsey & Co, EY and AON and seven years as an Army officer.

**External appointments**
Nathan's appointments have included: Zenzic Advisory Board, CBI AI and Digital Ethics Advisory Board, CBI Digital Transformation Advisory Board, Bristol Robotics Laboratory Advisory Board and the St Gobain Global Advisory Board.

Governance Report

## Chair's Introduction

# The Board has ensured robust governance practices across the Group

**Dear shareholder**

In this challenging year, the Board has continued its focus on maintaining the highest standards of corporate governance across the Group to support the implementation of our Leading Edge strategy, by promoting integrity and openness, valuing diversity and being responsive to the views of shareholders and wider stakeholders.

The Board recognises the value of good corporate governance to long-term sustainable success and welcomes the changes brought about by the 2018 UK Corporate Governance Code (the 2018 Code) which is applicable for the first time this year and with which we have been compliant.

### Leadership and strategy

In March 2019, we announced Andrew Wyllie's intention to retire and stand down as chief executive. He was replaced by Alex Vaughan after the AGM on 7 May 2019.

In July 2019, Alex brought to the Board for consideration his new 'Leading Edge' strategy, aimed at enhancing stakeholder value by more closely aligning our integrated services with our clients' changing, long-term infrastructure needs. As part of this review, the Board looked at our purpose 'to improve people's lives' and vision 'to be the UK's leading smart infrastructure solutions company', to ensure these continued to be aligned to our new Leading Edge strategy and our culture, which the Board agreed they do.

### Engaging stakeholders

It is important Costain builds trust by forging strong relationships with shareholders and key stakeholders. In the lead up to the introduction of the 2018 Code, the Board took the opportunity to review stakeholder engagement and you can see from pages 36 and 37 how the Board is meeting this new requirement.

In particular, with regard to workforce engagement, the Board decided to use the extensive range of existing activities that were already in place. Current engagement mechanisms include non-executive directors attending staff roadshows to participate in a panel question and answer session, site visits and, when applicable, reviewing the results of staff engagement surveys.

COSTAIN GROUP PLC BOARD OF DIRECTORS

**Governance Highlights**

**Board Evaluation**
See more on page 71

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

**Stakeholder Engagement**
See more on pages 36 and 37

*"The Board has continued its focus on maintaining the highest standards of corporate governance in support of the Leading Edge strategy"*

**Paul Golby**
Chairman

### Board evaluation

This year the Board again undertook an internal evaluation. The evaluation focused on the significant challenges faced by the Board during the year and also identified a number of areas for the Board to focus on in 2020 as it continues to oversee the implementation of the Leading Edge strategy. The results of this review can be found on page 71.

### Board developments and diversity

Alex's appointment as chief executive officer on 7 May 2019 was in accordance with the Board's succession plan and included an extensive internal and external search process led by Russell Reynolds Associates. Full details of this process are included in the Nomination Committee Report on pages 80 to 82.

There were no other Board changes in the year. On 6 February 2020, we announced that David McManus, non-executive director, will be stepping down from the Board with effect from the conclusion of the AGM on 7 May 2020 after six years of dedicated service.

The Nomination Committee has continued its focus on executive and senior leadership succession planning. We spent considerable time assessing the talent pipeline and identifying the skills needed to support our Leading Edge strategy and business long-term. For example, Nathan Marsh joined the Company on 2 October 2019 in the new position of chief digital officer and member of the Executive Board. Catherine Warbrick was appointed as Group HR director on 23 September 2019. Further details are included in the Nomination Committee Report on pages 80 to 82.

As described on page 81, 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 currently have 33% (three of nine) of our Executive Board being female. It is important that we continue to build a diverse pipeline within the business, not just in relation to gender but also to social and ethnic backgrounds, and cognitive and personal strengths.

### Remuneration

Our current remuneration policy was approved at our 2017 Annual General Meeting with over 98% of votes in favour of it, and we are required to submit our new policy for approval at our 2020 Annual General Meeting. The Committee considers that the policy continues to be fit for purpose, and appropriately supports our strategy. Therefore, the overall framework will remain the same, and there will be no changes to the quantum of variable pay. However, we are taking the opportunity to update aspects of the policy to provide further alignment with best practice, including the introduction of the 2018 Code. In determining the new policy, we have taken into account the shareholder experience during 2019, and in particular the impact on the share price. Our approach to the new policy has been to maintain our ethos of rewarding performance, and to further align the interests of executive directors with those of shareholders. We consulted with our major shareholders on the proposals prior to finalising them for approval by all shareholders at the 2020 AGM.

Please see the Directors' Remuneration Report on pages 83 and 107 for more information.

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

**Dr Paul Golby CBE**
Chairman

11 March 2020

### 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 2019, the Company is reporting in accordance with the 2018 UK Corporate Governance Code (the 2018 Code) which applies for financial years beginning on or after 1 January 2019, which sets out standards of good practice in relation to the following principles (i) board leadership and company purpose, (ii) division of responsibilities, (iii) composition, succession and evaluation, (iv) audit, risk and internal control and (v) remuneration. The Code is published by the Financial Reporting Council (FRC) and is available on its website www.frc.org.uk. Costain was compliant with the provisions of the 2018 Code in 2019.

The Audit Committee Report on pages 76 to 79, the Nomination Committee Report on pages 80 to 82 and the Directors' Remuneration Report on pages 83 to 107 are also incorporated into this report by reference.

Governance Report continued

Case Study on Board Engagement

# Board engagement with the workforce

**Engagement with and feedback from the workforce are vital to maintaining a sustainable business. This is not limited to Company employees but also includes contractors and agency workers.** We have adopted the following workforce engagement mechanism, being a combination of direct contact and a number of recognised indicators, which allow the Board to interact with a diverse cross section of the workforce through a range of different engagement activities, in compliance with the 2018 Code:

## Staff roadshows

- Staff roadshows are held annually across the country and attended on average by 28% of our employees. In 2019 for the first time a different non-executive director attended each of the four 'Costain in business' roadshows. These events offered the opportunity for staff to hear from the new chief executive officer about the 'Leading Edge' strategy and the expectations on employees to deliver the strategy including the behaviours required such as doing things differently, being curious, getting connected, embracing change and being leading edge in everything we do. The roadshows were also an opportunity to showcase examples of how Costain was bringing its strategy to life and importantly to network with colleagues from around the Group.
- To facilitate two-way communication, a 'question and answer' session with a panel including a non-executive director, the CEO, the chief financial officer, the divisional managing directors and the Group HR director also took place at the end of each roadshow. Questions were raised on the day using interactive technology which safeguarded the anonymity of employees to create a more open dialogue.
- All unanswered questions were subsequently addressed via three videos by each of the CEO, chief financial officer and Group HR director and streamed on the Company's intranet. Additionally, for those unable to attend the events, for the first time a webcast recording of one of the roadshows was also placed on the intranet.
- All Board members present at the roadshows then fed back views raised during the sessions to the next Board meeting which were then collectively discussed.

## Monthly Leadership briefings

Every month the CEO has a 30-minute telephone call with the senior leadership team. The purpose of the call is to update senior leaders on our business performance and priorities, to enable them to better communicate key messages to their teams. The format is a five-minute update with a short leadership message from the CEO followed by a Q&A session.

Those attending the calls then cascade what they have heard with their teams. In 2020, to support a broader level of engagement, we are rotating the chair of the leadership calls, to allow senior leaders to engage directly with other members of the Executive Board.

In addition, the CEO regularly sends out a blog to all staff to keep them updated on matters including examples of delivering the strategy.

Any themes or key messages are then communicated back to the Board by the CEO via his Board Report and weekly updates.

## 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, safety and environmental 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. At the end of each visit the non-executive director completes a form which he or she sends back to the company secretary capturing the key information and feedback from the visit. Relevant themes are then discussed at Board meetings.

| | |
|---|---|
| **Dr Paul Golby** | C412 Bond Street, C405 Paddington, STW – Strensham, M1 J16–13 Smart Motorways, Birmingham roadshow |
| **Jacqueline de Rojas** | C405 Paddington, C412 Bond Street, HS2 Main works, HS2 Enabling works, Maidenhead roadshow |
| **Alison Wood** | BAE Barrow, Worle, Manchester roadshow |
| **Jane Lodge** | STW – Barston |
| **David McManus** | AWE Project MENSA, London roadshow |

### July 2019 Board visit to Manchester

Offsite Board meetings combined with site visits give the directors an opportunity to engage with stakeholders collectively. In July 2019, a three-day Board visit to Manchester was attended by all directors and included:

- a visit to the offices of one of our major clients, United Utilities. The Board was able to engage directly with the client to understand their regulatory background and business challenges. The Board was given a tour of the digital control centre and met members of the Costain team working on the MSP project for the client
- deep dive presentations on:
  - innovation and decommissioning by the Nuclear team
  - hydrocarbon
  - water sector strategy
  - how work winning is supporting the transformation of the business
- presentations by four PhD students on their research sponsored by Costain followed by an informal dinner
- finally, the Board held a Q&A session with those members of our workforce based at our Manchester Office.

## Other

Non-executive directors took part in our Costain Awards Ceremony in January 2019. Each of our non-executive directors also acts as a mentor to a participant on our executive development programme.

## Our Governance Structure

# Delivering effective decision-making and meeting corporate governance standards

**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 here:

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 70.

NOMINATION COMMITTEE

### 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.

AUDIT COMMITTEE

### 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.

COSTAIN GROUP PLC BOARD OF DIRECTORS

## 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.

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.

## 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 seven 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 our senior female management population has increased from 13% to 25% since 2015.

In 2020 succession planning for our senior management population will also consider ethnic diversity, with the aim of increasing the BAME representation in our development programmes. This will build from the launch of our REACH (religion, ethnicity and cultural heritage) employee network and our efforts to increase the voluntary disclosure of ethnicity in our employee data.

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

TOP 50

We were proud to be **named as a Times Top 50 Employer for Women for a second consecutive year** in 2019, as well as receiving a BITC Gender Game Changer award.

**We signed up to the Disability Confident scheme**, being accredited to level one of three and setting a target to reach level two in 2020.

BLACK HISTORY MONTH

**We marked black history month** by holding a celebratory event with clients, colleagues and partners, hosted by our REACH network.

The Costain team led by Alex Vaughan and other senior leaders **participated in Pride parades in London and Manchester**.

## Female representation

| Level | Minimum target by June 2020 | Actual 31 Dec 2019 (%) | Actual 31 Dec 2019 (Number) | Actual 11 March 2020 (%) |
|---|---|---|---|---|
| **Board** | **33%** | **43%** | **3 of 7** | **43%** |
| **Executive Board** | **33%** | **30%** | **3 of 10** | **33%** |
| **Senior Management** | **33%** | **25%** | **9 of 36** | **26%** |

We became a member of Working Families, the UK's work life balance charity, to help us **build a flexible working environment and support people to balance their responsibilities.**

In 2019, **inclusion was incorporated into our safety, health and environment strategy**, rebranded to become our WiiSE (wellbeing, inclusion, innovation, safety and environment) strategy. Putting inclusion at the centre of wellbeing and safety considerations is crucial to addressing cultural and behavioural issues.

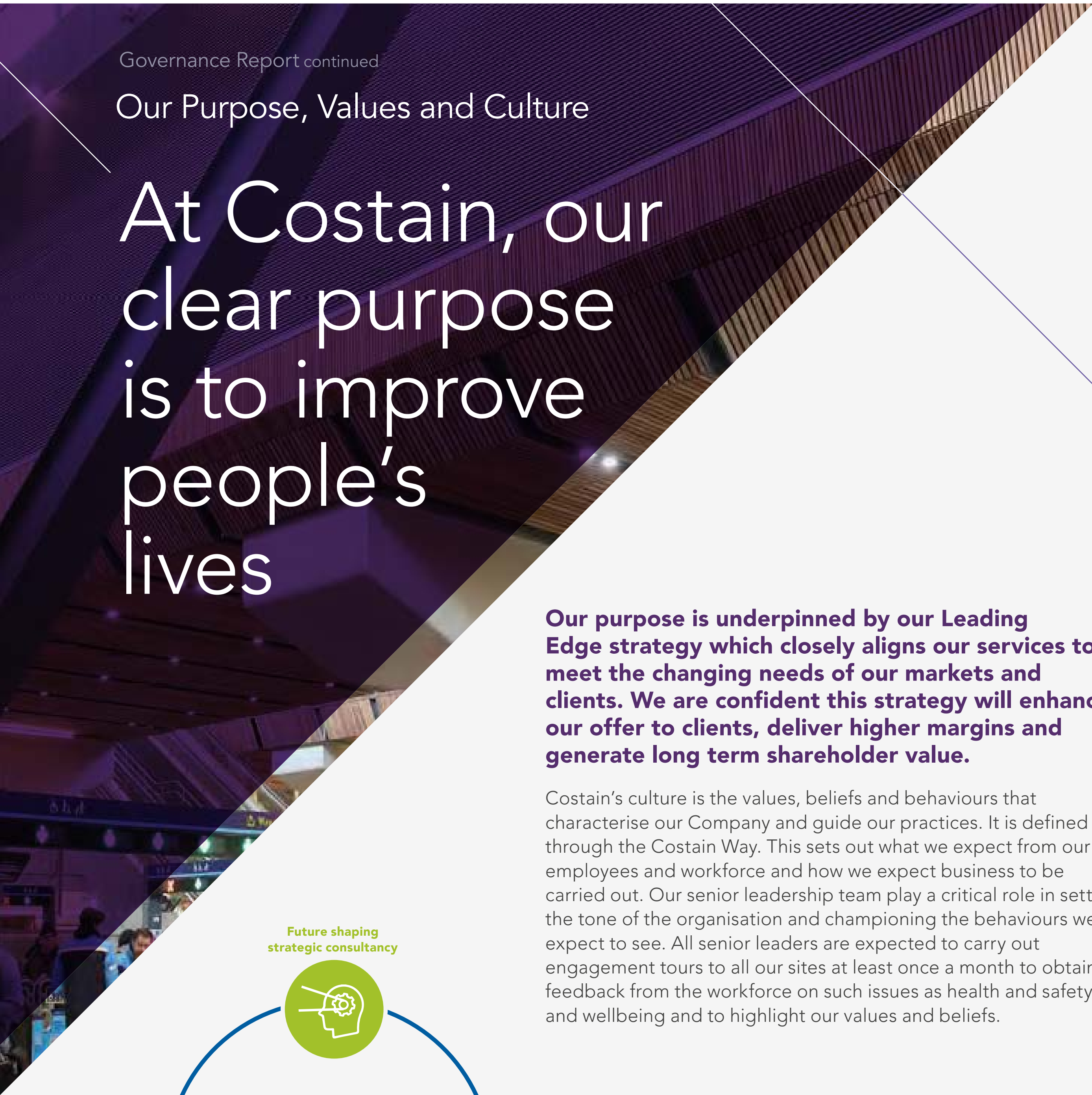
**23.65%**

In March 2020, **we published our third gender pay report revealing a third consecutive year of progression** in reducing our pay gap. At 5 April 2019 our gender pay gap was 23.65% (median) (2018: 24.25%).

**Our efforts to be more diverse and inclusive** were recognised at the IChemE global awards, with Costain winning the diversity and inclusion award.

**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.

**We have worked hard to ensure that development opportunities are accessible to all.** In 2019 39% of participants on our emerging leaders programme were female and 10% BAME. In early careers recruitment 44% of our graduates and 40% of apprentices were female and 21% of our graduates and 30% of apprentices BAME.



Governance Report continued

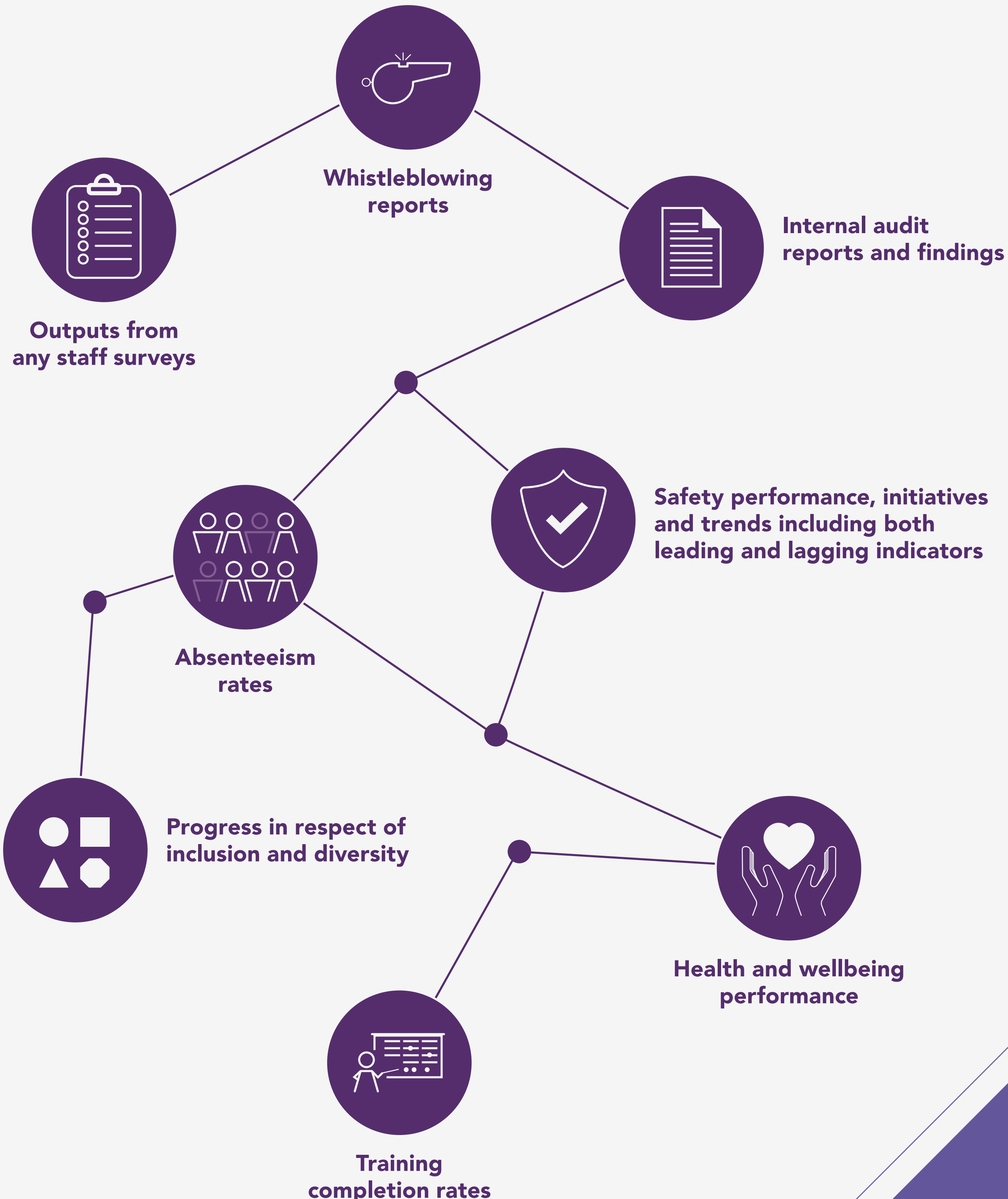
## Our Purpose, Values and Culture

# At Costain, our clear purpose is to improve people's lives

**Our purpose is underpinned by our Leading Edge strategy which closely aligns our services to meet the changing needs of our markets and clients. We are confident this strategy will enhance our offer to clients, deliver higher margins and generate long term shareholder value.**

Costain's culture is the values, beliefs and behaviours that characterise our Company and guide our practices. It is defined through the Costain Way. This sets out what we expect from our employees and workforce and how we expect business to be carried out. Our senior leadership team play a critical role in setting the tone of the organisation and championing the behaviours we expect to see. All senior leaders are expected to carry out engagement tours to all our sites at least once a month to obtain feedback from the workforce on such issues as health and safety and wellbeing and to highlight our values and beliefs.

# Recognised indicators of culture reviewed by the Board and its Committees include:



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 |
|---|---|
| **Business performance and oversight** | Received during the year regular updates on how the business is performing against our strategic priorities and KPIs, and areas of focus for 2020 (see pages 26 to 28 of the Strategic Report). |
| **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 advisors to obtain better visibility of strategic concepts and the market landscape, for example in November 2019, a market update from its financial advisor, Rothschild. |
| **Risk and opportunity** | Taken part in 'deep dive' reviews with our head of internal audit and risk on our principal risks to re-validate these risks and the risk appetite framework. |
| **Culture and governance** | Set and agreed a Board planner for 2019 and monitored progress against this plan.<br>Conducted an internally facilitated Board effectiveness review. Further information about this process can be found on page 71.<br>Approved the Group's Modern Slavery Statement for publication on the corporate website and the Board's Diversity Policy and Gender Pay Gap Reporting.<br>Agreed a schedule of formal and informal NED only dinners. |
| **Talent and people** | Starts every Board meeting with health, safety and wellbeing. Approved the launch of the three-year WiiSE strategy (see page 25).<br>Discussed succession planning and talent development for the chief executive officer and chief financial officer.<br>Talent Reviews – reviewed the current priorities in terms of succession and talent development across the business. Engaged with high potential candidates through presentations and 'deep dives' at Board meetings.<br>Reviewed and discussed the feedback from the staff roadshows.<br>Discussed the Company's gender pay in the context of the wider market.<br>Diversity and inclusion – discussed the action plan to address the pipeline of women and ethnic minorities 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. He promotes high standards of governance and supports and guides the CEO. |
| **Chief executive officer** | The CEO, Alex Vaughan, is responsible for managing the business of the Company through the implementation of policies and strategies as determined by the Board. Alex is responsible for maintaining dialogue with the Chairman, the Group's shareholders and other stakeholders. |
| **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.<br>The senior independent director is Jane Lodge. |
| **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. |

EMPLOYEES INVESTORS CLIENTS SUPPLIERS

## Principal Decisions

In making the following principal decisions, the Board, in accordance with Section 172(1), has considered the outcome of stakeholder engagement (as set out on pages 36 and 37) as well as the need to maintain a reputation for high standards of business conduct and the need to act fairly between the members of the Company.

| Key area of activity | Matters considered | Outcomes | Stakeholder group considered |
|---|---|---|---|
| **Board Appointments** | Succession planning | During the year Andrew Wyllie retired as chief executive and Alex Vaughan moved from his previous role as MD, natural resources, to become CEO. This resulted in several people changing roles and/or new people joining the Executive Board. For example, Maxine Mayhew replaced Alex Vaughan in his previous role as MD, Natural Resources, Darren James was appointed into the new role of chief operating officer and, later in the year, Catherine Warbrick was promoted to Group HR director and Nathan Marsh joined the Company as chief digital officer. | |
| **Strategic review** | Delivery of Leading Edge strategy | Upon his appointment, Alex Vaughan presented to the Board for approval his new Leading Edge strategy. This was then presented externally at a Capital Markets day on 2 July 2019. In approving this strategy, the Board ensured that it could enhance value and that it supported the Company's culture and purpose.<br>The 2020 budget and rolling three year business plan were approved by the Board following a comprehensive review of our strategic priorities and risks to the business by way of three 'deep dives' in October, November and December. The plan takes into account our clients' changing requirements and includes plans for a number of enhanced ways of working. | |
| **Performance of the business** | Trading Updates | In June and December, the Company updated the market on trading after performance had been impacted by a number of factors, as set out on page 36. | |
| | Improve cash generation | The Board considered certain commercial controls and contract management processes. | |
| **Capital Allocation** | Cash flow | The Group's major trading subsidiary, Costain Limited, is a signatory to the Prompt Payment Code. The Board approved revised processes to ensure that suppliers are paid promptly and in accordance with the Code. The associated working capital requirement impacted the cash position during the year.<br>The Board oversaw changes in the Group's cash management process. | |
| | Pension | Over a number of years, the Board has sought to address the deficit of the Costain Pension Scheme, a closed defined benefit pension scheme. Following a full actuarial valuation as at 31 March 2019, the Board agreed the updated recovery plan with the scheme trustee resulting in a core cash contribution of approximately £10 million rising in line with CPI. In addition, the Group will continue to make additional contributions so the overall contribution matches the total dividend paid by the Company each year. | |
| | Dividends | At Board meetings in March and August, the Board approved the 2018 final and 2019 interim dividend respectively, having regard to distributable reserves and associated sensitivities, and what it considered, in good faith, to be for the benefit of its members as a whole. | |
| **Corporate Activity** | Sale of non-core asset | During the year, the Board approved the strategy to divest its non-core business assets in Spain. In December, the Group announced the sale of Alcaidesa Holding S.A.U and its wholly owned subsidiary Alcaidesa Golf S.L.U. The Board also approved the future disposal of the 624 berth marina concession in 2020, subject to satisfactory terms. | |
| **Working responsibly** | Sustainability commitment | The Board has adopted an ambition to be carbon net zero on or before 2035 for all operations. Details of how Costain has identified and addressed the material sustainability issues that affect Costain and its stakeholders are set out on pages 32 to 35. | |

Ad hoc meetings were held to discuss the outcomes of the arbitration processes on the A465 contract dispute with the Welsh Government and with Diamond Light Source Limited in relation to the roof at the National Synchrotron facility.

## 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 2019 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 as appropriate to deal with matters between the scheduled meetings such as the results of arbitration processes (see also the Strategic Report on page 22 for more information).

| **Board attendance** | **Board** Maximum 7 | **Audit Committee** Maximum 4 | **Remuneration Committee** Maximum 4 | **Nomination Committee** Maximum 4 |
|---|---|---|---|---|
| **Executive directors** | | | | |
| Andrew Wyllie[1] | 2/2 | 1[a] | 1[a] | 0[a] |
| Anthony Bickerstaff | 7/7 | 4[a] | 3[a] | 1[a] |
| Alex Vaughan[2] | 5/5 | 3[a] | 2[a] | 2[a] |
| **Non-executive directors** | | | | |
| Paul Golby | 7/7 | 4[a] | 4[a] | 4/4 |
| Jane Lodge | 7/7 | 4/4 | 4/4 | 4/4 |
| Alison Wood | 7/7 | 4/4 | 4/4 | 4/4 |
| David McManus | 7/7 | 4/4 | 4/4 | 4/4 |
| Jacqueline de Rojas | 7/7 | 4/4 | 4/4 | 4/4 |

1 Andrew Wyllie retired from the Board after the conclusion of the AGM on 7 May 2019. He attended the Board meeting on that date.

2 Alex Vaughan joined the Board after the AGM on 7 May 2019. He also attended the 7 May 2019 Board meeting by invitation (not included above) as he was not appointed to the Board until after that meeting.

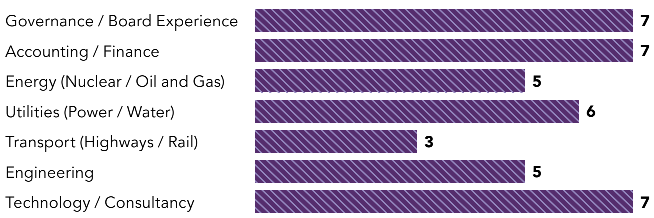
a Not a member of the Committee – attendance at meeting by invitation. Andrew Wyllie and Anthony Bickerstaff did not attend Nomination Committee meetings relating to the appointment of the new CEO.

## 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)




The non-executive directors provide constructive challenge, strategic guidance, specialist advice and hold management to account.

**2017**
**external** evaluation

**2018 and 2019**
**internal** evaluations

**2020**
**external** evaluation

## Board effectiveness

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

For the 2019 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 individually, without the chair present, to appraise the chair's performance and then also met with the chair. The senior independent director then reported the findings back to the February 2020 Board meeting.

After reviewing the outcomes of the Board evaluation process, the chair prepared a summary report that was discussed by the Board. Actions were agreed in the areas of improving risk management, the manner in which the Board challenges management and visibility of action completion via KPIs. 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 the 2017 Corporate Governance Report.

Progress made against the areas of focus that were identified during the 2018 internal evaluation are shown below.

## Board Effectiveness

| Areas of focus identified in 2018: | Action taken in 2019: |
| --- | --- |
| Increasing the visibility of emerging competitors, partners, customers together with the regulatory landscape as markets change | • Recruitment of chief digital officer.<br>• Provision of different perspectives and unbiased challenge via presentations eg by Leo Johnson, PwC on disruptive technologies.<br>• Presentations by senior management on the three-year strategic plan and risks to delivery. |
| Ensuring diversity of perspective and challenge as the Company moves at pace to address changing markets | • Appointment of new chief executive and approval of his Leading Edge strategy together with significant progress towards implementation.<br>• Other changes in senior management such as Group HR director. |
| Engagement with the Group's workforce | • A non-executive director to attend all staff roadshows.<br>• Feedback form to be completed after each director site visit. |
| Succession planning | • Via the Nomination Committee, oversaw the appointment of new CEO and management's development of succession plans. |

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

## Board independence

Having due regard to the results of the internally facilitated 2019 review of Board performance, the Board considers each of its non-executive directors standing for re-election continues 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. On 6 February 2020, we announced that David McManus will be stepping down from the Board with effect from the conclusion of the AGM on 7 May 2020 and will therefore not be standing for re-election at the AGM.

The current terms of appointment of all the directors are set out in the Directors' Remuneration Report on page 104.

At the time of his original appointment in May 2016, the chair, Dr Paul Golby, was considered independent by the Board.

In March 2019, Dr Golby was appointed as a director of the ERA Foundation, a small UK based engineering charity which promotes engineering careers to young people. Paul had stepped down as chair of the Engineering and Physical Sciences Research Council at the end of October 2018 which released more than sufficient time to perform this role. On 6 December 2019, Paul also stepped down as a member of the Prime Minister's Council for Science and Technology. None of these commitments are or were considered significant in terms of the time commitment required to perform them.

Alison Wood became non-executive director of Cairn Energy PLC on 1 July 2019. The Nomination Committee reviewed her time commitments and agreed that this appointment was appropriate.

Jacqueline de Rojas became non-executive director of FDM Group (Holdings) plc on 1 October 2019 having resigned from the Board of AO World PLC on 25 September 2019. The Board considered there to be no expected difference in overall time commitment for this change and therefore authorised the appointment.

## 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 advisors and stakeholders, including the Company's financial advisors/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.

As Alex Vaughan had been with the Company in a number of roles since 2006, he received a tailored induction focused more on building relationships with new external stakeholders and listed company governance in his new position as chief executive officer.

## 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.

### 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.
- Monthly management accounts and regular internal reports.
- Updates on legal, regulatory and governance matters.
- Presentations from external advisors.

### 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 directors 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.

## Operation of the Board

The chair sets the Board's agenda and ensures that adequate time is available for discussion of all agenda items. 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 and high potential employees 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 some 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 (see page 61 for further details).

In addition, between Board meetings, the chair and non-executive directors have access to the chief executive officer, 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 officer, 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 advisors.

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 advisors as and when required at the expense of the Company.

## 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 64 and 65 and in the Nomination Committee Report on page 81.

Details of the Company's Group-wide approach to issues of diversity and equality can also be found on pages 64 and 65 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, when appropriate, the executive directors to take up non-executive positions, with the prior consent of the Board, 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 proposed remuneration policy and how the current policy has been implemented, together with the activities of the Remuneration Committee, are to be found on pages 83 to 107 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 officer 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. The Board routinely 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 officer on the current trading performance and developments within the business. Board members, including the chairs of the Remuneration, Nomination and Audit Committees, attended the 2019 AGM and propose to attend the 2020 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 again by the 2018 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 113 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 77 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, for example in 2019 the half year trading update issued on 28 June.

## 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 Group's going concern statement is detailed in note 2 of the consolidated financial statements on page 130 and 131.

The long-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 48 to 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 to 51 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 79 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 78 of the Audit Committee Report.

# Audit Committee Report

AUDIT COMMITTEE

## Role of the Committee

In accordance with its terms of reference and in compliance with the 2018 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 Company's 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

*"The Committee remains satisfied with the efficiency and effectiveness of the external audit"*

**Jane Lodge**
Committee Chairman

## Governance of the Committee

The Audit Committee (the Committee) is comprised exclusively of independent non-executive directors, with myself acting as Committee chairman. The members of the Committee and details of their attendance at Committee meetings are given on page 70 and their biographies are shown on pages 54 and 55.

The company secretary is secretary to the Committee.

The Company considers that I, as Committee chairman, 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 2019, 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.

- 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
- developing and implementing policy on the engagement of the external auditor to supply non-audit services, considering the impact this may have on independence, taking into account the relevant regulations and ethical guidance in this regard and reporting to the Board on any improvement or action required
- reviewing its terms of reference and its effectiveness from time to time and recommending to the Board any changes required.

### Activities

In 2019, the principal activities of the Committee and the manner in which it discharged its responsibilities were as follows:

#### Endorsement of appointment of new Head of Internal Audit and Risk

The Committee approved the appointment of Elizabeth Tarr as head of the internal audit and risk function, following a thorough and transparent recruitment process overseen by the Committee.

#### 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 2019.

#### Significant accounting matters

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

**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.

#### (A) Significant areas of judgement and estimation

As detailed in note 2 on pages 130 to 140 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:

- Peterborough and Huntingdon compressor stations (see page 42)
- A465 Heads of the Valleys (see page 39)
- Thames Water AMP6
- HS2 Enabling works
- A14
- Thames Tideway Tunnel
- Crossrail Bond Street, Paddington and Systemwide
- Severn Trent AMP6
- M1 J 13–16.

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.

# Audit Committee Report continued

## Activities continued

### Significant accounting matters continued

**(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 22 on pages 167 to 169 of the financial statements.

The triennial actuarial review was carried out as at 31 March 2019 and in March 2020 an updated deficit recovery plan was agreed with the scheme trustee.

**(C) The carrying value of goodwill and intangible assets**

As set out in note 11 on pages 148 and 149 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.

**(D) Going concern and viability statement**

The Company has proposed a new equity capital raise of up to £100 million, which has been fully underwritten on a standby basis. In assessing the going concern assumptions, the Board has reviewed the base case plans, identified downsides, and, in applying these downside scenarios, whilst there is liquidity headroom, absent the anticipated net proceeds from the equity capital raise, there is only limited headroom when compared with the banking leverage covenant. The Committee considered the going concern assumption disclosures. In particular, they considered the fact that a shareholder vote is required to raise additional capital and that the standby underwriting agreement is subject to certain specific conditions which are outside the control of the Company, and the conclusion that these events and conditions indicate a material uncertainty regarding the success of the capital raise which may cast significant doubt about the Group's and Parent Company's ability to continue as a going concern.

The Committee considered the requirements of the Code as it applies to the Group's viability statement including the three-year period of assessment which aligns with the Group's planning horizon and the processes supporting the viability statement. After discussion and having considered the various scenarios that were presented as part of the viability assessment alongside the liquidity and debt positions of the business, the Committee determined that the three-year measurement period continued to be appropriate and that the viability statement (as set out on page 52 and 53) should be recommended to the Board for approval.

**(E) 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 16 (Leases) which first applies for 2019.

The impact on the Group of these standards is explained in note 28 on pages 179 and 180.

## 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 help the Group achieve its strategic priorities. In December 2018, the Committee agreed the 2019 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 Committee chairman 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 a small deterioration overall, largely due to the change in leadership of the function which had very recently taken place at the time of the assessment with temporary resource in place before that to cover a period of transition. Overall, 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 51 in the Strategic Report and page 75 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 whistleblowing 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.

### Effectiveness of the external audit process

Following the end of the 2018 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 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 2018.

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 2019, the Committee considered and approved the external audit plan for the audit of the Group for the year ended 31 December 2019. 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 outlook without sacrificing institutional knowledge. Jonathan Hook has served three years out of five with PwC having first been appointed as the Company's auditor in 2017 following a competitive tender process.

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 2020.

### 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 2019, 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 (2018: 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 out internally and facilitated by the company secretary under the direction of the chair. The effectiveness of the Committee and its chairman 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.

### Whistleblowing and fraud

During 2019, the Committee on behalf of the Board has also considered the confidential reporting and whistleblowing 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**

Committee Chairman

11 March 2020

Nomination Committee Report

# Alignment with the Leading Edge strategy

NOMINATION 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 70 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 officer, Group HR director, members of senior management and external advisors, may be invited to attend meetings as and when it is considered appropriate.

The outcome of all Committee meetings is 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.

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

**Paul Golby**
Chairman

### Role of the Committee

In accordance with its terms of reference and in compliance with the 2018 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.

## Activities

In 2019, the principal activities of the Committee and the manner in which it discharged its responsibilities were as follows:

### Succession planning

With the appointment of an internal candidate as chief executive officer (Alex Vaughan was previously MD, natural resources division), succession planning has continued to be a key area of focus during the year, both in respect of the Board, including both executive directors, 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 Leading Edge strategy which will accelerate the deployment of higher margin services to our blue-chip client base.

During the year, we spent considerable time assessing the talent pipeline including its diversity and identifying the skills needed to support our Leading Edge strategy and business long-term. For example, Nathan Marsh joined the Company on 2 October 2019 in the new position of chief digital officer and a member of the Executive Board to lead the accelerated implementation of Costain's commercial digital strategy, with responsibility for the delivery of Group-wide digital services enhancing the solutions to our clients. Nathan will also represent Costain on key strategic industry groups ensuring we continue to shape the future of digital infrastructure.

Catherine Warbrick was appointed as our new Group HR director on 23 September 2019 having previously held a number of senior leadership roles, most recently as director of learning and development and corporate responsibility and prior to that as investor relations director. Having had relevant experience in these roles, Catherine brings a strong focus on stakeholder engagement and responsible business standards.

In the year under review, the Committee also received updates from 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 to support the development of a diverse pipeline, 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 on pages 64 and 65.

By appreciating and celebrating our differences we are creating a Company that is a more dynamic and inspiring place to be for our employees. We are working hard to ensure that our workforce reflects the diverse communities we serve, and we create an inclusive culture where each employee can truly be themselves at work. Embracing diversity underpins our commitment to providing equal opportunities to our current and potential employees and applying fair and equitable employment practices.

Our directors come from broad industry and professional backgrounds, with varied experience and expertise aligned to the needs of our business.

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 on page 71.

## Reappointment of directors

At the 2019 AGM, for the first time, all our directors (with the exception of Andrew Wyllie who stepped down from the Board from the conclusion of the AGM on 7 May 2019) stood for re-election. In previous Codes this provision had only applied to larger companies.

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' general concerns regarding overboarding. The Committee, on behalf of the Board, is satisfied that all Board members have, and commit, the time required to discharge their roles at Costain effectively. This has been evidenced recently by a period of more sustained Board activity in respect of reviewing the desired financial position of the Company during which each Board member has contributed fully and effectively.

In February 2020, we announced that David McManus, non-executive director, will be stepping down from the Board with effect from the conclusion of the AGM on 7 May 2020 after six years of dedicated service. David has been appointed (effective 6 February 2020), as non-executive chairman of Genel Energy plc.

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**
Chairman

11 March 2020

# Nomination Committee Report continued

## CEO Succession

The Committee has considered executive director succession as part of its routine succession planning for a number of years. After Andrew Wyllie indicated that he was considering retiring, the Committee therefore agreed to identify an individual who, at the appropriate time, should it become necessary, would be able to undertake the role of CEO of Costain.

The Committee, supported by the Group HR director and the company secretary, agreed:

- a specification for the role and responsibilities for a new CEO
- to appoint Russell Reynolds Associates as the external search partner and
- an interview and selection process.

The Committee requested that the Remuneration Committee determine an indicative reward package in line with the remuneration policy for executive directors and the new 2018 Code. With the assistance of Russell Reynolds, a long list of candidates was drawn up for consideration by the Committee. Both internal and external candidates were invited to participate in the process.

Russell Reynolds also undertook both a benchmarking exercise and facilitated personal assessments, including psychometric profiles, to discover both external and internal candidates' skills, potential and further development requirements.

The Committee then considered the formal appraisals of a number of candidates selected from the long-list. A significant number of the candidates met with the chair and some of the non-executive directors. Following the conclusion of these meetings, the Committee met to agree a short list of candidates.

Three candidates were considered for further consideration. All three candidates met with the non-executive directors and the chair.

The Remuneration Committee, with support from the company secretary, worked with Andrew Wyllie to agree a retirement arrangement which was in line with the remuneration policy.

After contractual arrangements had been agreed with both parties in principle, the Board met to consider the recommendations of both the Committee and the Remuneration Committee. They unanimously approved the proposals and on 6 March 2019 we announced Andrew Wyllie's intention to retire and stand down as chief executive and the appointment of Alex Vaughan as CEO with effect from the conclusion of the AGM on 7 May 2019.

Having successfully secured a suitable candidate for the role and discharged its announcement obligations, the Committee tasked the company secretary with formulating transitional arrangements for the outgoing and incoming CEOs which included a detailed induction plan for Alex.

*With the appointment of an internal candidate succession planning has continued to be a key focus for the year.*

Directors' Remuneration Report

# Remuneration at a Glance

## How did we perform in the year?

### Group EBITA[3]

£18.2m

2018: £52.8m

2017: £49.4m

### Group health and safety

0.05AFR[1]

2018: 0.03

2017: 0.07

### Underlying[2] basic earnings per share

13.5p

2018: 38.2p

2017: 32.9p

### Cash flow (Average month end cash balance)

£41.2m

2018: £77.1m

2017: £96.7m

## 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 | Actual pay-out[#] |
|---|---|---|---|---|---|---|---|
| Alex Vaughan[5] | 0% | 5% | 0% | 0% | 13% | 18% | 0% |
| Anthony Bickerstaff | 0% | 5% | 0% | 0% | 13% | 18% | 0% |

# Due to the financial performance of the Group in 2019, the Remuneration Committee exercised its discretion and decided to not award any bonus to the executive directors.

### LTIP – Award achieved by executive directors

| | Aggregate EPS[6] for financial years ended 31 December 2017, 2018 and 2019 (75% of the award) | Cash conversion (25% of the award) | Total Achieved |
|---|---|---|---|
| Alex Vaughan[5] | 88.72 pence (maximum vesting level: 113.6 p or more) | 65% (maximum vesting level 100%) | Nil% |
| Andrew Wyllie[7] | 88.72 pence (maximum vesting level: 113.6 p or more) | 65% (maximum vesting level 100%) | Nil% |
| Anthony Bickerstaff | 88.72 pence (maximum vesting level: 113.6 p or more) | 65% (maximum vesting level 100%) | Nil% |

### Ensuring shareholder alignment

**33%**

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

**100%**

For LTIP grants from 2019, subject to performance targets being met, all LTIP shares vest after three years but will only be released after five years.

**100%** moving to **200%**

Company's Share Ownership Guidelines are currently set at 100% of salary for the executive directors. The target will increase to 200% in the new remuneration policy (see pages 88 to 94).

1 Accident frequency rate.

2 Before other items; amortisation of acquired intangible assets, employment related deferred consideration and other one-off costs as shown on the income statement.

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

4 Measured pre-acquisition and investments.

5 Alex Vaughan was appointed to the Board on 7 May 2019.

6 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.

7 Andrew Wyllie retired from the Board on 7 May 2019 and his award was subsequently prorated with effect from departure from the Company on 6 September 2019.

# Annual Statement by Chairman of the Remuneration Committee

REMUNERATION COMMITTEE

## At a glance summary; executive directors' remuneration

### 2019 variable pay outcomes

2019 AIP award outcome of 18% of maximum opportunity for the executive directors was based on the assessment of performance measures. The Committee, in consultation and agreement with the management team, exercised discretion to reduce the pay-out to nil for the executive directors in light of challenging financial performance during 2019 (see page 97).

The threshold EPS and cash conversion targets under the 2017 LTIP award were not achieved. The 2017 LTIP award therefore lapsed in full (see page 98).

### New remuneration policy

The policy continues to be fit for purpose and appropriately supports the Company's strategy.

The changes proposed are to further align the interests of executive directors with shareholders and to reflect the 2018 UK Corporate Governance Code:

- Formalise inclusion of discretion for the Committee to adjust LTIP vesting levels taking into account underlying business performance and safety, environmental and societal performance.
- Formalise inclusion of two year post-vesting holding period on all vested shares.
- Increase the within-employment shareholding guidelines from 100% of salary (as currently applied) to 200% of salary.
- Formalise inclusion of a maximum pension opportunity for newly appointed executive directors in line with the wider workforce (currently 10% of salary).

### Implementation in 2020

No salary increase awarded to the executive directors for 2020, a decision supported by the executive directors.

Maximum 2020 AIP opportunity equal to 150% of salary subject to a mixture of financial and non-financial performance measures (see page 100). One-third of any AIP award earned is deferred into shares for two years.

Maximum 2020 LTIP award opportunity of up to 100% of salary. Awards will not be granted until after the AGM and the quantum will be confirmed at grant (see page 101). Awards will be subject to EPS performance as regards two-thirds of the award and cash conversion performance as regards one-third of the award over the three financial years ending 31 December 2022 (see page 101 and 102 for further details). This represents a slight rebalance compared to previous years (75% EPS and 25% cash conversion). Any LTIP awards which vest are subject to a two year holding period.

*"We remain committed to a responsible approach to executive pay, continuing to align the interests of executive directors with shareholders"*

**Alison Wood**
Committee Chairman

# I am pleased to present our Directors' Remuneration Report for the year ended 31 December 2019

**This report is split into three sections:**

I. **this annual statement which includes an 'at a glance' summary of the remuneration decisions (see pages 84 to 87)**

II. **the 2020 remuneration policy (see pages 88 to 94), which will be subject to a binding vote at our 2020 AGM**

III. **the Annual Report on Remuneration (see pages 95 to 107), which will be subject to an advisory vote at our 2020 AGM**

### Link to strategy and culture

Our remuneration policy is designed to be simple and transparent, aligned with delivering our Leading Edge strategy, and ultimately supporting the creation of long term sustainable shareholder value.

Our core financial and strategic objectives, critical to the success of our long term transformational strategy, are largely embedded within the executive remuneration framework through the AIP and LTIP.

We hold ourselves accountable to the highest Safety, Health and Environment standards and are committed to operating sustainably, ethically and inclusively. A proportion of the AIP is therefore based on health and safety performance. The executive directors' personal performance objectives under the AIP are also linked to talent development and progressing the Group's inclusion strategy.

### Performance and variable pay outcomes for the year ended 31 December 2019

The 2019 AIP award 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 personal objectives linked to critical strategic and corporate activities.

Under the new leadership of Alex Vaughan, the Group has made good progress with the Leading Edge strategy, including strengthening the executive team with new leadership to support strategy implementation, driving a new sales approach and introducing focused marketing campaigns (further details are set out on pages 26 to 30 of the Strategic Report). The executive directors each earned an AIP award equal to 18% of the maximum opportunity based on assessment against the non-financial performance measures. However, it has been a challenging year for the Group in terms of financial performance given the backdrop of market conditions. The Group delivered EBITA of £18.2 million in 2019 which was below the AIP threshold performance target.
In light of this, the Committee, in consultation with and agreement of the management team, considered it appropriate to exercise its discretion to reduce the AIP award pay-out to nil for the executive directors. Further details are set out on page 97.

The LTIP award granted on 5 April 2017 was subject to EPS performance as regards 75% of the award and cash conversion performance as regards 25% of the award. The threshold performance targets were not achieved and the award therefore lapsed in full. Further details are set out on page 98.

Directors' Remuneration Report continued

# Annual Statement by Chairman of the Remuneration Committee continued

## Remuneration policy

Our current remuneration policy, which was approved by shareholders at our 2017 AGM (with over 98% of the votes cast in favour), is approaching the end of its three year term. We have used this opportunity to review the appropriateness of the policy. Our approach has been to maintain our ethos of rewarding performance and to further align the interests of executive directors with shareholders, meaning that the ultimate reward delivered to executive directors will reflect the longer term returns delivered to shareholders. The key changes which are summarised below reflect this approach, and take into account the 2018 UK Corporate Governance Code and feedback from major shareholders.

| | |
|---|---|
| **LTIP – formulaic outcomes** | Formally include discretion for the Committee to adjust the extent of vesting as determined by the formulaic output of the performance measures in appropriate circumstances (including having regard to underlying business performance and safety, environmental and societal performance).<br>The current policy already includes appropriate similar discretion for the AIP. |
| **LTIP – holding period** | Formally include the requirement for LTIP awards to be subject to a two year post-vesting holding period in respect of the whole of the vested award (an approach that has been applied in practice since 2019). |
| **Shareholding guideline** | Increase the within-employment shareholding guideline from 100% of salary (as currently applied) to 200% of salary, maintaining the requirement that 50% of after tax LTIP and deferred bonus shares are retained until the guideline is met.<br>Our approach to post-employment shareholdings will be to rely on the existing provisions relating to LTIP awards and deferred bonuses. In line with the current policy, we would not expect to release any LTIP or deferred bonus awards to a departing executive director in advance of the originally anticipated release date. |
| **Pension** | Formally include a maximum pension opportunity for newly appointed executive directors in line with the wider workforce (currently 10% of salary).<br>The chief financial officer's pension provision is currently 22% of salary. As part of our policy review we considered whether to seek agreement from the chief financial officer to a reduction in his pension provision, having regard to the terms of the 2018 UK Corporate Governance Code and the views of some shareholders on pension provision for incumbent executive directors. Recognising that this provision reflects a long standing contractual entitlement, and also the importance of maintaining stability within the business, we concluded that no immediate changes should be made. However, the Committee has committed to review this entitlement over the course of the new policy. |

No changes are proposed to the maximum opportunity of the AIP or LTIP, or to the structure of the performance measures. We will retain the flexibility within the policy to award an AIP of up to 150% of salary and an LTIP of up to 150% of salary, but subject to an overall variable pay maximum of 250% of salary.

The Committee has taken into account wider workforce remuneration, culture and engagement when reviewing the remuneration policy for executive directors. The Committee debated and had oversight of key people policies such as performance management, diversity and inclusion – including gender pay reporting, employee engagement and for the first time Costain's CEO:employee pay ratio. Please see pages 103 and 104 for more information.

### 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.

## Reward for the year ending 31 December 2020

In view of current business performance, the chief executive officer and chief financial officer will not receive a salary increase in 2020, a decision supported by them. A 2% salary increase will be applied across the Company in 2020 (effective 1 April) except for the senior leadership team who will not receive an increase.

The maximum AIP opportunity for executive directors will be 150% of salary. The AIP will be weighted 80% as regards financial measures, 10% as regards health and safety measures and 10% as regards other non-financial Group and personal measures. The Committee considers that this weighting appropriately aligns the AIP performance measures with key financial, strategic and workforce based priorities of the business. Details of the AIP performance measures are provided on page 101 and the targets with performance against them will be provided in the 2020 Directors' Remuneration Report.

One third of the AIP earned will be deferred under the SDP.

The maximum LTIP opportunity for executive directors will be up to 100% of salary. The LTIP awards will be granted after the AGM and the Committee will finalise the quantum of the grants at that time having regard to share price performance and market conditions at that time. Vesting will be subject to EPS performance as regards two thirds of the award and cash conversion performance as regards one third of the award. This represents a minor rebalance in weighting compared to recent LTIP awards reflecting that the sustainable generation of cash-backed profits is a key element to the future success of the Company. Details of the LTIP performance measures and targets are provided on page 101.

LTIP awards which vest will be subject to a two year holding period.

There will be no increase in non-executive directors' fees or the chair's fee for 2020.

## Conclusion

We remain committed to a responsible approach to executive pay. We believe the decisions made as a Committee as regards remuneration outcomes in respect of 2019 demonstrate our commitment to ensuring that executive directors' reward is aligned with performance and reflective of returns delivered to shareholders.

We look forward to receiving your support at our 2020 AGM, where I will be available to respond to any questions that shareholders may have on this report, our new remuneration policy or intended approach to reward for 2020.

Alison Wood

Committee Chairman

11 March 2020

### 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.

In this report we describe how the principles of good governance relating to directors' remuneration, as set out in the 2018 UK Corporate Governance Code, are applied in practice. The Committee addressed the factors in Provision 40 of the Code when determining the new policy as follows:

- **Clarity** – remuneration arrangements are simple and transparent and take account of pay policies for the wider workforce. Our decision to make minor refinements to the policy (see below) is, in part, based on the belief that the current arrangements are well understood by internal and external stakeholders.
- **Simplicity** – we follow a conventional UK market approach to remuneration with established incentive plans that operate on a clear and consistent basis.
- **Risk** – performance targets are set to reward sustainable business performance, while not encouraging inappropriate business risks to be taken. Malus and clawback provisions apply to AIP and LTIP awards, and the Committee has the means to apply discretion and judgement to vesting outcomes.
- **Predictability** – details of the potential values that may be earned by executive directors through their remuneration arrangements are set out in the remuneration policy.
- **Proportionality** – the AIP and LTIP performance measures are clearly aligned to the Group's strategic objectives. The Committee takes into account underlying business performance and the experience of shareholders and the wider workforce when determining vesting outcomes, ensuring that poor performance is not rewarded.
- **Alignment to culture** – the Committee reviewed the policy with the intention that it should drive the right behaviours, and reflect the Group's purpose, values and strategy. The Committee will regularly review the remuneration framework to ensure that this continues to be the case.

This report is unaudited unless otherwise stated.

# Remuneration Policy

The Company's policy on the remuneration of its directors is set out on pages 88 to 94 and will be put to a binding shareholder vote at the 2020 AGM. Subject to shareholder approval the policy will take formal effect from the end of that meeting.

Our current remuneration policy was approved at the Company's 2017 AGM with over 98% of votes cast in favour of it. As set out in the Committee chairman's statement on pages 84 to 87, the Committee considers that policy continues to be fit for purpose and appropriately supports the Company's strategy. The changes proposed, which are summarised in the Committee chairman's statement, are to further align the interests of executive directors with shareholders and to reflect the 2018 UK Corporate Governance Code.

## Directors' remuneration policy

The directors' remuneration policy to apply from the end of the 2020 AGM, is set out below.

| Element | Purpose and link to strategy | Operation | Performance metrics | Maximum opportunity |
|---|---|---|---|---|
| **Salary** | • To attract and retain high-calibre individuals.<br>• Reflects skills, experience and performance in role.<br>• 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.<br>• Set with reference to individual performance, experience and responsibilities.<br>• 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.<br>• Increases will usually be in line with average salary increases for the wider workforce (in percentage terms).<br>• Higher increases may be appropriate in certain circumstances, which include but are not limited to, where an individual is promoted or 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** | • To incentivise the achievement of key financial and strategic targets for the forthcoming year without encouraging excessive risk taking.<br>• Promotes greater alignment with shareholders.<br>• To facilitate share ownership. | • Two thirds paid in cash.<br>• Not pensionable.<br>• 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.<br>• 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.<br>• Deferred share awards may include the right to receive a benefit 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 the date on which shares can first be acquired. The benefit may assume the reinvestment of dividends.<br>• 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.<br>• Awards may be subject to malus and clawback as described below. | • The Committee considers and approves the performance measures and targets at the start of each year and ensures they are aligned with business strategy and are sufficiently stretching.<br>• 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.<br>• In setting financial parameters, the Committee takes into account the Company's internal budgets and, where applicable, brokers' forecasts. 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.<br>• The Committee may amend the pay-out if it considers that the level of vesting that would otherwise apply is not appropriate, including where that level would materially deviate from the intention of the policy, is unreflective of underlying financial or non-financial performance of the Group or executive director over the relevant period or is not appropriate in the context of unexpected or unforeseen circumstances. | • Maximum: 150% of salary.<br>• The combined AIP and LTIP maximum opportunities for any year may not exceed 250% of salary. |

| Element | Purpose and link to strategy | Operation | Performance metrics | Maximum opportunity |
|---|---|---|---|---|
| **Long-Term Incentive Plan** | • Aligned to main strategic objectives of delivering sustainable performance which in turn should deliver enhanced returns. | • Annual grant of performance shares, which vest subject to performance measured over three years. Awards may be granted as conditional awards or nil or nominal cost options.<br>• Awards are subject to a further holding period of two years following the end of the performance period.<br>• LTIP awards may include the right to receive a benefit 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 the date on which the vested shares can first be acquired. The benefit may assume the reinvestment of dividends.<br>• 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.<br>• At least 50% of the opportunity will be subject to an EPS performance measure.<br>• Up to 25% of the maximum is earned for threshold performance, 100% for maximum with straight line vesting usually applying between these points.<br>• The Committee has discretion to vary the formulaic vesting outturn if it considers that the level of vesting that would otherwise apply is not appropriate, including where that level would materially deviate from the intention of the policy, is unreflective of underlying financial or non-financial performance of the Group or executive director over the vesting period or is not appropriate in the context of circumstances that were unexpected or unforeseen at the grant date. | • LTIP awards with a face value of not more than 150% of salary.<br>• 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.<br>• 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.<br>• Paid as a cash contribution to the Defined Contribution pension scheme, personal pension arrangements and/or a cash supplement. | • N/A | • As regards Anthony Bickerstaff, 22% of base salary. This will be reviewed over the course of the new policy.<br>• As regards any other executive director, a percentage of base salary not exceeding the pension contribution available to the majority of the wider workforce (which is currently 10%). |
| **Other Benefits** | • To aid retention and be competitive in the market place.<br>• Healthcare benefits to minimise business disruption. | • Company car (or car allowance) and fuel allowance.<br>• Medical insurance.<br>• Life assurance.<br>• Other benefits as appropriate, for example, relocation expenses and travel and subsistence. | • N/A | • N/A |

## Share ownership guidelines

The Company has adopted share ownership guidelines to provide further alignment between the interests of the Board and the Company's shareholders. During employment, executive directors are expected to build and maintain a shareholding worth not less than 200% of base salary. Shares subject to LTIP awards for which the performance period has ended (i.e. which are in a holding period, or which have been released but which are not exercised) and shares subject to SDP awards 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 guidelines are met.

The Committee's policy on post-employment shareholding requirements is to apply the 'leaver' provisions under the Company's share plans (described on pages 91 and 92) as regards both unvested awards which are subject to performance conditions (i.e. LTIP awards which are in their performance period) and vested awards (i.e. LTIP awards which are in a holding period and SDP awards which are in a deferral period).

Directors' Remuneration Report continued

# Remuneration Policy continued

## Notes

### Performance measures

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

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

### Recovery provisions

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

For up to two years following the payment of the cash element of an AIP award, the Committee may require repayment of all or part of the bonus in the event of a material misstatement or error in assessing performance measures which has led to an overpayment of the bonus or in the event of dismissal due to gross misconduct, or in the event of criminal behaviour, serious reputational damage or serious corporate failure. 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 or vested but unreleased LTIP awards) in the event of a material misstatement or error in assessing performance measures which has led to an award vesting to a greater degree than would otherwise have been the case or in the event of dismissal due to gross misconduct, serious corporate failure or serious reputational damage.

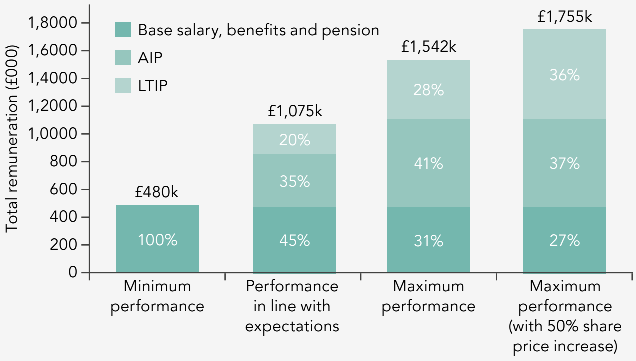
## Incentive plan operation

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

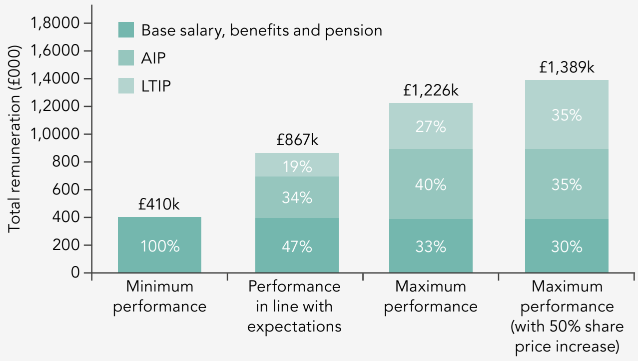
Share awards under the SDP, LTIP and SAYE Scheme (and any applicable performance conditions) may be adjusted in the event of a variation of the Company's share capital or a demerger, special dividend or other event which affects the market price of a share. Share awards under the SDP and LTIP may be satisfied, in whole or in part, in cash, although the Committee has no intention to settle any executive director's award in cash and would do so only in exceptional circumstances, such as where there was a regulatory restriction on the delivery of shares, or to settle tax liabilities arising in connection with the acquisition of shares. Awards 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.

## Illustration of application of Remuneration Policy

### Alex Vaughan




### Anthony Bickerstaff



The charts below set out an illustration of the remuneration that might be received by each of the two executive directors for 2020 under the Policy set out above in four different performance scenarios.

| | Fixed pay | Variable pay | |
|---|---|---|---|
| **Performance scenario** | **Base salary pension and benefits** | **AIP** | **LTIP** |
| Minimum | • Salary effective 1 April 2020<br>• Pension contribution: 10% in the case of Alex Vaughan and 22% in the case of Anthony Bickerstaff<br>• Benefits as paid in 2019 | N/A | N/A |
| On-Target | | 60% vesting (90% of salary) | 50% vesting (50% of salary) |
| Maximum | | 100% vesting (150% of salary) | 100% vesting (100% of salary) |
| Maximum plus share price appreciation | | As with the Maximum scenario, but assuming a 50% share price increase for the purposes of the LTIP element | |

## Service agreements and loss of office

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

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

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

| Executive directors | Date of contract | Expiry date | Termination payment | Remuneration entitlements | Compensation on termination following a change of control |
|---|---|---|---|---|---|
| Alex Vaughan<br>Tony Bickerstaff | 7 May 2019<br>3 March 2006 | Terminable on 12 months' notice. | Base salary plus benefits paid monthly and subject to mitigation. Benefits provided in connection with termination may include for example, pension, outplacement fees, payments in respect of accrued holiday and legal fees. | No other specific entitlements are contained within our contracts. | No additional provisions other than those contained in the 'Termination payment' column. |

The treatment of any incentive payment on termination will be determined in accordance with the rules of the AIP, SDP or LTIP. The principal provisions of the rules are summarised below. SAYE Scheme options may vest on termination in accordance with the Scheme rules, which do not include any discretion on the part of the Committee.

| | |
|---|---|
| **AIP** | Ordinarily, there will be no entitlement to a bonus unless the participant is employed and not under notice at the bonus payment date.<br><br>In the event of termination due to death, redundancy, injury, ill-health, disability or retirement (a 'good leaver') a time pro-rated bonus may be earned. The Committee has discretion to pay the bonus following the end of the year (subject to assessment of the performance measures) or at termination (subject to the Committee's assessment of the performance measures at that time).<br><br>A good leaver will ordinarily only be entitled to a bonus calculated by reference to the proportion of their AIP award which would have been paid in cash, and not to an SDP award. However, the Committee retains discretion to award the SDP element or to pay the whole of the AIP award for the year of termination (and prior year) in cash (after assessment of performance and application of time pro-rating). The Committee would only pay the whole of the bonus in cash where the termination was in compassionate circumstances (such as in the event of death or due to ill-health). |

# Remuneration Policy continued

### Service agreements and loss of office continued

| | |
|---|---|
| **SDP** | In the event of termination due to injury, disability, or any other reason at the Committee's discretion, unvested SDP awards shall continue and vest on the normal vesting date. If a participant dies, their unvested SDP awards will vest at that time.<br><br>Unvested SDP awards shall lapse on termination for any other reason. |
| **LTIP** | *Termination during the vesting period*<br>Unvested LTIP awards will usually lapse on termination.<br><br>However, in the event of termination due to injury, disability, or any other reason at the Committee's discretion, unvested LTIP awards shall continue and vest and be released on the normal timescale, although in the case of injury or disability the Committee may permit the award to be released at vesting. The extent of vesting will be determined by reference to the extent to which the performance conditions are satisfied and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed at the date of cessation.<br><br>If a participant dies, their unvested LTIP awards will vest and be released at the date of cessation, with the extent of vesting determined by reference to the extent to which the performance conditions are satisfied at that date (as assessed by the Committee) and, unless the Committee determines otherwise, the proportion of the vesting period that has elapsed at the date of cessation.<br><br>*Termination during the holding period*<br>If a participant is dismissed during the holding period for misconduct, their award will lapse.<br><br>If a participant ceases employment during the holding period other than due to dismissal for misconduct, their award will continue and be released (to the extent vested by reference to the performance conditions) on the normal release date, although the Committee has discretion to release the award at cessation. |

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

### Recruitment remuneration

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

The Committee will not use its discretion to make payments or awards outside the policy set out above to offer a non-performance related incentive payment (for example a 'guaranteed sign-on bonus').

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

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

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

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

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

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

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

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

Fees payable to a newly-appointed chair or non-executive director will be in line with the fee policy in place at the time of appointment.

### External directorships

The Company encourages executive directors to take up non-executive appointments, with the prior consent of the Company, in the belief that such appointments broaden their skills and the contribution which they can make to the Company's performance. Generally, no more than one such appointment may be undertaken. There must be no conflict of interest and the time devoted to the external appointment must be reasonable in relation to the individual's commitment to the Company. Fees paid for external appointments may be retained by the individual concerned.

### Chair and other non-executive directors

The non-executive directors have letters of appointment. The non-executive directors are appointed for initial three year terms which thereafter may be extended. The appointment of a non-executive director can be terminated by not less than one month's notice on either side without compensation for loss of office. Each non-executive director is subject to re-election at the AGM each year.

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

| Non-executive director | Date of original appointment |
|---|---|
| Paul Golby | 5 May 2016 |
| Jane Lodge | 1 August 2012 |
| David McManus | 12 May 2014 |
| Alison Wood | 1 February 2014 |
| Jacqueline de Rojas | 20 November 2017 |

# Remuneration Policy continued

### Remuneration policy for chair and non-executive directors

| Element | Purpose and link to strategy | Operation | Maximum opportunity |
|---|---|---|---|
| **Fees** | • Attract and retain high performing individuals. | • Remuneration for non-executive directors, other than the chair, is determined by the Board, following consultation between the chair and the chief executive officer. The chair's fee is determined by the Board following consultation between the Committee and the CEO. Fees are reviewed annually and any increase is usually effective from 1 April.<br>• 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 undertaking other roles such as the senior independent director, and chairmanship of the Audit and Remuneration Committees.<br>• Overall fees will remain within the limit set out in the Company's Articles of Association.<br>• 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.<br>• May be entitled to benefits such as travel and subsistence and secretarial support, or other benefits as appropriate. | • N/A |

### Share ownership guidelines

The Company has adopted share ownership guidelines to provide further alignment between the interests of the Board and the Company's shareholders. Non-executive directors are expected to build and maintain a shareholding worth not less than 100% of their annual fee.

### Legacy arrangements

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

### Consideration of employee views

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

### Consideration of shareholder views

The Committee considers shareholder feedback received in relation to the AGM each year at a meeting following the AGM. This feedback, plus any additional feedback received during any meetings from time to time, is then considered as part of the Company's annual review of remuneration policy.

When there are material issues relating to executive remuneration or proposed changes in policy, we engage actively with major shareholders to ensure we understand the range of their views. When significant changes are made within the policy, the Committee Chairman will inform shareholders of these.

# Annual Report on Remuneration

The Annual Report on Remuneration set out on pages 95 to 107 provides details of how our remuneration policy was implemented in the year ended 31 December 2019 and how we intend for the new policy to apply for the year ending 31 December 2020. The Annual Report on Remuneration will be subject to an advisory vote at the 2020 AGM.

## Governance of the Committee

The Remuneration 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 70. 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 advisors 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, noting an additional meeting took place in 2019 to discuss the new remuneration policy.

| Date | Key agenda items |
|---|---|
| **7 February 2019** | Consideration given to the extent to which the performance measures were likely to have been met with regard to the LTIP granted in 2016 |
| | Approved the 2018 AIP annual cash bonuses subject to final audit of the 2018 accounts |
| | Approved the 2019 AIP performance measures and list of participants |
| | Approved indicative performance targets for the 2019 LTIP grant |
| | Noted the automatic vesting of the 2017 SDP Share Awards on 5 April 2019 |
| | Approved the outgoing chief executive officer's remuneration arrangements and the new chief executive officer's remuneration arrangements |
| | Reviewed the chair's and non-executive directors' fees for 2019 |
| | Approved the executive directors' and senior executives' salaries for 2019 |
| | Reviewed the 2018 Directors' Remuneration Report |
| | Approved the Gender Pay Gap Report for 2018 |
| | Reviewed wider workforce bonus structures |
| **3 April 2019** | Granted awards under the SDP relating to the 2018 year-end AIP bonus |
| | Granted awards under the 2019 LTIP with effect from the conclusion of the AGM |
| **14 November 2019** | Confirmed the appointment of Catherine Warbrick as Group HR director, whose appointment the Committee had approved since the last meeting |
| | Reviewed a discussion paper on the new remuneration policy |
| | Reviewed the history of LTIP targets including historical and projected outturns |
| **16 December 2019** | Reviewed the draft proposed remuneration policy |
| | Consideration of proposed timetable for shareholder consultation on the new remuneration policy |
| | Reviewed the proposed performance targets for the 2020 LTIP |
| | Reviewed the proposed 2020 AIP performance measures and list of participants |
| | Determined nil 2020 annual salary increase for the executive directors and Group Executive Board and 2% for the wider workforce |
| | Reviewed a draft of a new workforce pay and policy dashboard |

Directors' Remuneration Report continued

# Annual Report on Remuneration continued

### Advice provided to the Committee

Advice was sought, where appropriate, from a number of sources. During the course of the year, the chief executive officer, 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 £44,520 (2018: £20,100) for the year ended 31 December 2019 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 objective and independent. During the year, Deloitte LLP also provided advice to the Company in relation to the operation of the Company's share plans and employment tax.

### Voting on the Remuneration Report at the AGM in 2019

Last year's Remuneration Report was approved by shareholders with a 99.73% (2018 AGM: 99.58%) vote in favour (including discretionary votes).

### Voting on the remuneration policy at the AGM in 2017

The current policy was approved by shareholders with a 98.24% vote in favour (including discretionary votes) at the Company's 2017 AGM. As above, a new policy is being submitted to shareholders for approval at the 2020 AGM.

### Implementation of policy in the year to 31 December 2019

#### Single total figure of remuneration for each director

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

| | 2019 | | | | | | 2018 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Salary and fees £ | Taxable benefits £ | Pension* £ | Annual incentive £ | LTIP £ | Total £ | Salary and fees £ | Taxable benefits £ | Pension ** £ | Annual incentive £ | LTIP*** £ | Total £ |
| **Executive directors** | | | | | | | | | | | | |
| A Wyllie[1] | 169,983 | 4,622 | 37,322 | 0 | 0 | 211,927 | 479,746 | 13,173 | 105,544 | 453,255 | 496,798 | 1,548,516 |
| A J Vaughan[2] | 275,336 | 9,309 | 27,597 | 0 | 0 | 312,242 | – | – | – | – | – | – |
| A O Bickerstaff | 324,597 | 11,659 | 71,412 | 0 | 0 | 407,668 | 317,852 | 11,673 | 69,928 | 300,292 | 329,181 | 1,028,926 |
| **Non-executive chair** | | | | | | | | | | | | |
| P Golby | 166,460 | – | – | – | – | 166,460 | 163,000 | – | – | – | – | 163,000 |
| **Non-executive directors** | | | | | | | | | | | | |
| J A Lodge | 62,817 | – | – | – | – | 62,817 | 59,551 | – | – | – | – | 59,551 |
| D McManus | 46,817 | – | – | – | – | 46,817 | 45,844 | – | – | – | – | 45,844 |
| A J Wood | 53,817 | – | – | – | – | 53,817 | 52,844 | – | – | – | – | 52,844 |
| J de Rojas | 46,817 | – | – | – | – | 46,817 | 45,844 | – | – | – | – | 45,844 |

1 Retired from the Board on 7 May 2019.

2 Appointed to the Board on 7 May 2019.

* A pension contribution of £3,478 for the period to 7 May 2019 was paid to Andrew Wyllie's chosen pension arrangement and the balance was paid to him directly as a taxable benefit. For the period 8 May 2019 to 31 December 2019 a pension contribution of £6,522 was paid into the Company's Group Flexible Retirement Plan for Alex Vaughan 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.

** 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 vested in April 2019, is based on the share price as at the date of vesting, 8 April 2019, being 355 pence per share. In accordance with the applicable regulations, the value included in the 2018 Directors' Remuneration Report was based on the average share price over the final three months of 2018, being 364 pence per share.

## 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 2019 (for the period to 7 May 2019 for Andrew Wyllie and from 7 May 2019 for Alex Vaughan), and their approximate values, were a car allowance of £4,226 (2018: £12,000) for Andrew Wyllie, £10,500 (2018: £10,500) for Anthony Bickerstaff and £8,546 (2018: nil) for Alex Vaughan, together with private medical insurance for Andrew Wyllie of £396 (2018: £1,173), Anthony Bickerstaff of £1,159 (2018: £1,173) and Alex Vaughan of £763 (2018: nil). This package of benefits was unchanged from 2018.

### (b) Determination of the 2019 annual incentive

The maximum AIP opportunity for the chief executive and the chief financial officer for the year ended 31 December 2019 remained unchanged from 2018 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.

The performance measures established by the Committee for the 2019 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 £61.8 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 2019 financial year. As shown in the table below, the executive directors each earned an AIP award equal to 18% of the maximum opportunity based on an assessment against the performance targets. However, taking into account the overall financial performance of the Group during 2019, the Committee exercised its discretion to reduce the AIP award pay-out to nil for the executive directors.

| | AIP opportunity – maximum percentage of bonus | | AIP award – as a percentage of bonus | | AIP performance measure | | | |
|---|---|---|---|---|---|---|---|---|
| **Performance measures** | **Alex Vaughan*** | **Anthony Bickerstaff** | **Alex Vaughan*** | **Anthony Bickerstaff** | **Threshold** | **Maximum** | **Actual performance** | **% Pay-out** |
| Group EBITA[1] | 50% | 50% | 0% | 0% | £50.6m | £61.8m | £18.2m | 0 |
| Group Health and Safety[2] | 10% | 10% | 5% | 5% | n/a | AFR 0.04 | AFR 0.05 | 0[4] |
| Order Book (level of secured gross profit) | 10% | 10% | 0% | 0% | £73.9m | £90.3m | £61.2m | 0 |
| Cash Flow[3] (average month end cash balance) | 10% | 10% | 0% | 0% | £81.0m | £99.0m | £62.0m | 0 |
| Personal Performance | 20% | 20% | 13% | 13% | see personal performance section below | | | 0[4] |
| **Total** | 100% | 100% | 18% | 18% | | | | 0 |

* Appointed to the Board from 7 May 2019.

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 Discretion exercised by the Committee, in consultation and agreement with the management team, to reduce the pay-out to nil taking into account the overall financial performance of the Group during 2019.

### Personal performance

Personal performance was based on progress towards delivery of the Leading Edge strategy and corporate activities critical to the strategic transformation of the business which were the personal responsibility of the executive directors. The Committee, in consultation and agreement with the management team, exercised discretion to reduce the pay-out to nil for the executive directors in light of challenging financial performance during 2019. Details of the executive directors' performance against their personal objectives are set out below.

# Annual Report on Remuneration continued

## Additional notes to the single total figure of remuneration continued

### (b) Determination of the 2019 annual incentive continued

**Alex Vaughan (from 7 May 2019) and Anthony Bickerstaff**

| Objective | Achievement during the year | Maximum | Award |
|---|---|---|---|
| Technology and consulting | • Appointment of chief digital officer.<br>• Over 150 new technology and consultancy contract wins and an increase in pipeline of opportunities. | 5 | 2 |
| Developing the senior team, including EDI performance | • Successful appointments made to strengthen the executive team, including the appointment of managing director, chief digital officer and Group HR director; and senior succession planning for executive succession.<br>• Significant progress in the implementation of our inclusion strategy including being named as a Times Top 50 Employer for Women for a second year and a game changer for early careers recruitment. We have also increased female representation in our senior leadership team to 25% up from 22% in 2018. | 5 | 5 |
| Transformational change | • Strengthened executive team with new leadership to support strategy implementation.<br>• Driven new sales approach with key account structure, inaugural sales conference, sales training and revised incentivisation structure for sales roles.<br>• Implemented operational excellence model across the Group focusing on maximising productivity and operational effectiveness to enhance margins.<br>• Introduction of focused marketing campaigns.<br>• First robotics processes automation launch and automation academy held with robotics efficiencies delivered. | 10 | 6 |
| | | 20% | 13% |

### (c) Vesting of the 5 April 2017 LTIP award

The LTIP award granted on 5 April 2017 was based on EPS and cash conversion performance for the three years ended 31 December 2019.

Performance against the measures and the resulting vesting outcome is shown below. The threshold EPS and cash conversion performance targets were not achieved and as such the 2017 LTIP award lapsed in full. This includes the 2017 LTIP award granted to Andrew Wyllie for which he was determined a good leaver and the 2017 LTIP award granted to Alex Vaughan prior to his appointment to the Board.

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

| Aggregate EPS for the financial years ended 31 December 2017, 2018 and 2019 | Vesting level for awards |
|---|---|
| Below 101.4 pence | 0% |
| 101.4 pence | 15% |
| Between 101.4 pence and 113.6 pence | 15% – 100% pro rata |
| 113.6 pence or more | 100% |
| Actual performance: 88.72 pence | Vesting outcome: 0% |

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.

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

| Average cash conversion for the financial years ended 31 December 2017, 2018 and 2019 | Vesting level for awards |
|---|---|
| Below 80% | 0% |
| 80% | 15% |
| Between 80% and 100% | 15% – 100% pro rata |
| 100% | 100% |
| Actual performance: 65% | Vesting outcome: 0% |

### (d) Pensions and life assurance

The pension provision for new executive directors is subject to a limit aligned with the wider workforce which is currently 10%. Alex Vaughan's pension was set on this basis. Anthony Bickerstaff's pension provision is 22% of salary and reflects a long standing contractual entitlement. 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 (until his retirement from the Board on 7 May 2019), Anthony Bickerstaff and Alex Vaughan (from his appointment to the Board on 7 May 2019) were £925 (2018: £2,481), £1,816 (2018: £1,644) and £1,544 (2018 nil) respectively.

The Group offers a Group Flexible Retirement Plan which was set up in 2009 with Standard Life for employees and senior management. Alex Vaughan is a participant of this scheme.

### e) Chair

Remuneration for the chair comprised a basic annual fee of £167,280 from 1 April 2019.

### (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 chairmanship of the Audit and Remuneration Committees. The annual fees set with effect from 1 April 2019 were as follows:

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

## Grants made during the year

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

### 2019 LTIP Grant

Grants were made under the LTIP on 7 May 2019. The grant level for the executive directors remained at 100% of salary. The award vests after three years, subject to continued service and the achievement of performance measures (as set out below), but cannot be exercised until 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 2019 LTIP are as follows:

### (A) EPS performance measure (relating to 75% of the award)

| Aggregate EPS over the financial years ended 31 December 2019, 2020 and 2021 | Vesting level |
|---|---|
| Below 128.2 pence | 0% |
| 128.2 pence | 15% |
| Between 128.2 pence and 141.0 pence | 15% – 100% pro rata |
| 141.0 pence or more | 100% |

Directors' Remuneration Report continued

# Annual Report on Remuneration continued

## Grants made during the year continued

### 2019 LTIP Grant continued

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

| Average cash conversion for the financial years ended 31 December 2019, 2020 and 2021 | Vesting level |
|---|---|
| Below 80% | 0% |
| 80% | 15% |
| Between 80% and 100% | 15% – 100% pro rata |
| 100% | 100% |

The share awards granted under the 2019 LTIP are as follows:

| | Number of shares | Face value[1] | End of performance period | Threshold vesting | Weighting (% of award) |
|---|---|---|---|---|---|
| Alex Vaughan | 130,769 | £424,999 | 31 December 2021 | 15% | 100% |
| Anthony Bickerstaff | 100,368 | £326,196 | 31 December 2021 | 15% | 100% |

1 Valued using the share price on the business day prior to the date of grant (3 May 2019), being 325p pence per share.

### 2019 SDP Grant

The Company granted awards under the SDP to the executive directors on 3 April 2019, details of which are shown on page 106.

### All-employee share plan

The Company granted options under the SAYE scheme to the executive directors during 2019, details of which are shown on page 107.

## Implementation of policy in the year to 31 December 2020

### Salary

In view of current business performance, the chief executive and chief financial officer will not receive a salary increase in 2020. A 2% salary increase will be applied across the Company in 2020 (effective 1 April) except for the senior leadership team who will not receive an increase. The base salary for Alex Vaughan on his appointment as chief executive was £425,000. This was set 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 2020 | Salary 2019 | % change |
|---|---|---|---|
| Alex Vaughan | £425,000 | £425,000 | Nil |
| Anthony Bickerstaff | £326,196 | £326,196 | Nil |

### Non-executive director fees

Non-executive directors' fees are to remain the same with effect from 1 April 2020, as shown in the table below:

| 2020 Fees | Basic Fee | Senior independent director | Audit Committee chairman | Remuneration Committee chairman |
|---|---|---|---|---|
| Fees | £47,048 | £6,600 | £9,400 | £7,000 |

### 2020 Annual incentive

Executive directors and the wider senior leadership team 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 AIP opportunity for the chief executive officer and the chief financial officer for the year ending 31 December 2020 will remain unchanged from 2019 at 150% of base salary, with one third of earned AIP deferred into shares for a further two years, to be awarded under the SDP, and two thirds of earned AIP paid in cash.

The performance measures for the 2020 AIP are as follows:

| | 2020 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) | 20% | 20% |
| Personal performance | 10% | 10% |
| **Total** | 100% | 100% |

The Committee has chosen not to disclose in advance the performance targets for the year ending 31 December 2020, 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.

### 2020 LTIP Grant

The grant level for the executive directors will be up to 100% of salary. The LTIP awards will be granted after the AGM and the Committee will finalise the quantum of the grants at that time having regard to share price performance and market conditions at that time. As with the 2019 awards, 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.

Previously, the weightings have been 75% EPS and 25% cash conversion. For the 2020 LTIP awards, a minor re-balancing is proposed so that the measures will be two thirds EPS and one third cash conversion, reflecting that the sustainable generation of cash backed profits is a key element to the future success of the Company.

The proposed targets are set out below.

### EPS performance measure

| Aggregate EPS over the financial years ending 31 December 2020, 2021 and 2022 | Vesting level for awards |
|---|---|
| Below 87.0 pence | 0% |
| 87.0 pence | 15% |
| Between 87.0 pence and 95.0 pence | 15% – 100% pro rata |
| 95.0 pence or more | 100% |

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.

# Annual Report on Remuneration continued

## Grants made during the year continued

### 2019 LTIP Grant continued

### Cash conversion performance measure

| Average cash conversion for the financial years ending 31 December 2020, 2021 and 2022 | Vesting level for awards |
|---|---|
| Below 80% | 0% |
| 80% | 15% |
| Between 80% and 100% | 15% – 100% pro rata |
| 100% | 100% |

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 2022.

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

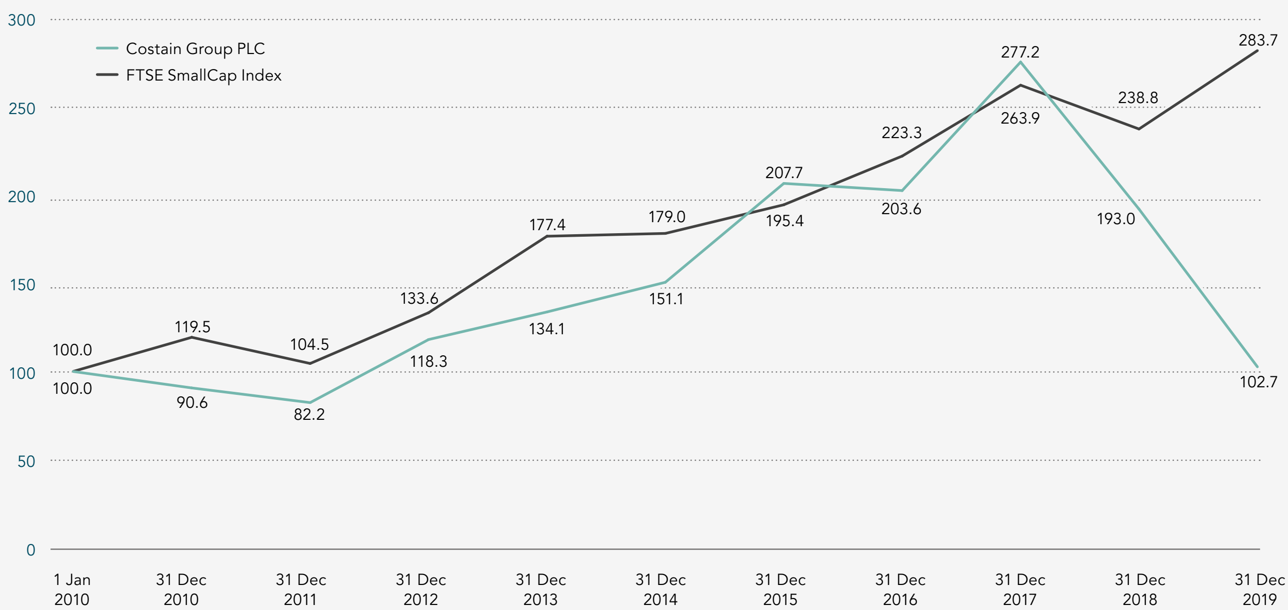
The Committee has the discretionary power to vary these targets, should circumstances change, so that the original targets are no longer considered appropriate (e.g. in the case of a material acquisition or divestment in the Group or other material transaction).

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 2019, of £100 invested in Costain Group PLC on 1 January 2010 compared with the value of £100 invested in the FTSE SmallCap Index. The Committee believes that the FTSE SmallCap Index is the most appropriate index to use as it is the index in which the Company is a constituent and comprises companies of a similar size to Costain.



## Change in chief executive officer's remuneration

| | Year ending 31 December | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019[1] | |
| Chief executive officer | AW | AW | AW | AW | AW | AW | AW | AW | AW | AW | AV |
| Total remuneration | £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 | £211,927 | £312,242 |
| AIP (%) | 94% | 86% | 55% | 75% | 71.6% | 79.8% | 75.4% | 81% | 62.6% | Nil | Nil |
| LTIP vesting (%) | 96% | 100% | 100% | 50% | 50% | 50% | Nil% | 79.1% | 100% | Nil | Nil |

1 Andrew Wyllie stepped down from the Board on 7 May 2019 and Alex Vaughan was appointed to the Board on 7 May 2019.

## CEO pay ratio

The table below shows the ratio of the pay of the CEO to that of the best full time equivalent lower quartile, median and upper quartile employee within the Group in 2019.

| | Year | Methodology used | 25th Percentile Pay Ratio | 50th Percentile Pay Ratio | 75th Percentile Pay Ratio |
|---|---|---|---|---|---|
| Ratio of CEO pay to employee pay | 2019* | Option B | 17:1 | 10:1 | 7:1 |

* The Single Total Figure of Remuneration for the CEO has been calculated as the total remuneration paid to A Wyllie for the period 1 January 2019 to 7 May 2019 plus the total remuneration paid to A Vaughan for the period 8 May 2019 to 31 December 2019.

We have chosen to use Option B of the available methodologies to calculate the ratio. This methodology is based on the data collected as part of gender pay reporting. Option B was selected on the basis that it is an efficient and robust approach, recognising that the data required to calculate the ratio comes from multiple sources. Analysis has been performed to ensure that the lower quartile, median and upper quartile employees are reasonably representative

The table below shows the UK employee percentile pay and benefits used to determine the above pay ratios and the salary component for each figure.

| £ | CEO | 25th percentile | Median | 75th percentile |
|---|---|---|---|---|
| Total pay and benefits | £524,169 | £30,923 | £50,903 | £75,304 |
| Salary component | £445,319 | £29,837 | £45,170 | £60,137 |

The UK employee percentile pay and benefits has been calculated based on the amount paid or receivable for the year ended 31 December 2019. The calculations are on the same basis as required for the CEO's remuneration for single total figure purposes.

A high proportion of the chief executive's total reward is performance related and delivered in shares. The ratios will therefore depend significantly on the chief executive's variable pay outcomes and may fluctuate year to year.

The Board believes that the median pay ratio is consistent with the Group's wider policies on pay, reward and progression.

# 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.

| | 2019 | 2018 | % change |
|---|---|---|---|
| **Chief executive** | | | |
| – salary | £445,319 | £479,746 | (7.2)% |
| – benefits | £13,931 | £13,173 | 5.8% |
| – bonus (annual incentive)[1] | £nil | £453,255 | (100)% |
| **Average per employee** | | | |
| – salary[2] | £49,330 | £47,964 | 2.8% |
| – benefits[3] | £5,389 | £5,307 | 1.5% |
| – bonus (annual incentive)[4] | £272 | £2,721[5] | (90)% |

1 2019 salary and benefit figures for the chief executive are calculated based on the combined salary and benefits received by Andrew Wyllie and Alex Vaughan during their respective tenures as chief executive.

Bonus figures for the chief executive are calculated based on 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 based on 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

5 The average bonus per employee in 2018 has been restated to reflect bonuses earned by reference to performance in 2018, rather than bonuses paid in 2018, for consistency with the approach to the CEO's bonus.

## 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 2018 to the financial year ended 31 December 2019.

| | 2019 £m | 2018 £m | % change |
|---|---|---|---|
| Overall expenditure on pay | 206.5 | 225.0 | (8.2)% |
| Dividends and share buybacks | 14.8 | 15.2 | (2.6)% |

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 | Effective date of latest appointment letter | Expiry of current term[1, 2] | Next AGM at which the director is required to stand for re-election[2] |
|---|---|---|---|---|
| Alex Vaughan | 7 May 2019 | 7 May 2019 | Terminable on 12 months' notice | 2020 AGM |
| Anthony Bickerstaff | 3 March 2006 | 3 March 2006 | Terminable on 12 months' notice | 2020 AGM |
| Paul Golby | 5 May 2016 | 5 May 2019 | 5 May 2022 | 2020 AGM |
| Jane Lodge | 1 August 2012 | 8 May 2018[3] | 1 August 2021 | 2020 AGM |
| Alison Wood | 1 February 2014 | 1 February 2020 | 1 February 2023 | 2020 AGM |
| David McManus | 12 May 2014 | 12 May 2017 | 12 May 2020 | –[4] |
| Jacqueline de Rojas | 20 November 2017 | 20 November 2017 | 20 November 2020 | 2020 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.

3 Jane Lodge was appointed Senior Independent Director with effect from 8 May 2018.

4 David McManus will be stepping down from the Board on 7 May 2020 and will not be seeking re-election at the 2020 AGM.

## 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 period from 1 January 2019 until his retirement from the Board on 7 May 2019, was paid £17,572 (2018: £50,000).

Anthony Bickerstaff was reappointed, with effect from 12 November 2017, for a second three year term as a non-executive director and chairman 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 2019, he was paid £31,000 (2018: £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 2019#* | 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 2019*** | Actual/ expected vesting/ release date |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Andrew Wyllie | 09.03.15[1] | 56,046 | – | 316p | – | – | – | – | – | 56,046 | March 2018 March 2020 |
| | 06.04.16[2] | 132,678 | – | 346.25p | 66,339 | – | 355p | 355p | £138,486 | 66,339 | 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] | 37,130 | – | 316p | – | – | – | – | – | 37,130 | March 2018 March 2020 |
| | 06.04.16[2] | 87,913 | – | 346.25p | 43,957 | – | 355p | 355p | £91,760 | 43,956 | 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 |
| | 07.05.19[5] | – | 100,368 | 325p | – | – | – | – | – | 100,368 | May 2024 |
| Alex Vaughan | 05.04.17[3] | 19,896 | – | 455p | – | – | – | | – | 19,896 | April 2020 April 2022 |
| | 04.04.18[4] | 20,130 | – | 461p | – | – | – | – | – | 20,130 | April 2021 April 2023 |
| | 07.05.19[5] | – | 130,769 | 325p | – | – | – | – | – | 130,769 | May 2024 |

\# Awards under the LTIP are structured as options with a nil exercise price.

* Balance at the date of appointment to the Board on 7 May 2019 for Alex Vaughan.

** In addition, dividend shares were awarded upon vesting – Andrew Wyllie: 7,265 shares; Anthony Bickerstaff: 4,814 shares.

*** Balance at the date of retiring from the Board on 7 May 2019 for Andrew Wyllie prior to subsequent prorating at the time of departure from the Company on 6 September 2019 for the 2017 and 2018 LTIP awards.

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 vested 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 vested 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 vested by 100% based on aggregate EPS performance during the period.

# Annual Report on Remuneration continued

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

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. This award is due to lapse in full based on the performance against these targets during the period.

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.

5 Performance targets are as follows:

(a) an EPS target (relating to 75% of the award) of 128.2p (for 15% vesting) and 141.0p (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.

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 2021, but will not normally be released and become exercisable until 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 2019, the derived mid-market price of the ordinary shares in the Company, as advised by the Company's brokers, was 159.40 pence. The range of the closing share price of the ordinary shares during 2019 was 144.4 pence to 397.50 pence.

## 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 2019[1,2] | Granted during year[1] | Share price at date of grant | Vested during year[3] | 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 2019[1,4] | Actual/ expected vesting date[5] |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Andrew Wyllie | 05.04.17 | 38,064 | – | 455p | 38,064 | – | 357p | 354.25p | £76,940 | – | April 2019 |
| | 04.04.18 | 41,368 | – | 461p | – | – | – | – | – | 41,368 | April 2020 |
| | 03.04.19 | – | 44,112 | 342.5p | – | – | – | – | – | 44,112 | April 2021 |
| Anthony Bickerstaff | 05.04.17 | 25,221 | – | 455p | 25,221 | – | 357p | 354.25p | £50,980 | – | April 2019 |
| | 04.04.18 | 27,410 | – | 461p | – | – | – | – | – | 27,410 | April 2020 |
| | 03.04.19 | – | 29,225 | 342.5p | – | – | – | – | – | 29,225 | April 2021 |
| Alex Vaughan | 04.04.18 | 12,109 | – | 461p | – | – | – | – | – | 12,109 | April 2020 |
| | 03.04.19 | 16,076[6] | – | 342.5p | – | – | – | – | – | 16,076 | April 2021 |

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

2 Balance at the date of appointment to the Board on 7 May 2019 for Alex Vaughan.

3 In addition, dividend shares were awarded upon vesting – Andrew Wyllie: 2,917 shares; Anthony Bickerstaff: 1,932 shares.

4 Balance at the date of retiring from the Board on 7 May 2019 for Andrew Wyllie.

5 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.

6 Award granted prior to Alex Vaughan's appointment to the Board on 7 May 2019.

## Share Options under the SAYE Scheme (SAYE)

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

| Director | Date granted | Balance at 1 January 2019[1] | 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 2019[2] | Exercised/ exercisable from/to |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Andrew Wyllie | 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 | 26.09.16 | 1,251 | – | 279p | – | – | – | – | – | 1,251[3] | 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 |
| | 23.09.19 | – | 1,398 | 118.40p | – | – | – | – | – | 1,398 | Nov 2022 May 2023 |
| Alex Vaughan | 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 |
| | 23.09.19 | – | 1,398 | 118.40p | – | – | – | – | – | 1,398 | Nov 2022 May 2023 |

1 Balance at the date of appointment to the Board on 7 May 2019 for Alex Vaughan.

2 Balance at the date of retiring from the Board on 7 May 2019 for Andrew Wyllie.

3 Option still outstanding as at 31 December 2019, the market price of a share being lower than the option price.

No executive director exercised a SAYE share option in 2019 and therefore there was no gain on exercise.

## Directors' shareholdings

Details of the directors' share interests in the Company as at 31 December 2019, 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] |
|---|---|---|---|---|---|---|
| Alex Vaughan[1] | 119,176 | 28,185[4] | 170,795[4] | 4,031[4] | 100% | 81.61% |
| Anthony Bickerstaff[1] | 324,147 | 56,635 | 319,397 | 5,252 | 100% | 283.39% |
| Paul Golby[2] | 35,000 | – | – | – | 100% | 66.42% |
| Jane Lodge | 24,658 | – | – | – | 100% | 89.35% |
| Alison Wood | 6,666 | – | – | – | 100% | 27.75% |
| David McManus | 0 | – | – | – | 100% | 0% |
| Jacqueline de Rojas[2] | 4,495 | – | – | – | 100% | 40.74% |

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.

4 2017 and 2018 awards were granted prior to Alex Vaughan becoming a director.

The executive directors are expected to build and maintain a shareholding of not less than 100% of base salary (increasing to 200% under the new policy) through the retention of vested share awards or through open market purchases. 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 2019.

The Governance Report on pages 54 to 107 and the Strategic Report on pages 18 to 53 (and in particular pages 30, 34 to 37 and 65 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 2020 AGM will be held on Thursday 7 May 2020 at The Lincoln Centre, 18 Lincoln's Inn Fields, London WC2A 3ED. A circular incorporating the Notice of AGM accompanies this annual report.

## (Loss)/profit, dividend payments and dividend policy

The loss after tax for the financial year ended 31 December 2019 was £2.9 million (2018: profit £32.8 million). An interim dividend of 3.80 pence per share (2018: 5.15 pence) amounting to £3.5 million (2018: £5.5 million) was paid on 18 October 2019.

The Company will pay no final dividend in respect of the year ended 31 December 2019. The total dividend paid for the year, including the interim dividend, will therefore be 3.80 pence per share (2018: 15.15 pence).

Recognising the importance to the Group of maintaining a strong and growing capital base, following the proposed equity raise (see page 21), Costain will target a dividend cover of around three times underlying earnings, taking into account the free cash flow generated in the period. The first dividend to be paid under the new policy is expected to be an interim dividend for the six months ending 30 June 2020, payable in October 2020.

## 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% or more 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 2019 was £54,141,537, consisting of 108,283,074 ordinary shares of 50 pence each. Further details of the share capital of the Company can be found in note 23 on page 171.

The awards granted in April 2016 under the 2014 Long-Term Incentive Plan (LTIP) matured as at 31 December 2018, resulting in the vesting of awards in April 2019 over 412,903 ordinary shares of 50 pence each (excluding dividend shares) with a nil exercise price. A further 110,295 awards granted under the LTIP in April 2016 are due to vest in April 2021. Further details regarding the vesting of the 2016 LTIP awards can be found in the Directors' Remuneration Report on page 105. Details regarding the 2017 LTIP awards that are due to vest in April 2020 but have not met their performance targets, can be found in the Directors' Remuneration Report on page 98.

Share options granted under the Company's Save As You Earn Scheme (SAYE) in November 2016 (at an option price of 279p) matured as at 1 November 2019. As the market price was less than the option price, the maturity resulted in the exercise of nil options over ordinary shares as at 31 December 2019. Further details of the SAYE Scheme can be found on page 107 of the Directors' Remuneration Report.

At the 2019 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 2022 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.

In May 2019, 197,710 ordinary shares of 50 pence each were allotted to shareholders in respect of the final dividend for 2018 and, in October 2019, 376,569 ordinary shares of 50 pence each were allotted to shareholders in respect of the interim dividend for 2019. Further information on the scrip dividend scheme is set out on page 182. 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 2019 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 |
|---|---|---|---|---|---|---|
| GLG Partners LP* | 10/10/2019 | 8,871,793 | 8.22 | <5% | 1.61 | 9.83 |
| Ennismore Fund Management Limited | 04/07/2019 | 8,698,003 | 8.06 | n/a | n/a | 8.06 |
| J O Hambro Capital Management Limited | 28/10/2019 | 5,580,502 | 5.15 | 44,498 | 0.04 | 5.19 |
| Standard Life Aberdeen plc | 11/09/2019 | 5,214,923 | 4.83 | n/a | n/a | 4.83 |
| KBI Global Investors Ltd | 25/02/2019 | 3,212,629 | 3.00 | n/a | n/a | 3.00 |

* Subsequent notification received from GLG Partners on 13 February 2020 that they had decreased their total interest in the Company to less than 5% of voting rights.
Save as noted above in respect of GLG Partners, the Company did not receive any further notifications pursuant to DTR5 in the period from 31 December 2019 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 7 May 2019, shareholders granted an authority to the directors to allot ordinary shares up to an aggregate nominal amount of £17.8 million. As at 31 December 2019, 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 2020, 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 2019 or during the period from 1 January 2020 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 2019, Buck Trustees (Guernsey) Limited (formerly, ACS HR Solutions Share Plan Services (Guernsey) Limited), as Trustee of the Costain Group Employee Trust, held 0.64% 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 articles of association is available on the Company's website at www.costain.com.

### Political donations

No political donations were made during the year ended 31 December 2019 (2018: 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 2019 AGM. The Board is proposing the reappointment of PwC as auditor from the conclusion of the AGM in May 2020 until the conclusion of the next general meeting at which the accounts are laid before the Company. See page 79 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 19 on pages 157 to 164. 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

The Board has concluded that it is in the best interests of the Group to raise up to £100 million of new equity to strengthen the Group's balance sheet.

Further details on the proposed capital raising, which has been fully underwritten on a standby basis, were announced on the 11 March 2020.

## 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 35 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.

## Overseas interests

Details of the Company's overseas subsidiary undertakings can be found in note 26 on pages 172 to 177. The Company has two overseas branches in Abu Dhabi.

## 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. Andrew Wyllie stepped down as chief executive and was succeeded by Alex Vaughan, both changes effective 7 May 2019. 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.

## Appointment and replacement of directors

The appointment and replacement of directors is governed by the Company's articles, the 2018 UK Corporate Governance 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. New articles reflecting the requirements of the 2018 Code in relation to annual reappointment of directors, as applicable to smaller companies below the FTSE 350 from 2019, were approved by shareholders at the Company's 2019 AGM. At every AGM of the Company, all directors of the Company are therefore required to retire from office and may offer themselves for reappointment by the members.

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

The Company may, by special resolution, remove any director before the expiration of his/her period of office. The office of a director shall also be vacated under a number of situations which are set out in the articles of 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 2019, are contained in the Directors' Remuneration Report, which appears on pages 83 to 107.

### 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 81 and the Strategic Report on pages 64 and 65.

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 144.

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, the strategy and other matters of concern to them as employees, through various means including regular updates from the chief executive officer and other senior managers and via the Company's intranet site. Employees also have the opportunity to provide feedback and ask questions at the annual staff 'Costain in business' roadshows which take place around the country, as shown on page 60.

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

### Stakeholder Engagement

For more information on how the directors have engaged with the workforce, clients, suppliers and others, and how the directors have had regard to their interests, and the effect of that regard including on principal decisions, see the Stakeholder Engagement section of the Strategic Report on pages 36 and 37 and page 69 of the Corporate Governance Report.

### 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

11 March 2020

# 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

**Alex Vaughan**
Chief Executive Officer

11 March 2020

# Independent Auditors' 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 Parent Company financial statements (the 'financial statements'):

- give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2019 and of the Group's loss and the Group's and the Parent 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 Parent 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 Annual Report and Accounts (the 'Annual Report'), which comprise: the Consolidated statement of financial position and the Company statement of financial position as at 31 December 2019; the Consolidated income statement and Consolidated statement of comprehensive income and expense, the Consolidated cash flow statement and Company cash flow statement, the Consolidated statement of changes in equity and the 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 Parent Company.

Other than those disclosed in note 4 to the financial statements, we have provided no non-audit services to the Group or the Parent Company in the period from 1 January 2019 to 31 December 2019.

## Material uncertainty related to going concern

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in note 2 to the financial statements concerning the Group's and Parent Company's ability to continue as a going concern.

### Explanation of material uncertainty

The financial statements explain how the Board has formed a judgement that it is appropriate to adopt the going concern assumption as the basis of preparation for the Group and Parent Company. We draw your attention to note 2 on pages 130 and 131 which indicates that there is a material uncertainty relating to the Group's and Parent Company's ability to continue as a going concern.

The Group's forecast cash flows, included within the Group's strategic plan, contain assumptions over revenue, profitability and cash generation. These forecasts have been stress-tested for severe but plausible scenarios that could impact the Group. The analysis shows that in a reasonable worst case scenario, while the headroom on committed facilities is adequate, the headroom on the leverage covenant is limited. The Group's £187 million (2018: £191 million) of committed facilities are subject to covenant testing quarterly.

The Board considers that the Group and the Company have adequate resources to remain in operation for the foreseeable future and therefore have continued to adopt the going concern basis for the preparation of the financial statements. However, as set out in note 2, the Board has concluded that to provide greater flexibility and headroom, and for the Company to take advantage of market opportunity, it would be prudent to take steps to conduct a capital raise to strengthen the balance sheet of the Group. The Company has entered into a standby underwriting agreement to support a capital raise, subject to certain specific conditions which, although customary in nature, are outside the control of the Parent Company.

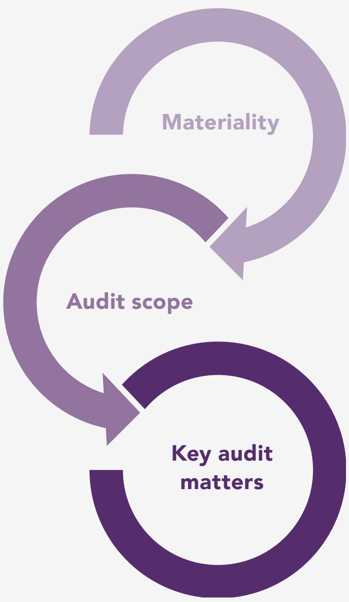
The capital raise is dependent, inter alia, on shareholder support. Although the Board has concluded it is likely that the relevant shareholder resolution will be passed, nevertheless there is some uncertainty as to whether sufficient shareholders will vote in favour of such resolution to enable the capital raise to proceed.

The conclusion of the capital raise constitutes a material uncertainty which may cast significant doubt about the Group's and Parent Company's ability to continue as a going concern. The directors believe that adopting the going concern basis in preparing the financial statements is appropriate and the financial statements do not include the adjustments that would result if the Group and Parent Company were unable to continue as a going concern.

### Audit procedures performed

In concluding there is a material uncertainty, we evaluated the directors' going concern assessment and in particular performed the following procedures:

- we obtained the facility agreement together with the amendments agreed in March 2020.
- we assessed the appropriateness of the cash flow forecasts in the context of the Group's 2019 financial position and evaluated the directors' downside sensitivities against these forecasts.
- we evaluated the key assumptions in the forecasts and considered whether these appeared reasonable, for example by comparing forecast sales growth to levels of future revenue that has been secured.
- we examined the minimum committed facility headroom under the base case cash flow forecasts and sensitised cases, both with and without the proposed equity raise.
- we obtained and reperformed the Group's projected quarterly forecast covenant compliance calculations.
- we considered the impact of the Group's financial performance, and specifically its presentation of profit before exceptional items and amortisation of acquired intangibles, on its covenant calculations.
- we inspected the terms of the proposed equity raise, including the stand by underwriting agreement, to assess the impact on the forecast models and to check completeness of disclosures concerning the material uncertainty .
- we also reviewed the disclosures provided relating to the going concern basis of preparation including that sufficient details were provided concerning the material uncertainty, and found that these provided an explanation of the directors' assessment that was consistent with the evidence we obtained.




## Our audit approach

### Overview

- Overall group materiality: £1.7 million (2018: £2.3 million), based on 5% of profit before tax adjusted for 'other items' which are deemed to be one off in nature and for the impact of the A465 arbitration referred to on page 22.
- Overall Parent Company materiality: £1.7 million (2018: £1.8 million), based on 1% of net assets (capped at Group materiality).

- We identified five reporting units and performed procedures over specific balances in other Group entities, which accounted for 97% of the Group revenues and 80% 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 scheme's obligation.
- Going concern (refer to material uncertainty above).

# Independent Auditors' Report continued

To the members of Costain Group PLC

## **Our audit approach** continued

### 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.

### **Capability of the audit in detecting irregularities, including fraud**

Based on our understanding of the Group and industry, 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), and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006. 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's procedures included:

- discussion with management, internal audit and the Group's in-house legal advisors, including consideration of known or suspected instances of non-compliance with laws and regulations 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. Also, 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.

### 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. In addition to going concern, described in the material uncertainty related to going concern section above, we determined the matters described below to be the key audit matters to be communicated in our report. This is not a complete list of all risks identified by our audit.

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| **Group**<br><br>**Timing and accuracy of contract revenue and profit recognition including recoverability of amounts due from clients**<br><br>Refer to page 77 (Audit Committee Report), pages 130 to 140 note 2 (Summary of significant accounting policies and significant areas of judgement and estimation).<br><br>The valuation of amounts recoverable on construction contracts is dependent on estimates around stage of completion and remaining costs to complete, as well as the associated provisions.<br><br>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 or fully agreed with the customer. This impacts on the recorded work in progress at the balance sheet date.<br><br>In particular this year the contract for the upgrade of National Grid's Peterborough and Huntingdon compressor stations has been subject to a significant degree of change and therefore programme delay and cost increases. At this stage only a limited proportion of the £90 million reforecast outturn cost associated with the additional scope has been formally agreed by the client therefore this has been a focus of our work.<br><br>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:<br>• high levels of revenue recognised in the year<br>• low margin or loss making contracts<br>• contracts with significant balance sheet exposure and<br>• through our discussions with management, review of Board minutes, review of legal reports and review of publicly available information.<br><br>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:<br>• obtaining an understanding of the contract and its particulars<br>• agreeing forecast revenue to signed contracts, signed variations, agreed compensation events or other supporting documentation<br>• 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<br>• 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<br>• obtaining details of unagreed compensation events and challenging entitlement to assumed recoveries<br>• re-performing the key calculations behind the margin applied, the profit taken and the stage of completion, as well as balance sheet exposure<br>• testing a sample of actual costs incurred<br>• 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<br>• assessing the recoverability of balance sheet items by comparing to external certification of the value of work performed<br>• holding discussions with management to understand and challenge other areas of judgement taken and<br>• reviewing legal correspondence and expert advice obtained in respect of the judgements and where necessary speaking directly with management's experts who had provided this advice.<br><br>In particular this year we focused on the accounting for the Peterborough and Huntingdon contract with National Grid (refer to note 2). We challenged management's assumptions regarding recovery of compensation events (CEs) not yet agreed, inspected the contractual terms and tested the evidence in respect of the compensation events and the actual and forecast cost data available, together with the latest correspondence with the client. We reviewed the reports provided by and discussed directly with management's external legal counsel and management's external engineering expert. We reviewed evidence of managements track record in agreeing CEs in respect of other contracts of a similar nature. We also reviewed the disclosure provided by management.<br><br>For the remaining contract population we performed the following:<br>• 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<br>• attended contract review meetings, and inspected Contract Leader Reports ('CLRs') to obtain evidence regarding the controls in place<br>• considered management provisions across all contracts<br>• recalculated the percentage completion based on costs to date and recalculated revenue to agree to those reported by management and<br>• for all contracts which generated in excess of £1.5 million of revenue in the year, we agreed the September certificate to cash received, verified cumulative costs to the underlying cost ledgers and recomputed the cumulative revenue recognised.<br><br>Based on all of the evidence obtained in the above procedures, we are satisfied with the recognition of contract revenue and profit and the recoverability of amounts due from clients is supportable.<br><br>Given the degree of estimation, we also considered the disclosures around significant ongoing contracts included on pages 44 to 47 of the Chief Financial Officer's report. |

# Independent Auditors' Report continued

To the members of Costain Group PLC

## Capability of the audit in detecting irregularities, including fraud continued

### Key audit matters continued

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| **Group and Company**<br><br>**Impairment of goodwill and other intangible assets**<br><br>Refer to page 78 (Audit Committee Report), pages 130 to 140 note 2 (Significant areas of judgement and estimation), and pages 148 and 149 note 11 – Intangible Assets.<br><br>At 31 December 2019 the Group had a net balance of £54.1 million of goodwill (2018: £54.1 million) and £4.9 million of intangible assets (2018: £4.4 million)<br><br>The Company had a corresponding investments in subsidiaries balance of £141.3 million (2018: £140.5 million).<br><br>Goodwill has been allocated to the applicable cash generating units of the transportation segment (£15.5 million, 2018: infrastructure £15.5 million) and the natural resources segment (£38.6 million, 2018: £38.6 million).<br><br>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 transport and natural resources.<br><br>We performed the following testing:<br><br>• 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<br>• we challenged the discount rate used by independently recalculating the cost of capital, which was consistent with the discount rate used<br>• we tested the level of secured work by tracing it to supporting orders<br>• we tested the cost forecasts by comparing a sample to tenders from subcontractors or calculations of man hours required, noting that 77% of the 2020 forecast revenue has been secured<br>• we compared 2019 financial performance to budget and understood the drivers of improvement in profitability; and<br>• we performed sensitivity analysis around the key drivers of the cash flow forecasts, in particular the revenue growth and margin assumptions.<br><br>We concluded management's assessment was reasonable. |
| **Group**<br><br>**Valuation of defined benefit pension schemes' obligation**<br><br>Refer to page 78 (Audit Committee Report), pages 139 and 140 note 2 (significant areas of judgement and estimation), and page 167 note 22 – Employee Benefits.<br><br>The Group has significant retirement benefit obligations. At 31 December 2019 the present value of these obligations was £812.1 million (2018: £752.7 million) offset by plan assets at fair value of £817.0 million (2018: £748.5 million) in respect of funded schemes.<br><br>These retirement benefit obligations were determined based on a number of actuarial assumptions and calculations, which were subject to significant judgement and estimate.<br><br>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 2019 and tested the valuation of the pension liabilities as follows:<br><br>• 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 2019. 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<br>• 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<br>• we tested the underlying census data to supporting documents to confirm completeness and accuracy.<br><br>We did not identify any issues within our testing and were satisfied the assumptions applied are within an appropriate range. |

## 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; transportation 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. We identified the following five legal entities requiring full scope audit; Costain Limited, Costain Oil and Gas Process Limited, Costain Engineering & Construction Limited, Richard Costain Limited 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. 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. In total, these accounted for 97% of Group revenues and 80% of Group Profit before tax. The percentage of Group Profit before tax is calculated on an absolute basis, which aggregates component profits and losses.

## 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 | Parent Company financial statements |
|---|---|---|
| **Overall materiality** | £1.7 million (2018: £2.3 million). | £1.7 million (2018: £1.8 million). |
| **How we determined it** | 5% of profit before tax adjusted for 'other items' which are deemed to be one off in nature and for the impact of the A465 arbitration announced in December 2019. | 1% of net assets (capped at Group materiality). |
| **Rationale for benchmark applied** | Based on the benchmark used in the annual report, profit before tax adjusted for 'other items' is the primary measure used by the shareholders in assessing the performance of the Group, and is 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 £0.3 million and £1.7 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.1 million (Group audit) (2018: £0.1 million) and £0.1 million (Parent Company audit) (2018: £0.1 million) 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 Parent Company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements. | We have nothing material to add or to draw attention to other than the material uncertainty we have described in the material uncertainty related to going concern section above.<br><br>However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Parent Company's ability to continue as a going concern. For example, the terms of the United Kingdom's withdrawal from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the Group's trade, customers, 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. |

# Independent Auditors' Report continued

To the members of Costain Group PLC

## 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 and Directors' Report, 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 2019 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 Parent 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)

**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 Parent 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 113, 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 Parent Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Parent Company obtained in the course of performing our audit
- the section of the annual report on page 76 to 79 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 Parent 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' Responsibilities Statement set out on page 113, 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 Parent 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 Parent 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 Parent 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 Parent 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 Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

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 three years, covering the years ended 31 December 2017 to 31 December 2019.

**Jonathan Hook (Senior Statutory Auditor)**

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors

London

11 March 2020

# Consolidated Income Statement

Year ended 31 December

| | Notes | 2019 Underlying £m | 2019 Other items £m | 2019 Total £m | 2018 Underlying £m | 2018 Other items £m | 2018 Total £m |
|---|---|---|---|---|---|---|---|
| **Continuing operations** | | | | | | | |
| Revenue including share of revenue of joint ventures and associates | 3 | **1,162.9** | **–** | **1,162.9** | 1,489.3 | – | 1,489.3 |
| Less: Share of revenue of joint ventures and associates | 13 | **(7.3)** | **–** | **(7.3)** | (25.6) | – | (25.6) |
| **Group revenue** | | **1,155.6** | **–** | **1,155.6** | 1,463.7 | – | 1,463.7 |
| Cost of sales before other items | | **(1,105.1)** | **–** | **(1,105.1)** | (1,373.8) | – | (1,373.8) |
| Arbitration award on historical building project | 4 | **–** | **(9.7)** | **(9.7)** | – | – | – |
| Cost of sales | | **(1,105.1)** | **(9.7)** | **(1,114.8)** | (1,373.8) | – | (1,373.8) |
| Gross profit/(loss) | | **50.5** | **(9.7)** | **40.8** | 89.9 | – | 89.9 |
| Administrative expenses before other items | | **(32.6)** | **–** | **(32.6)** | (37.4) | – | (37.4) |
| Impairment of Alcaidesa marina | 12 | **–** | **(5.9)** | **(5.9)** | – | – | – |
| Pension GMP equalisation charge | 22 | **–** | **–** | **–** | – | (8.6) | (8.6) |
| RDEC grant income | 4 | **–** | **–** | **–** | – | 2.6 | 2.6 |
| Loss on disposal of subsidiary undertakings | 29 | **–** | **(3.0)** | **(3.0)** | – | – | – |
| Amortisation of acquired intangible assets | | **–** | **(2.3)** | **(2.3)** | – | (3.0) | (3.0) |
| Employment related and other deferred consideration | | **–** | **(0.2)** | **(0.2)** | – | (0.4) | (0.4) |
| Administrative expenses | | **(32.6)** | **(11.4)** | **(44.0)** | (37.4) | (9.4) | (46.8) |
| **Group operating profit/(loss)** | | **17.9** | **(21.1)** | **(3.2)** | 52.5 | (9.4) | 43.1 |
| Share of results of joint ventures and associates | 13 | **0.3** | **–** | **0.3** | 0.3 | – | 0.3 |
| **Profit/(loss) from operations** | 3 | **18.2** | **(21.1)** | **(2.9)** | 52.8 | (9.4) | 43.4 |
| Finance income | 7 | **1.0** | **–** | **1.0** | 0.4 | – | 0.4 |
| Finance expense | 7 | **(4.6)** | **(0.1)** | **(4.7)** | (3.5) | (0.1) | (3.6) |
| Net finance expense | | **(3.6)** | **(0.1)** | **(3.7)** | (3.1) | (0.1) | (3.2) |
| **Profit/(loss) before tax** | 3/4 | **14.6** | **(21.2)** | **(6.6)** | 49.7 | (9.5) | 40.2 |
| Taxation | 8 | **(0.1)** | **3.8** | **3.7** | (9.1) | 1.7 | (7.4) |
| **Profit/(loss) for the year attributable to equity holders of the Parent** | | **14.5** | **(17.4)** | **(2.9)** | 40.6 | (7.8) | 32.8 |
| **Earnings/(loss) per share** | | | | | | | |
| Basic | 9 | **13.5p** | **(16.2)p** | **(2.7)p** | 38.2p | (7.2)p | 30.9p |
| Diluted | 9 | **13.5p** | **(16.2)p** | **(2.7)p** | 37.4p | (7.2)p | 30.2p |

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

# Consolidated Statement of Comprehensive Income and Expense

Year ended 31 December

| | 2019 £m | 2018 £m |
|---|---|---|
| **(Loss)/profit for the year** | **(2.9)** | 32.8 |
| **Items that may be reclassified subsequently to profit or loss:** | | |
| Exchange differences on translation of foreign operations | **(1.4)** | 0.2 |
| Exchange differences on translation transferred to the income statement | **(3.7)** | – |
| Net investment hedge: | | |
| Effective portion of changes in fair value during year | **1.6** | 0.1 |
| Net changes in fair value transferred to the income statement | **2.0** | – |
| Cash flow hedges: | | |
| Effective portion of changes in fair value during year | **(0.4)** | (0.1) |
| Net changes in fair value transferred to the income statement | **(0.8)** | – |
| **Total items that may be reclassified subsequently to profit or loss** | **(2.7)** | 0.2 |
| **Items that will not be reclassified to profit or loss:** | | |
| Remeasurement of retirement benefit asset/(obligations) | **(7.0)** | 13.3 |
| Tax recognised on remeasurement of retirement benefit asset/(obligations) | **1.2** | (2.5) |
| **Total items that will not be reclassified to profit or loss** | **(5.8)** | 10.8 |
| **Other comprehensive (expense)/income for the year** | **(8.5)** | 11.0 |
| **Total comprehensive (expense)/income for the year attributable to equity holders of the parent** | **(11.4)** | 43.8 |

# Consolidated Statement of Financial Position

As at 31 December

| | Notes | 2019 £m | 2018 £m |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Intangible assets | 11 | **59.0** | 58.5 |
| Property, plant and equipment | 12 | **44.1** | 40.0 |
| Investments in equity accounted joint ventures | 13 | **0.4** | 0.4 |
| Investments in equity accounted associates | 13 | **0.6** | 0.5 |
| Loans to equity accounted associates | 13 | **1.5** | 1.6 |
| Retirement benefit asset | 22 | **4.9** | – |
| Other | 15 | **2.1** | 3.6 |
| Deferred tax | 8 | **4.6** | 2.7 |
| **Total non-current assets** | | **117.2** | 107.3 |
| **Current assets** | | | |
| Inventories | | **1.3** | 1.5 |
| Trade and other receivables | 15 | **247.6** | 276.5 |
| Taxation | 8 | **5.5** | – |
| Cash and cash equivalents | 16 | **180.9** | 189.3 |
| **Total current assets** | | **435.3** | 467.3 |
| **Total assets** | | **552.5** | 574.6 |
| **Equity** | | | |
| Share capital | 23 | **54.1** | 53.5 |
| Share premium | | **16.4** | 15.0 |
| Translation reserve | | **1.1** | 2.6 |
| Hedging reserve | | **(0.5)** | 0.7 |
| Retained earnings | | **86.6** | 110.5 |
| **Total equity** | | **157.7** | 182.3 |
| **Liabilities** | | | |
| **Non-current liabilities** | | | |
| Retirement benefit obligations | 22 | **–** | 4.2 |
| Other payables | 20 | **0.7** | 0.9 |
| Interest-bearing loans and borrowings | 17 | **48.0** | 60.5 |
| Lease liabilities | 12 | **17.2** | – |
| **Total non-current liabilities** | | **65.9** | 65.6 |
| **Current liabilities** | | | |
| Trade and other payables | 20 | **247.4** | 313.2 |
| Taxation | 8 | **–** | 2.6 |
| Interest-bearing loans and borrowings | 17 | **68.0** | 10.0 |
| Lease liabilities | 12 | **12.8** | – |
| Provisions for other liabilities and charges | 21 | **0.7** | 0.9 |
| **Total current liabilities** | | **328.9** | 326.7 |
| **Total liabilities** | | **394.8** | 392.3 |
| **Total equity and liabilities** | | **552.5** | 574.6 |

The financial statements were approved by the Board of directors on 11 March 2020 and were signed on its behalf by:

**A Vaughan**
Director

**A O Bickerstaff**
Director

**Registered number: 1393773**

# Company Statement of Financial Position

As at 31 December

| | Notes | 2019 £m | 2018 £m |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Investments in subsidiaries | 13 | **141.3** | 140.5 |
| **Total non-current assets** | | **141.3** | 140.5 |
| **Current assets** | | | |
| Trade and other receivables | 15 | **175.4** | 138.9 |
| Cash and cash equivalents | 16 | **0.1** | – |
| **Total current assets** | | **175.5** | 138.9 |
| **Total assets** | | **316.8** | 279.4 |
| **Equity** | | | |
| Share capital | 23 | **54.1** | 53.5 |
| Share premium | | **16.4** | 15.0 |
| Other reserves | | **25.9** | 25.1 |
| Hedging reserve | | **(0.2)** | 0.2 |
| Retained earnings | | **74.6** | 86.3 |
| **Total equity** | | **170.8** | 180.1 |
| **Liabilities** | | | |
| **Non-current liabilities** | | | |
| Interest-bearing loans and borrowings | 17 | **48.0** | 60.0 |
| Provisions for other liabilities and charges | 21 | **0.8** | 0.9 |
| **Total non-current liabilities** | | **48.8** | 60.9 |
| **Current liabilities** | | | |
| Trade and other payables | 20 | **27.6** | 27.0 |
| Taxation | 8 | **1.5** | 1.5 |
| Interest-bearing loans and borrowings | 17 | **68.0** | 9.8 |
| Provisions for other liabilities and charges | 21 | **0.1** | 0.1 |
| **Total current liabilities** | | **97.2** | 38.4 |
| **Total liabilities** | | **146.0** | 99.3 |
| **Total equity and liabilities** | | **316.8** | 279.4 |

The profit for the year was £3.3 million (2018: £42.5 million).

The financial statements were approved by the Board of directors on 11 March 2020 and were signed on its behalf by:

**A Vaughan**
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 2018 | 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 |
| At 1 January 2019 | **53.5** | **15.0** | **2.6** | **0.7** | **110.5** | **182.3** |
| Loss for the year | **–** | **–** | **–** | **–** | **(2.9)** | **(2.9)** |
| Other comprehensive expense | **–** | **–** | **(1.5)** | **(1.2)** | **(5.8)** | **(8.5)** |
| Issue of ordinary shares under employee share option plans | **0.3** | **0.4** | **–** | **–** | **(0.2)** | **0.5** |
| Shares purchased to satisfy employee share schemes | **–** | **–** | **–** | **–** | **(0.7)** | **(0.7)** |
| Equity-settled share-based payments | **–** | **–** | **–** | **–** | **0.5** | **0.5** |
| Dividends paid | **0.3** | **1.0** | **–** | **–** | **(14.8)** | **(13.5)** |
| **At 31 December 2019** | **54.1** | **16.4** | **1.1** | **(0.5)** | **86.6** | **157.7** |

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 2018 | 52.8 | 12.1 | 22.2 | (0.2) | 59.3 | 146.2 |
| Total 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 |
| At 1 January 2019 | **53.5** | **15.0** | **25.1** | **0.2** | **86.3** | **180.1** |
| Total comprehensive (expense)/income | **–** | **–** | **–** | **(0.4)** | **3.3** | **2.9** |
| Issue of ordinary shares under employee share option plans | **0.3** | **0.4** | **–** | **–** | **(0.2)** | **0.5** |
| Equity-settled share-based payments granted to employees of subsidiaries | **–** | **–** | **0.8** | **–** | **–** | **0.8** |
| Dividends paid | **0.3** | **1.0** | **–** | **–** | **(14.8)** | **(13.5)** |
| **At 31 December 2019** | **54.1** | **16.4** | **25.9** | **(0.2)** | **74.6** | **170.8** |

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 | 2019 £m | 2018 £m |
|---|---|---|---|
| **Cash flows from/(used by) operating activities** | | | |
| **(Loss)/profit for the year** | | **(2.9)** | 32.8 |
| Adjustments for: | | | |
| Share of results of joint ventures and associates | 13 | **(0.3)** | (0.3) |
| Finance income | 7 | **(1.0)** | (0.4) |
| Finance expense | 7 | **4.7** | 3.6 |
| Taxation | 8 | **(3.7)** | 7.4 |
| Loss on disposal of subsidiary undertakings | | **3.0** | – |
| Impairment of Alcaidesa marina | | **5.9** | – |
| Depreciation of property, plant and equipment | 4 | **17.7** | 3.2 |
| Amortisation of intangible assets | 4 | **2.6** | 3.4 |
| Employment related and other deferred consideration | | **0.2** | 0.4 |
| Pension GMP equalisation charge | | **–** | 8.6 |
| Shares purchased to satisfy employee share schemes | | **(0.7)** | (1.3) |
| Share-based payments expense | 5 | **0.5** | 2.9 |
| **Cash from operations before changes in working capital and provisions** | | **26.0** | 60.3 |
| Decrease/(increase) in inventories | | **0.1** | (0.1) |
| Decrease in receivables | | **30.2** | 8.6 |
| Decrease in payables | | **(63.5)** | (90.9) |
| Movement in provisions and employee benefits | | **(16.3)** | (15.8) |
| **Cash used by operations** | | **(23.5)** | (37.9) |
| Interest received | | **1.0** | 0.4 |
| Interest paid | | **(4.6)** | (2.4) |
| Taxation paid | | **(5.1)** | (8.2) |
| **Net cash used by operating activities** | | **(32.2)** | (48.1) |
| **Cash flows from/(used by) investing activities** | | | |
| Dividends received from joint ventures and associates | 13 | **0.2** | 0.5 |
| Additions to property, plant and equipment | 12 | **(3.8)** | (1.0) |
| Additions to intangible assets | 11 | **(3.1)** | (0.3) |
| Proceeds of disposals of property, plant and equipment and intangible assets | | **0.3** | 2.1 |
| Repayment of loans by joint ventures and associates | 13 | **0.1** | – |
| Acquisition related deferred consideration | 19 | **(1.5)** | – |
| Proceeds of sale of subsidiaries | 29 | **11.8** | – |
| **Net cash from investing activities** | | **4.0** | 1.3 |
| **Cash flows from/(used by) financing activities** | | | |
| Issue of ordinary share capital | | **0.5** | 1.8 |
| Ordinary dividends paid | 10 | **(13.5)** | (13.7) |
| Repayments of lease liabilities | | **(13.6)** | – |
| Drawdown of loans | 17/18 | **70.0** | 30.0 |
| Repayment of loans | 17/18 | **(23.6)** | (30.5) |
| **Net cash from/(used by) financing activities** | | **19.8** | (12.4) |
| **Net decrease in cash and cash equivalents** | | **(8.4)** | (59.2) |
| Cash and cash equivalents at beginning of the year | 16 | **189.3** | 248.7 |
| Effect of foreign exchange rate changes | | **–** | (0.2) |
| **Cash and cash equivalents at end of the year** | 16 | **180.9** | 189.3 |

# Company Cash Flow Statement

Year ended 31 December

| | Notes | 2019 £m | 2018 £m |
|---|---|---|---|
| **Cash flows from/(used by) operating activities** | | | |
| **Profit for the year** | | **3.3** | 42.5 |
| Adjustments for: | | | |
| Finance income | | **(5.7)** | (14.9) |
| Finance expense | | **3.3** | 3.1 |
| Taxation | | **–** | 0.3 |
| Release of provision against investment | | **–** | (29.5) |
| **Cash from operations before changes in working capital and provisions** | | **0.9** | 1.5 |
| (Increase)/decrease in receivables | | **(37.2)** | 0.2 |
| Increase/(decrease) in payables | | **0.6** | (1.5) |
| Movement in provisions | | **(0.1)** | – |
| **Cash (used by)/from operations** | | **(35.8)** | 0.2 |
| Interest received | | **2.2** | 0.9 |
| Interest paid | | **(3.3)** | (3.1) |
| Taxation received | | **0.3** | 0.3 |
| **Net cash used by operating activities** | | **(36.6)** | (1.7) |
| **Cash flows from investing activities** | | | |
| Dividends received | | **3.5** | 14.0 |
| **Net cash from investing activities** | | **3.5** | 14.0 |
| **Cash flows from/(used by) financing activities** | | | |
| Issue of ordinary share capital | | **0.5** | 1.8 |
| Ordinary dividends paid | 10 | **(13.5)** | (13.7) |
| Drawdown of loans | 17/18 | **70.0** | 30.0 |
| Repayment of loans | 17/18 | **(23.8)** | (30.4) |
| **Net cash from/(used by) financing activities** | | **33.2** | (12.3) |
| **Net movement in cash and cash equivalents** | | **0.1** | – |
| Cash and cash equivalents at beginning of the year | 16 | **–** | – |
| **Cash and cash equivalents at end of the year** | 16 | **0.1** | – |

# Notes to the Financial Statements

## 1 General information

Costain Group PLC ('the Company') is a public limited company domiciled in England and incorporated in England and Wales. The address of its registered office and principal place of business is disclosed on page 183 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 2019 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 11 March 2020.

## 2 Summary of significant accounting policies

### Basis of preparation

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 and the Companies Act 2006 applicable to companies reporting under Adopted IFRS. On publishing the Parent Company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in 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.

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 19.

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.

In determining the appropriate basis of preparation of the financial statements for the year ended 31 December 2019, the Directors are required to consider whether the Group can continue in operational existence for the foreseeable future. The Board has concluded that it is appropriate to adopt the going concern basis, having undertaken a rigorous assessment of the financial forecasts and with consideration of the anticipated net proceeds from the announced equity capital raise which the Board is confident will be approved.

#### Equity raise

The Company has proposed a new equity capital raise of up to £100 million, which has been fully underwritten on a standby basis.

### Material uncertainties

The Board considers that the Group and the Company have adequate resources to remain in operation for the foreseeable future and therefore have continued to adopt the going concern basis for the preparation of the financial statements.

In assessing the going concern assumptions, the Board has reviewed the base case plans, identified reasonable worst case downsides and anticipated receipt of proceeds from the capital raise. Applying these reasonable worst case downside scenarios the Board concluded that, while there is liquidity headroom, absent the anticipated net proceeds from the capital raise, in a reasonable worst case scenario, while the headroom on committed facilities is adequate, the headroom on the leverage covenant is limited.

The Board has concluded that to provide greater flexibility and headroom, and for the Company to take advantage of market opportunity, it would be prudent to take steps to conduct a capital raise to strengthen the balance sheet of the Group.

The Company has entered into a standby underwriting agreement to support a capital raise. While the Board has a reasonable expectation that the Company and the Group will be able to operate as a going concern for the foreseeable future, in undertaking their assessment, the Board has considered the fact that a shareholder vote is required to raise additional capital, and that the standby underwriting agreement is subject to certain specific conditions which, although customary in nature, are outside the control of the Company.

Under accounting standards these events and conditions indicate a material uncertainty on the completion of the capital raise which may cast significant doubt about the Group's and Parent Company's ability to continue as a going concern. However, in the absence of the capital raise, there are a range of alternative actions that would be available to the Board, including entering into discussions in respect of an alternative financing plan with the Group's lenders if required.

Therefore, the financial statements do not include any adjustments which would be required if the going concern basis of preparation is inappropriate. The Auditors' Report refers to this material uncertainty, and their opinion is not qualified or modified in this regard.

## 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.

The following standards and interpretations are effective for the year ended 31 December 2019:

- IFRS 16 Leases replaces IAS 17 Leases along with three Interpretations (IFRIC 4 Determining whether an Arrangement contains a Lease, SIC 15 Operating Leases-Incentives and SIC 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease). The standard is mandatory for reporting periods beginning on or after 1 January 2019.

  Under the new standard, an asset (the right-of-use asset) and a financial liability are recognised. The only exceptions are short term and low value leases.

  The Group has applied the modified retrospective approach to the transition to IFRS 16, recognising the cumulative effect at the date of initial application (1 January 2019). On transition, for leases previously accounted as operating leases with a lease term of less than 12 months and for leases of low-value assets, the Group has applied the optional exemptions in the standard to not recognise right-of-use assets but to account for the lease expense on a straight-line basis over the remaining lease term.

  The Group has elected not to include initial direct costs in the measurement of the right-of-use asset for operating leases in existence at the date of initial application of IFRS 16. The Group also elected to measure the right-of-use assets at an amount equal to the lease liability adjusted for any prepaid or accrued lease payments that existed at the date of transition. Instead of performing an impairment review on the right-of-use assets at the date of initial application, the Group has relied on its historic assessment as to whether leases were onerous immediately before the date of initial application of IFRS 16 and has benefited from the use of hindsight for determining lease term when considering options to extend and terminate leases. The Group has also elected not to reassess whether a contract is, or contains, a lease at the date of initial application. Instead, for contracts entered into before the transition date the Group relied on its assessment made applying IAS 17 Leases and IFRIC 4 Determining whether an arrangement contains a lease.

  The impact of the adoption of this standard is discussed in note 28.

# Notes to the Financial Statements continued

## 2 Summary of significant accounting policies continued

### Accounting policies continued

- IFRIC 23 – Uncertainty over Income Tax Treatments clarifies the accounting for uncertainties in income tax.
- Prepayment Features with Negative Compensation – Amendments to IFRS 9.
- Long-term Interests in Associates and Joint Ventures – Amendments to IAS 28.
- Annual Improvements to IFRS Standards 2015 – 2017 Cycle.
- Plan Amendment, Curtailment or Settlement – Amendments to IAS 19.

The other amendments listed above did not have any impact on the amounts recognised in prior periods and are not expected to significantly affect the current or future periods.

### 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 starts 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 starts 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.

### 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 90% 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.

# Notes to the Financial Statements continued

## 2 Summary of significant accounting policies continued

### Income statement presentation – Other items

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 and, therefore, exceptional or related to the accounting treatment of acquisitions. These results in presenting underlying profit and EPS which is a Non-GAAP measure. Other items includes:

- amortisation of acquired intangibles and employment related deferred consideration
- in 2019, the one-off exceptional costs of an arbitration award in respect of the remedial works deemed required to the roof in relation to a building contract completed in 2006 (note 4), the loss on disposal of two companies within the non-core Alcaidesa operation in Spain (note 29) and an impairment charge recognised on the Alcaidesa marina (note 12) and
- in 2018, the pension GMP equalisation charge (note 22) and adjustments to the estimates of the prior year RDEC grant income following the change to the methodology adopted (note 4).

These items 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 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. Development expenditure that satisfies all the relevant conditions is capitalised as an intangible asset (see below).

### 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, development expenditure 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, development expenditure and patents are carried at cost. Once the asset is complete, 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.

Internally generated development expenditure is recognised as an intangible asset only if all of the following conditions are satisfied:

- the asset can be identified
- it is probable that the asset will create future economic benefits
- the development costs can be measured reliably.

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

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

### Property, plant and equipment

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

| | |
|---|---|
| Freehold buildings | – 50 years |
| Leasehold buildings | – shorter of 50 years or lease term |
| Marina (Alcaidesa) | – concession period (18 years remaining) |
| Golf courses (Alcaidesa) | – 50 years (up to date of disposal) |
| Plant and equipment | – remaining useful life (generally 3 to 10 years) |

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

### Investments – Company

Company investments in subsidiaries are carried at cost less 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.

# Notes to the Financial Statements continued

## 2 Summary of significant accounting policies continued

### 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 used. 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

Where the Group is party to a lease, except for short-term leases or leases of low value assets (as noted below), the Group recognises a right-of-use asset and a lease liability upon lease commencement.

The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the start date, any initial direct costs incurred and an estimate of costs to dismantle and remove or to restore the underlying asset or the site on which is located, less any lease incentives received.

The asset is subsequently depreciated using the straight-line method from the start date to the earlier of the end of the useful life of the asset or the end of lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property, plant and equipment. In addition, the right-of-use asset is reduced by any impairment losses and adjusted for certain remeasurements of the lease liability associated with changes to the lease term.

The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the incremental borrowing rate.

The amount charged to the income statement comprises the depreciation of the right-of-use asset and the imputed interest on the lease liability.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in the income statement. Short-term leases are leases with a lease term of 12 months or less.

### 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.

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 22. 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 a charge to reflect the impact of GMP equalisation was included in other items in the income statement in 2018. 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

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.

### Trade and other receivables

Trade and other receivables do not carry interest and are stated at their initial value less impairment losses. Trade receivables mostly relate to long-term contracts.

### Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits.

# Notes to the Financial Statements continued

## 2 Summary of significant accounting policies continued

### Financial assets and liabilities continued

#### 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.

#### (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.

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 20.

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.

## 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.

During the course of the contract, there is often significant change to the scope of the works and this has an impact on the programme and costs on the contract. The amount of resulting compensation events can be substantial and at any time these are often not fully agreed with the customer due to the timing and requirements of the contractual process. Also many will relate to work yet to be undertaken or completed. Therefore, assessments are based on an estimate of the potential cost impact of the compensation events.

The Group's five largest compensation events positions at the year-end are summarised in aggregate below. The most significant amounts in 2019 relate to the A465 and Peterborough and Huntingdon contracts.

| | 2019 £m | 2018 £m |
|---|---|---|
| Overall contract value | **1,334.0** | 1,376.6 |
| Revenue in year | **281.3** | 260.1 |
| Total estimated end of contract compensation events | **472.1** | 372.2 |
| Total estimated unagreed end of contract compensation events | **238.6** | 247.2 |
| Total unagreed compensation events valued at year-end | **45.7** | 39.5 |

The financial impact of changes to the value of compensation events finally agreed will depend on the precise terms of the contract and the interaction with incentive arrangements, such pain/gain mechanisms and bonus or KPI arrangements, and any assessments made about costs disallowed under the contract. If the estimated value of the unagreed end of contract compensation events in relation to the currently estimated change in these contracts was increased or decreased by 10%, the impact on the financial results over the life of the contract could be an increase or decrease of up to £15.0 million (2018: up to £13.0 million). Additional compensation events for further change may also arise over the remaining contract period.

# Notes to the Financial Statements continued

## 2 Summary of significant accounting policies continued

### Significant areas of judgement and estimation continued

Our contract for the upgrade of National Grid's Peterborough and Huntingdon compressor stations has experienced significant change and additional scope which has impacted on the forecast target cost and schedule for the completion of the works, expected in 2021. We, and the client, are working to an agreed project level escalation process that includes a requirement to demonstrate our entitlement regarding the compensation events. Costs on the project have doubled due to additional scope and at this stage only a limited proportion of the £90 million reforecast outturn cost has been formally agreed. Supported by external advice, we believe that we have strong entitlement to recover the costs to date and remaining costs to be incurred over the next 18 months.

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 22.

### IFRSs not applied

The following IFRSs and amendments having been endorsed, will be applicable from 1 January 2020:

- Definition of Material – Amendments to IAS 1 and IAS 8.
- Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2019 reporting periods and have not been early adopted by the Group.

Except for the above, 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 transportation 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.

During the year, the Group transferred the nuclear business from within the infrastructure segment to natural resources and the remaining infrastructure segment has been renamed transportation. The segment information reflects this change as effective at 1 January 2019 and comparative segmental information has been represented to reflect the current segments.

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.

| 2019 | Natural resources £m | Transportation £m | Alcaidesa £m | Central costs £m | Total £m |
|---|---|---|---|---|---|
| **Segment revenue** | | | | | |
| Group revenue | 429.4 | 720.6 | 5.6 | – | 1,155.6 |
| Share of revenue of joint ventures and associates | 5.0 | 2.3 | – | – | 7.3 |
| **Total segment revenue** | 434.4 | 722.9 | 5.6 | – | 1,162.9 |
| | | | | | |
| **Segment profit/(loss)** | | | | | |
| Operating profit/(loss) before other items | 15.4 | 9.7 | (0.7) | (6.5) | 17.9 |
| Share of results of joint ventures and associates | 0.3 | – | – | – | 0.3 |
| **Profit/(loss) from operations before other items** | 15.7 | 9.7 | (0.7) | (6.5) | 18.2 |
| Other items: | | | | | |
| Exceptional costs of arbitration award on historical building project | (9.7) | – | – | – | (9.7) |
| Impairment of Alcaidesa marina | – | – | (5.9) | – | (5.9) |
| Loss on the sale or termination of operations | – | – | (3.0) | – | (3.0) |
| Amortisation of acquired intangible assets | (1.4) | (0.9) | – | – | (2.3) |
| Employment related and other deferred consideration | (0.2) | – | – | – | (0.2) |
| **Profit/(loss) from operations** | 4.4 | 8.8 | (9.6) | (6.5) | (2.9) |
| Net finance expense | | | | | (3.7) |
| **Loss before tax** | | | | | (6.6) |
| | | | | | |
| Segment profit/(loss) is stated after charging the following: | | | | | |
| Depreciation | 6.7 | 9.6 | 1.4 | – | 17.7 |
| Impairment | – | – | 5.9 | – | 5.9 |
| Amortisation (including acquired intangible assets) | 1.6 | 1.0 | – | – | 2.6 |
| | | | | | |
| **Segment assets** | | | | | |
| Reportable segment assets | 144.3 | 206.5 | 5.2 | 0.6 | 356.6 |
| Unallocated assets: | | | | | |
| Retirement benefit asset | | | | | 4.9 |
| Deferred tax | | | | | 4.6 |
| Taxation | | | | | 5.5 |
| Cash and cash equivalents | | | | | 180.9 |
| **Total assets** | | | | | 552.5 |
| | | | | | |
| **Expenditure on non-current assets** | | | | | |
| Property, plant and equipment | 0.9 | 2.7 | 0.2 | – | 3.8 |
| Intangible assets | 0.1 | 3.0 | – | – | 3.1 |
| | | | | | |
| **Segment liabilities** | | | | | |
| Reportable segment liabilities | 104.9 | 159.4 | 1.5 | 13.0 | 278.8 |
| Unallocated liabilities: | | | | | |
| Borrowings | | | | | 116.0 |
| **Total liabilities** | | | | | 394.8 |

# Notes to the Financial Statements continued

## 3 Operating segments continued

| 2018 (Restated) | Natural resources £m | Transportation £m | Alcaidesa £m | Central costs £m | Total £m |
|---|---|---|---|---|---|
| **Segment revenue** | | | | | |
| Group revenue | 472.7 | 985.6 | 5.4 | – | 1,463.7 |
| Share of revenue of joint ventures and associates | 7.1 | 18.5 | – | – | 25.6 |
| **Total segment revenue** | 479.8 | 1,004.1 | 5.4 | – | 1,489.3 |
| **Segment profit/(loss)** | | | | | |
| Operating profit/(loss) before other items | 18.7 | 41.4 | (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** | 19.0 | 41.4 | (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** | 17.2 | 39.8 | (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 | 125.6 | 218.2 | 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 | 106.8 | 184.7 | 2.3 | 21.2 | 315.0 |
| Unallocated liabilities: | | | | | |
| Retirement benefit obligations | | | | | 4.2 |
| Borrowings | | | | | 70.5 |
| Taxation | | | | | 2.6 |
| **Total liabilities** | | | | | 392.3 |

### 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.

| 2019 | External revenue £m | Share of revenue of JVs and assoc's £m | Total segment revenue £m | Non-current assets £m |
|---|---|---|---|---|
| UK | **1,150.0** | **7.3** | **1,157.3** | **107.5** |
| Spain | **5.6** | **–** | **5.6** | **6.0** |
| | **1,155.6** | **7.3** | **1,162.9** | **113.5** |

| 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 |

### Customers accounting for more than 10% of revenue

Three customers (2018: three) in the transportation segment accounted for revenue of £631.4 million (2018: £758.1 million).

## 4 Other operating expenses and income

| | 2019 £m | 2018 £m |
|---|---|---|
| (Loss)/profit before tax is stated after charging: | | |
| Amortisation of intangible assets (note 11) | **2.6** | 3.4 |
| Depreciation and impairment of property, plant and equipment (note 12) | **17.7** | 3.2 |
| Exceptional costs of arbitration award on historical building project | **9.7** | – |
| Pension GMP equalisation charge (note 22) | **–** | 8.6 |
| Loss on disposal of subsidiary undertakings (note 29) | **3.0** | – |
| Hire of plant and machinery | **32.8** | 31.6 |
| Rent of land and buildings | **0.2** | 4.3 |
| and after crediting: | | |
| Income from sub-leases of land and buildings | **0.1** | 0.2 |
| RDEC grant income | **3.8** | 1.7 |
| RDEC grant income – prior year | **–** | 2.6 |

An arbitration award in favour of the client for the cost of remedial works deemed required to the roof of a building constructed by the Group under a contract completed in 2006 was expensed in the year (2018: £nil).

The impairment includes £5.9 million in respect of Alcaidesa marina reflecting the fair value based on the latest offers for the asset.

### Auditors' remuneration

| | 2019 £m | 2018 £m |
|---|---|---|
| Fees payable to the Group's auditors for the audit of the annual financial statements | **0.1** | 0.1 |
| Fees payable to the Group's auditors and its associates in respect of: | | |
| Audit of financial statements of subsidiaries of the Company | **0.5** | 0.4 |
| | **0.6** | 0.5 |

An amount of less than £0.1 million was paid to the Group's auditors in 2019 (2018: 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 auditors 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.

# Notes to the Financial Statements continued

## 5 Employee benefit expense

| Group | 2019 £m | 2018 £m |
|---|---|---|
| Wages and salaries | **206.5** | 219.5 |
| Social security costs | **22.3** | 24.4 |
| Other pension costs – defined contribution schemes (note 22) | **10.4** | 9.8 |
| Share-based payments expense (note 22) | **0.5** | 2.9 |
| | **239.7** | 256.6 |

| | 2019 Number | 2018 (Restated) Number |
|---|---|---|
| **Average number of persons employed** | | |
| Natural resources | **1,418** | 1,353 |
| Transportation | **2,109** | 2,521 |
| Alcaidesa | **68** | 70 |
| Central | **18** | 18 |
| | **3,613** | 3,962 |

Of the above employees 70 were employed overseas (2018: 72).

### 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 2019 and 2018 are detailed below.

| | 2019 £m | 2018 £m |
|---|---|---|
| Remuneration | **1.2** | 1.7 |
| Post-employment benefits | **0.1** | 0.2 |
| Gains made on the exercise of share-based plans | **–** | 1.1 |
| | **1.3** | 3.0 |

## 7 Net finance expense

| | 2019 £m | 2018 £m |
|---|---|---|
| Interest income from bank deposits | **0.7** | 0.3 |
| Interest income on loans to related parties | **0.2** | 0.1 |
| Interest income on the net assets of the defined benefit pension scheme (note 22) | **0.1** | – |
| Finance income | **1.0** | 0.4 |
| Interest payable on interest bearing bank loans, borrowings and other similar charges | **(3.3)** | (3.1) |
| Interest expense on lease liabilities | **(1.3)** | – |
| Unwind of discount on deferred consideration | **(0.1)** | (0.1) |
| Interest expense on the net liabilities of the defined benefit pension scheme (note 22) | **–** | (0.4) |
| Finance expense | **(4.7)** | (3.6) |
| Net finance expense | **(3.7)** | (3.2) |

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

| | 2019 £m | 2018 £m |
|---|---|---|
| **On (loss)/profit for the year** | | |
| UK corporation tax at 19% (2018: 19%) | **1.1** | (6.6) |
| Adjustment in respect of prior years | **1.9** | 3.7 |
| Current tax credit/(expense) for the year | **3.0** | (2.9) |
| Deferred tax expense for the current year | **(1.2)** | (0.8) |
| Adjustment in respect of prior years | **1.9** | (3.7) |
| Deferred tax credit/(expense) for the year | **0.7** | (4.5) |
| **Tax credit/(expense) in the consolidated income statement** | **3.7** | (7.4) |

| | 2019 £m | 2018 £m |
|---|---|---|
| **Tax reconciliation** | | |
| (Loss)/profit before tax | **(6.6)** | 40.2 |
| Taxation at 19% (2018: 19%) | **1.3** | (7.6) |
| Share of results of joint ventures and associates | **–** | 0.1 |
| Amounts qualifying for tax relief and disallowed expenses | **(1.2)** | 0.1 |
| Rate adjustment relating to deferred taxation and overseas profits and losses | **(0.2)** | – |
| Adjustments in respect of prior years | **3.8** | – |
| **Tax credit/(expense) in the consolidated income statement** | **3.7** | (7.4) |
| **Effective rate of tax** | **56.1%** | 18.4% |

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.

# Notes to the Financial Statements continued

## 8 Taxation continued

The current tax assets of £5.5 million (2018: liabilities of £2.6 million) for the Group and liability of £1.5 million (2018: £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 assets and liabilities, where appropriate.

Accumulated tax trading losses carried forward in the UK were £13.0 million (2018: £0.1 million).

Accumulated tax losses carried forward in Spain were £11.2 million (2018: £60.5 million). See note 29.

| | 2019 £m | 2018 £m |
|---|---|---|
| **Deferred tax asset recognised** | | |
| Accelerated capital allowances | **1.3** | 1.3 |
| Short-term temporary differences | **1.9** | 0.6 |
| Retirement benefit obligations | **(0.8)** | 0.8 |
| Tax losses | **2.2** | – |
| **Deferred tax asset** | **4.6** | 2.7 |

UK deferred tax assets have been recognised at 17% (2018: 17% or 19% as applicable) and Spanish tax losses have not been recognised.

It is expected that £2.1 million of deferred tax assets will be reversed during 2020.

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

| | 2019 £m | 2018 £m |
|---|---|---|
| **Analysis of deferred tax movements** | | |
| At 1 January | **2.7** | 10.1 |
| **Deferred tax in consolidated income statement** | | |
| Accelerated capital allowances | **–** | (0.3) |
| Short-term temporary differences | **1.3** | 0.4 |
| Retirement benefit assets/obligations | **(2.8)** | (1.2) |
| Tax losses | **2.2** | (3.4) |
| | **0.7** | (4.5) |
| **Deferred tax in other comprehensive income and expense statement** | | |
| Retirement benefit assets/obligations | **1.2** | (2.5) |
| **Deferred tax recognised directly in the consolidated statement of changes in equity** | | |
| Short-term temporary differences | **–** | (0.4) |
| **At 31 December** | **4.6** | 2.7 |

## 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 (2018: 17%, or 19% where the asset unwound during 2019).

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 | |
|---|---|---|---|---|
| | **2019 £m** | **2018 £m** | **2019 £m** | **2018 £m** |
| Accelerated capital allowances | **–** | 2.2 | **–** | – |
| Short-term temporary differences | **–** | 6.3 | **–** | – |
| Trading tax losses | **0.1** | 0.1 | **–** | – |
| Total | **0.1** | 8.6 | **–** | – |
| 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 | **11.2** | 60.5 | **–** | – |
| Capital losses | **270.6** | 270.6 | **241.0** | 241.0 |

The current year tax effect, at 17%, of claiming short-term temporary differences and trading tax losses was £nil (2018: £nil) 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 (Loss)/earnings per share

The calculation of (loss)/earnings per share is based on loss of £2.9 million (2018: profit £32.8 million) and the number of shares set out below.

| | **2019 Number (millions)** | **2018 Number (millions)** |
|---|---|---|
| Weighted average number of ordinary shares in issue for basic earnings per share calculation | **107.6** | 106.3 |
| Dilutive potential ordinary shares arising from employee share schemes | **0.2** | 2.3 |
| Weighted average number of ordinary shares in issue for diluted earnings per share calculation | **107.8** | 108.6 |

At 31 December 2019, 1,463,187 options were excluded from the weighted average number of ordinary shares calculation because they were anti-dilutive (2018: no options were excluded).

# Notes to the Financial Statements continued

## 10 Dividends

| | Dividend per share pence | 2019 £m | 2018 £m |
|---|---|---|---|
| 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 |
| Final dividend for the year ended 31 December 2018 | 10.00 | **10.7** | – |
| Interim dividend for the year ended 31 December 2019 | 3.80 | **4.1** | – |
| Amount recognised as distributions to equity holders in the year | | **14.8** | 15.2 |
| Dividends settled in shares | | **(1.3)** | (1.5) |
| Dividends settled in cash | | **13.5** | 13.7 |

Consistent with the rationale for the proposed equity raise, the Company will pay no final dividend in respect of the year ended 31 December 2019, therefore resulting in a total dividend paid for the year, including the interim dividend, of 3.8 pence per share (2018: 15.15 pence).

## 11 Intangible assets

| Group | Goodwill £m | Customer relationships £m | Other acquired intangibles £m | Other intangibles £m | Total £m |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| 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 |
| At 1 January 2019 | **54.1** | **15.4** | **9.7** | **7.7** | **86.9** |
| Additions | **–** | **–** | **–** | **3.1** | **3.1** |
| **At 31 December 2019** | **54.1** | **15.4** | **9.7** | **10.8** | **90.0** |
| **Accumulated amortisation** | | | | | |
| 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 |
| At 1 January 2019 | **–** | **12.5** | **8.9** | **7.0** | **28.4** |
| Charge in year | **–** | **1.8** | **0.5** | **0.3** | **2.6** |
| **At 31 December 2019** | **–** | **14.3** | **9.4** | **7.3** | **31.0** |
| **Net book value** | | | | | |
| **At 31 December 2019** | **54.1** | **1.1** | **0.3** | **3.5** | **59.0** |
| At 31 December 2018 | 54.1 | 2.9 | 0.8 | 0.7 | 58.5 |
| At 1 January 2018 | 54.1 | 5.2 | 1.5 | 1.7 | 62.5 |

The amortisation charges for the year are included in administration expenses.

The net book value of other acquired intangible assets includes £0.3 million (2018: £0.6 million) relating to order book.

Other intangibles includes development expenditure of £2.8 million (2018: £nil).

Goodwill has been allocated to the applicable cash generating units of the transportation 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 transportation CGU was 10.9% and for the natural resources CGU was 10.2%. In 2018, the discount rates used for the two CGUs were infrastructure 10.7% and natural resources 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** | **Transportation %** | **Natural resources %** |
|---|---|---|
| Year 4 | 1.4 | 1.4 |
| Year 5 | 1.4 | 1.4 |
| Long-term average | 1.4 | 1.4 |

At 31 December 2019, 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 10.2% to 22.8%
- growth rate – reduce from positive 1.5% to a negative value
- underlying operating margin – reduce forecast margin by 2.9%.

# Notes to the Financial Statements continued

## 12 Property, plant and equipment

| Group | Land and buildings £m | Plant and equipment £m | Right-of-use assets: Land and buildings £m | Right-of-use assets: Vehicles, plant and equipment £m | Total £m |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| 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 |
| At 1 January 2019 | **32.1** | **32.2** | **–** | **–** | **64.3** |
| Adjustment on transition to IFRS 16 | **–** | **–** | **20.0** | **13.0** | **33.0** |
| Restated at the beginning of the financial year | **32.1** | **32.2** | **20.0** | **13.0** | **97.3** |
| Currency movements | **(1.1)** | **(0.2)** | **–** | **–** | **(1.3)** |
| Additions | **0.1** | **3.7** | **1.7** | **12.1** | **17.6** |
| Disposal of subsidiary undertakings (note 29) | **(18.4)** | **(1.0)** | **–** | **–** | **(19.4)** |
| Disposals | **(0.2)** | **(2.4)** | **(2.2)** | **(3.9)** | **(8.7)** |
| **At 31 December 2019** | **12.5** | **32.3** | **19.5** | **21.2** | **85.5** |
| **Accumulated depreciation** | | | | | |
| 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 |
| At 1 January 2019 | **3.8** | **20.5** | **–** | **–** | **24.3** |
| Currency movements | **(0.3)** | **(0.1)** | **–** | **–** | **(0.4)** |
| Charge in year | **0.8** | **2.9** | **4.6** | **9.4** | **17.7** |
| Impairment | **5.9** | **–** | **–** | **–** | **5.9** |
| Disposal of subsidiary undertakings (note 29) | **(0.5)** | **(0.4)** | **–** | **–** | **(0.9)** |
| Disposals | **(0.2)** | **(2.1)** | **(0.3)** | **(2.6)** | **(5.2)** |
| **At 31 December 2019** | **9.5** | **20.8** | **4.3** | **6.8** | **41.4** |
| **Net book value** | | | | | |
| **At 31 December 2019** | **3.0** | **11.5** | **15.2** | **14.4** | **44.1** |
| At 31 December 2018 | 28.3 | 11.7 | – | – | 40.0 |
| At 1 January 2018 | 30.0 | 13.0 | – | – | 43.0 |

Land and buildings includes an impairment charge of £5.9 million in relation to the Alcaidesa marina.

### Leased assets

Other amounts recognised in the income statement:

| | 2019 £m | 2018 £m |
|---|---|---|
| Interest expense (included in finance expense) | **(1.3)** | – |
| Expense relating to short-term leases (included in cost of sales and administrative expenses) | **(0.9)** | – |

The lease liabilities relating to these assets are as follows:

| | 2019 £m | 1 January 2019 £m |
|---|---|---|
| Current | **12.8** | 13.4 |
| Non-current | **17.2** | 19.6 |
| | **30.0** | 33.0 |

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

| | Investments | | Loans | |
|---|---|---|---|---|
| **Group** | **Joint ventures £m** | **Associates £m** | **Associates £m** | **Total £m** |
| **Cost** | | | | |
| At 1 January 2018 | 14.4 | 0.1 | 1.6 | 16.1 |
| At 31 December 2018 | 14.4 | 0.1 | 1.6 | 16.1 |
| At 1 January 2019 | **14.4** | **0.1** | **1.6** | **16.1** |
| Repayments | **–** | **–** | **(0.1)** | **(0.1)** |
| **At 31 December 2019** | **14.4** | **0.1** | **1.5** | **16.0** |
| **Share of post-acquisition reserves** | | | | |
| 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) |
| At 1 January 2019 | **(14.0)** | **0.4** | | **(13.6)** |
| Dividends | **–** | **(0.2)** | | **(0.2)** |
| Profit for the year | **–** | **0.3** | | **0.3** |
| **At 31 December 2019** | **(14.0)** | **0.5** | | **(13.5)** |
| **Net book value** | | | | |
| **At 31 December 2019** | **0.4** | **0.6** | **1.5** | **2.5** |
| At 31 December 2018 | 0.4 | 0.5 | 1.6 | 2.5 |
| At 1 January 2018 | 0.3 | 0.8 | 1.6 | 2.7 |

# Notes to the Financial Statements continued

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

### Analysis of Group share of joint ventures and associates revenue, income and assets and liabilities

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Joint ventures £m | Associates £m | Total £m | Joint ventures £m | Associates £m | Total £m |
| Revenue | **6.5** | **0.8** | **7.3** | 24.8 | 0.8 | 25.6 |
| Profit before tax | **–** | **0.3** | **0.3** | 0.1 | 0.2 | 0.3 |
| Taxation | **–** | **–** | **–** | – | – | – |
| Profit for the year | **–** | **0.3** | **0.3** | 0.1 | 0.2 | 0.3 |
| Non-current assets | **–** | **–** | **–** | – | – | – |
| Trade and other receivables | **6.9** | **1.4** | **8.3** | 6.7 | 1.5 | 8.2 |
| Cash and cash equivalents | **0.2** | **0.6** | **0.8** | 2.9 | 0.5 | 3.4 |
| Trade and other payables – current | **(6.7)** | **(0.2)** | **(6.9)** | (9.2) | (0.3) | (9.5) |
| Non-current liabilities | **–** | **(1.2)** | **(1.2)** | – | (1.2) | (1.2) |
| Investments in joint ventures and associates | **0.4** | **0.6** | **1.0** | 0.4 | 0.5 | 0.9 |
| Dividends received by Group | **–** | **0.2** | **0.2** | – | 0.5 | 0.5 |

Net interest payable by joint ventures and associates in 2019 was £nil (2018: £nil). The applicable interest rates during the year are income of 0.2% to 13.6% per annum (2018: 0.2% to 13.6%) and expense of 10.7% to 13.6% per annum (2018: 10.7% to 13.6%).

At the year-end, there were no capital or financial commitments entered into by the joint ventures or associates (2018: £nil).

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

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Joint ventures £m | Associates £m | Total £m | Joint ventures £m | Associates £m | Total £m |
| Revenue | **17.3** | **2.0** | **19.3** | 71.5 | 2.0 | 73.5 |
| Profit before tax | **–** | **0.7** | **0.7** | 0.1 | 0.7 | 0.8 |
| Taxation | **–** | **(0.1)** | **(0.1)** | – | (0.1) | (0.1) |
| Profit for the year | **–** | **0.6** | **0.6** | 0.1 | 0.6 | 0.7 |
| Non-current assets | **–** | **–** | **–** | 0.1 | – | 0.1 |
| Trade and other receivables | **19.4** | **3.5** | **22.9** | 18.3 | 3.7 | 22.0 |
| Cash and cash equivalents | **0.5** | **1.5** | **2.0** | 8.3 | 1.3 | 9.6 |
| Trade and other payables – current | **(19.0)** | **(0.6)** | **(19.6)** | (25.7) | (0.7) | (26.4) |
| Non-current liabilities | **–** | **(3.0)** | **(3.0)** | – | (3.0) | (3.0) |
| Equity | **0.9** | **1.4** | **2.3** | 1.0 | 1.3 | 2.3 |

Details of subsidiary undertakings, joint ventures, joint operations and associates are shown in note 26.

There is no other comprehensive income/(expense) in respect of joint ventures and the associates.

## Company

| Investments in subsidiaries | £m |
|---|---|
| **Cost** | |
| At 1 January 2018 | 377.3 |
| Additions | 2.9 |
| At 31 December 2018 | 380.2 |
| At 1 January 2019 | **380.2** |
| Additions | **0.8** |
| **At 31 December 2019** | **381.0** |
| **Amounts written off** | |
| At 1 January 2018 | (269.2) |
| Release of provision | 29.5 |
| At 31 December 2018 | (239.7) |
| At 1 January 2019 | **(239.7)** |
| **At 31 December 2019** | **(239.7)** |
| | |
| **Net book value** | |
| **At 31 December 2019** | **141.3** |
| At 31 December 2018 | 140.5 |
| At 1 January 2018 | 108.1 |

Additions relate to the increase in the cost of investments in subsidiaries by the equivalent amount of the equity-settled share-based payment charge in relation to employees of subsidiaries included in the income statement.

Details of the subsidiaries in which the Company has an interest are set out in note 26.

### 14 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:

| | 2019 £m | 2018 £m |
|---|---|---|
| Contract assets | **133.5** | 141.8 |
| Non-current assets recognised relating to customer retentions | **1.5** | 3.0 |
| Contract liabilities | **(6.4)** | (13.7) |

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. 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 2019 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 £4,063.0 million (2018: £3,894.6 million). Progress billings and advances received from customers under open construction contracts amounted to £3,938.2 million (2018: £3,706.3 million). Advances for which work has not started, and billings in excess of costs incurred and recognised profits are included in credit balances on long-term contracts.

# Notes to the Financial Statements continued

## 14 Assets and liabilities related to contracts with customers continued

### Unsatisfied long-term contracts

The following table shows unsatisfied performance obligations resulting from long-term contracts:

| | 2019 £m | 2018 £m |
|---|---|---|
| Aggregate amount of the transaction price allocated to long-term contracts that are partially or fully unsatisfied as at 31 December | **1,358.8** | 1,653.8 |

Management expects that approximately 50% of the transaction price allocated to the unsatisfied contracts as of 31 December 2019 will be recognised as revenue during the next reporting period (£657 million). The remaining 50% will be recognised in the period up to and including 2024.

### 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.

## 15 Trade and other receivables

| | Group | | Company | |
|---|---|---|---|---|
| | 2019 £m | 2018 £m | 2019 £m | 2018 £m |
| **Amounts included in current assets** | | | | |
| Trade receivables | **70.0** | 85.2 | **–** | – |
| Other receivables | **10.1** | 19.7 | **–** | – |
| Contract assets | **133.5** | 141.8 | **–** | – |
| Prepayments and accrued income | **31.0** | 28.3 | **–** | 0.3 |
| Amounts owed by joint ventures and associates | **3.0** | 1.5 | **–** | – |
| Amounts owed by subsidiary undertakings | **–** | – | **175.4** | 138.6 |
| | **247.6** | 276.5 | **175.4** | 138.9 |
| **Amounts included in non-current assets** | | | | |
| Other | **2.1** | 3.6 | **–** | – |

At 31 December 2019, contract assets falling due within one year include retentions of £2.3 million (2018: £5.2 million) relating to long-term contracts in progress. Other receivables falling due after more than one year include retentions of £1.5 million (2018: £3.0 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 35 days (2018: 33 days). The analysis of the due dates of the trade receivables was £60.5 million (2018: £72.6 million) due within 30 days, £2.1 million (2018: £6.7 million) due between 30 and 60 days and £7.4 million (2018: £5.9 million) due after 60 days. An analysis of trade receivables that are beyond their due dates is shown in note 19.

In respect of the Company, amounts due from subsidiary undertakings are repayable on demand and may be interest-bearing.

## 16 Cash and cash equivalents

Cash and cash equivalents are analysed below, and include the Group's share of cash held by joint operations of £83.5 million (2018: £84.5 million).

| | Group | | Company | |
|---|---|---|---|---|
| | 2019 £m | 2018 £m | 2019 £m | 2018 £m |
| Cash and cash equivalents | **180.9** | 189.3 | **0.1** | – |
| **Cash and cash equivalents in the cash flow statement** | **180.9** | 189.3 | **0.1** | – |

## 17 Interest-bearing loans and borrowings

| | Group | | Company | |
|---|---|---|---|---|
| | 2019 £m | 2018 £m | 2019 £m | 2018 £m |
| **Current** | | | | |
| Revolving Credit Facility | **60.0** | 9.8 | **60.0** | 9.8 |
| Term Loan | **8.0** | – | **8.0** | – |
| Other loans | **–** | 0.2 | **–** | – |
| | **68.0** | 10.0 | **68.0** | 9.8 |
| **Non-current** | | | | |
| Term Loan | **48.0** | 60.0 | **48.0** | 60.0 |
| Other loans | **–** | 0.5 | **–** | – |
| | **48.0** | 60.5 | **48.0** | 60.0 |

The Group's borrowings facilities are described in note 19.

# Notes to the Financial Statements continued

## 18 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 | |
|---|---|---|---|---|
| | 2019 £m | 2018 £m | 2019 £m | 2018 £m |
| Cash and cash equivalents (note 16) | **180.9** | 189.3 | **0.1** | – |
| Borrowings – current (note 17) | **(68.0)** | (10.0) | **(68.0)** | (9.8) |
| Borrowings – non-current (note 17) | **(48.0)** | (60.5) | **(48.0)** | (60.0) |
| Net cash/(debt) | **64.9** | 118.8 | **(115.9)** | (69.8) |

| Group | Cash and cash equivalents £m | Borrowings – current £m | Borrowings – non-current £m | Total £m |
|---|---|---|---|---|
| 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 |
| Net cash/(debt) at 1 January 2019 | **189.3** | **(10.0)** | **(60.5)** | **118.8** |
| Cash flows | **(8.4)** | **(58.9)** | **12.5** | **(54.8)** |
| Disposal of subsidiary undertakings | **–** | **0.7** | **–** | **0.7** |
| Effect of foreign exchange rate changes | **–** | **0.2** | **–** | **0.2** |
| Net cash/(debt) at 31 December 2019 | **180.9** | **(68.0)** | **(48.0)** | **64.9** |

| Company | Cash and cash equivalents £m | Borrowings – current £m | Borrowings – non-current £m | Total £m |
|---|---|---|---|---|
| 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) |
| Net cash/(debt) at 1 January 2019 | **–** | **(9.8)** | **(60.0)** | **(69.8)** |
| Cash flows | **0.1** | **(58.2)** | **12.0** | **(46.1)** |
| Net cash/(debt) at 31 December 2019 | **0.1** | **(68.0)** | **(48.0)** | **(115.9)** |

## 19 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, 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 £41.2 million (2018: £77.1 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 2019, the Group had banking and bonding facilities, including a £131.0 million (2018: £131.0 million) Revolving Credit Facility and a £56.0 million (2018: £60.0 million) Term Loan, extending to 25 June 2022. The unsecured 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 2019. The unsecured bonding facilities are set out below:

| | Group and Company | |
|---|---|---|
| | **2019 £m** | **2018 £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 2019, the utilisation of these bonding facilities amounted to £122.0 million (2018: £99.9 million).

# Notes to the Financial Statements continued

## 19 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 considers the timing and amounts of progress payments and will enter into a contract only if these assessments are 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 £1,123.5 million (2018: £1,428.8 million) was attributable to Group 1 customers and £32.1 million (2018: £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 2019 and 31 December 2018 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 2019** | | | | | |
| **Group 1** | | | | | |
| Expected loss rate | **0.00%** | **0.10%** | **0.25%** | **0.50%** | |
| | **£m** | **£m** | **£m** | **£m** | **£m** |
| Trade receivables | **58.3** | **3.4** | **2.2** | **6.1** | **70.0** |
| Contract assets | **90.4** | **24.8** | **8.3** | **10.0** | **133.5** |
| **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 | **–** | **0.1** | **–** | **–** | **0.1** |
| Contract assets | **–** | **–** | **–** | **–** | **–** |
| **Loss allowance** | **–** | **–** | **–** | **–** | **–** |
| **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 |

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 £0.4 million (2018: £0.5 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 up to the date of the disposal of the subsidiary undertakings, in Spain. The largest constituents are UK balances denominated in pounds sterling.

The Group has interest rate swap arrangements that fix 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 £0.7 million (2018: approximately £1.0 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 remaining Spanish subsidiary, Alcaidesa Servicios SAU is denominated in euro. At the year-end, the carrying value of the net assets was £4.9 million (2018: Alcaidesa Holding S.A.U. and subsidiaries £25.5 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 2019 was €6.0 million (£5.1 million) (2018: €28.0 million (£25.0 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 (2018: £0.1 million), but would have no impact on the statement of financial position (2018: £nil).

# Notes to the Financial Statements continued

## 19 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 2019, 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 (2018: none).

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | **(0.5)** | **(13.0)** | **(12.5)** | **(0.5)** | 0.7 | (18.1) | (17.2) | (0.9) |
| Sales | **0.1** | **1.0** | **0.5** | **0.5** | (0.1) | (2.6) | (2.6) | – |
| | **(0.4)** | **(12.0)** | **(12.0)** | **–** | 0.6 | (20.7) | (19.8) | (0.9) |
| Interest rate swaps | **(0.2)** | **(0.7)** | **(0.5)** | **(0.2)** | 0.2 | (1.5) | (0.6) | (0.9) |
| | **(0.6)** | **(12.7)** | **(12.5)** | **(0.2)** | 0.8 | (22.2) | (20.4) | (1.8) |

The carrying amount of hedge instruments is included in trade and other receivables or trade and other payables. The expected impact on the income statement of the foreign exchange contracts is £0.4 million and of the interest rate swaps is £0.1 million in 2020.

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 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 |
| At 1 January 2019 | **0.5** | **0.2** | **0.7** |
| Change in fair value of hedging instrument recognised in OCI for the year | **0.1** | **(0.5)** | **(0.4)** |
| Reclassified from OCI to profit or loss | **(0.8)** | **–** | **(0.8)** |
| Deferred tax | **–** | **–** | **–** |
| At 31 December 2019 | **(0.2)** | **(0.3)** | **(0.5)** |

The Company is party to the interest rate swaps. It does not have any forward foreign currency contracts or other derivatives.

## 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

| | 2019 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | **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 | **178.9** | **178.9** | **–** | **–** | 186.1 | 186.1 | – | – |
| other | **2.0** | **2.0** | **–** | **–** | 3.2 | 3.2 | – | – |
| | **180.9** | **180.9** | **–** | **–** | 189.3 | 189.3 | – | – |
| Loans to joint ventures and associates: | | | | | | | | |
| pounds sterling | **1.5** | **0.1** | **0.4** | **1.0** | 1.6 | 0.1 | 0.4 | 1.1 |
| Trade, other receivables and amounts owed by joint ventures and associates: | | | | | | | | |
| pounds sterling | **85.1** | **83.0** | **2.1** | **–** | 109.5 | 105.9 | 3.6 | – |
| other | **0.1** | **0.1** | **–** | **–** | 0.5 | 0.5 | – | – |
| | **85.2** | **83.1** | **2.1** | **–** | 110.0 | 106.4 | 3.6 | – |
| **Total financial assets not measured at fair value** | **267.6** | **264.1** | **2.5** | **1.0** | 300.9 | 295.8 | 4.0 | 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 £1.5 million (2018: £1.6 million), but not by a material amount.

### Financial assets measured at fair value

The Group measures its currency forwards and interest rate swaps at fair value (see above) but does not have any other financial assets measured at fair value.

# Notes to the Financial Statements continued

## 19 Financial instruments – Fair values and risk management continued

### Financial assets and liabilities continued

### b) Currency and maturity of financial liabilities

#### Financial liabilities not measured at fair value

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | 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 | **56.0** | **8.0** | **48.0** | 60.0 | – | 60.0 |
| Revolving Credit Facility: | | | | | | |
| pounds sterling | **60.0** | **60.0** | **–** | – | – | – |
| euro | **–** | **–** | **–** | 9.8 | 9.8 | – |
| Other loans – euro | **–** | **–** | **–** | 0.7 | 0.2 | 0.5 |
| | **116.0** | **68.0** | **48.0** | 70.5 | 10.0 | 60.5 |
| Lease liabilities – pounds sterling | **30.0** | **12.8** | **17.2** | – | – | – |
| Trade and other payables: | | | | | | |
| pounds sterling | **126.2** | **125.5** | **0.7** | 161.7 | 160.8 | 0.9 |
| other | **–** | **–** | **–** | 1.8 | 1.8 | – |
| | **126.2** | **125.5** | **0.7** | 163.5 | 162.6 | 0.9 |
| **Total financial liabilities not measured at fair value** | **272.2** | **206.3** | **65.9** | 234.0 | 172.6 | 61.4 |

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.

Lease liabilities are carried at the present value of the minimum lease payments.

#### Financial liabilities measured at fair value

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | 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 | – |

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.

### c) Reconciliation of trade and other receivables and trade and other payables to the statement of financial position

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Current £m** | **Non-current £m** | **Current £m** | **Non-current £m** |
| Trade and other receivables (as above) | **83.1** | **2.1** | 106.4 | 3.6 |
| Contract assets | **133.5** | **–** | 141.8 | – |
| Prepayments and accrued income | **31.0** | **–** | 28.3 | – |
| | **247.6** | **2.1** | 276.5 | 3.6 |

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Current £m** | **Non-current £m** | **Current £m** | **Non-current £m** |
| Trade and other payables (as above) | **125.5** | **0.7** | 162.6 | 0.9 |
| Deferred consideration (as above) | **–** | **–** | 1.2 | – |
| Contract liabilities | **6.4** | **–** | 13.7 | – |
| Accruals and deferred income | **115.5** | **–** | 135.7 | – |
| | **247.4** | **0.7** | 313.2 | 0.9 |

### d) Effective interest rates of financial assets and liabilities

| | 2019 | 2018 |
|---|---|---|
| **Financial assets** | | |
| Cash and cash equivalents | **0.0% to 0.7%** | 0.0% to 0.6% |
| 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) and had other loans in the prior year. The £56.0 million (2018: £60.0 million) Term Loan and £60.0 million (2018: £9.8 million) of the RCF were drawn at the year-end. 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 in the prior year totalled £0.7 million and were secured on the assets acquired from the loan proceeds and carried interest at a margin over EURIBOR).

The Company's financial assets comprised cash at bank of £0.1 million (2018: £nil) and trade and other receivables of £175.4 million (2018: £138.6 million) with £174.2 million (2018: £127.8 million) denominated in pounds sterling and £1.2 million (2018: £10.8 million) denominated in euros and all maturing within one year.

The Company's financial liabilities comprise trade and other payables of £26.4 million (2018: £26.4 million) denominated in pounds sterling, the £56.0 million (2018: £60.0 million) Term Loan denominated in pounds sterling and the £60.0 million RCF denominated in pounds sterling (2018: £9.8 million RCF denominated in euro). The Term Loan matures between one and five years, all other liabilities mature within one year.

# Notes to the Financial Statements continued

## 19 Financial instruments – Fair values and risk management continued

### 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 2018 | 0.7 |
| Addition charged to income statement (including unwind of discount) | 0.5 |
| At 31 December 2018 | 1.2 |
| At 1 January 2019 | **1.2** |
| Addition charged to income statement (including unwind of discount) | **0.3** |
| Payments | **(1.5)** |
| **At 31 December 2019** | **–** |

There were no transfers out of Level 3 during the year.

## 20 Trade and other payables

| | Group | | Company | |
|---|---|---|---|---|
| | **2019 £m** | **2018 £m** | **2019 £m** | **2018 £m** |
| **Current liabilities** | | | | |
| Trade payables | **97.4** | 125.6 | **–** | – |
| Other payables | **21.2** | 29.2 | **0.1** | 0.1 |
| Social security | **6.5** | 7.4 | **–** | – |
| Contract liabilities | **6.4** | 13.7 | **–** | – |
| Accruals and deferred income | **115.5** | 135.7 | **1.2** | 0.6 |
| Deferred consideration | **–** | 1.2 | **–** | – |
| Amounts owed to joint ventures and associates | **0.4** | 0.4 | **–** | – |
| Amounts owed to subsidiary undertakings | **–** | – | **26.3** | 26.3 |
| | **247.4** | 313.2 | **27.6** | 27.0 |
| **Non-current liabilities** | | | | |
| Other payables | **0.7** | 0.9 | **–** | – |
| | **0.7** | 0.9 | **–** | – |

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 2018 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.

# Notes to the Financial Statements continued

## 21 Provisions for other liabilities and charges

| Group | Property £m | Other £m | Total £m |
|---|---|---|---|
| **Current** | | | |
| 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 |
| At 1 January 2019 | **–** | **0.9** | **0.9** |
| Provided | **–** | **0.6** | **0.6** |
| Utilised | **–** | **(0.8)** | **(0.8)** |
| **At 31 December 2019** | **–** | **0.7** | **0.7** |
| **Non-current** | | | |
| At 1 January 2018 | – | – | – |
| At 31 December 2018 | – | – | – |
| At 1 January 2019 | **–** | **–** | **–** |
| **At 31 December 2019** | **–** | **–** | **–** |

| Company | Funding obligations £m |
|---|---|
| **Current** | |
| At 1 January 2018 | 0.1 |
| Reclassified from non-current | 0.1 |
| Utilised | (0.1) |
| At 31 December 2018 | 0.1 |
| At 1 January 2019 | **0.1** |
| Reclassified from non-current | **0.1** |
| Utilised | **(0.1)** |
| **At 31 December 2019** | **0.1** |
| **Non-current** | |
| At 1 January 2018 | 0.9 |
| Provided | 0.1 |
| Reclassified to current | (0.1) |
| **At 31 December 2018** | 0.9 |
| At 1 January 2019 | **0.9** |
| Reclassified to current | **(0.1)** |
| **At 31 December 2019** | **0.8** |

### Group

Property provisions related to costs of vacant properties and were used or released during the prior year.

Other provisions, mainly comprise insurance provisions and provisions for remedial costs, most of which are expected to be used over the next year.

### Company

Provisions in the Company relate to funding obligations to a non-trading overseas subsidiary, which eliminates on consolidation.

## 22 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 £12.7 million comprising £12.8 million included in operating costs less £0.1 million interest income included in net finance expense (2018: £20.8 million, comprising £20.4 million in operating costs plus £0.4 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 2019 and this was updated to 31 December 2019 by a qualified independent actuary. At 31 December 2019, there were 2,870 retirees and 2,846 deferred members. The weighted average duration of the obligations is 16.4 years.

| | 2019 £m | 2018 £m | 2017 £m |
|---|---|---|---|
| Present value of defined benefit obligations | **(812.1)** | (752.7) | (803.4) |
| Fair value of scheme assets | **817.0** | 748.5 | 779.5 |
| Recognised asset/(liability) for defined benefit obligations | **4.9** | (4.2) | (23.9) |

### Movements in present value of defined benefit obligations

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | **752.7** | 803.4 |
| Past service cost – GMP equalisation charge | **–** | 8.6 |
| Interest cost | **20.6** | 19.6 |
| Remeasurements – demographic assumptions | **(7.5)** | (20.7) |
| Remeasurements – financial assumptions | **74.6** | (25.9) |
| Remeasurements – experience adjustments | **9.0** | 3.9 |
| Benefits paid | **(37.3)** | (36.2) |
| **At 31 December** | **812.1** | 752.7 |

### Movements in fair value of scheme assets

| | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | **748.5** | 779.5 |
| Interest income | **20.7** | 19.2 |
| Remeasurements – return on assets | **69.1** | (29.4) |
| Contributions by employer | **16.3** | 15.7 |
| Administrative expenses | **(0.3)** | (0.3) |
| Benefits paid | **(37.3)** | (36.2) |
| **At 31 December** | **817.0** | 748.5 |

# Notes to the Financial Statements continued

## 22 Employee benefits continued

### Pensions continued

### Expense recognised in the income statement

| | 2019 £m | 2018 £m |
|---|---|---|
| Administrative expenses paid by the pension scheme | **(0.3)** | (0.3) |
| Administrative expenses paid directly by the Group | **(1.7)** | (1.7) |
| GMP equalisation charge | **–** | (8.6) |
| Interest income/(expense) on the net assets/liabilities of the defined benefit pension scheme | **0.1** | (0.4) |
| | **(1.9)** | (11.0) |

The GMP (Guaranteed Minimum Pension) equalisation charge resulted 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 was recorded as a past service cost, was an increase of £8.6 million on the reported pension liabilities in the prior year.

| Fair value of scheme assets | 2019 £m | 2018 £m |
|---|---|---|
| Overseas equities | **–** | 80.7 |
| Global equities | **162.4** | 52.4 |
| Multi-asset growth funds | **162.2** | 140.7 |
| Multi-credit fund | **160.3** | 90.8 |
| LDI plus collateral | **251.8** | 276.6 |
| PFI investments | **51.0** | 51.6 |
| Property | **17.7** | 21.2 |
| Cash | **11.6** | 34.5 |
| | **817.0** | 748.5 |

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.

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)

| | 2019 % | 2018 % | 2017 % |
|---|---|---|---|
| Discount rate | **2.05** | 2.80 | 2.50 |
| Future pension increases | **2.85** | 3.00 | 2.90 |
| Inflation assumption | **2.95** | 3.20 | 3.10 |

Weighted average life expectancy from age 65 as per mortality tables used to determine benefits at 31 December 2019 and 31 December 2018 is:

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | Male (years) | Female (years) | Male (years) | Female (years) |
| Currently aged 65 | **22.3** | **24.2** | 22.4 | 24.3 |
| Non-retirees currently aged 45 | **23.6** | **25.7** | 23.8 | 25.9 |

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 | 32.2 | 0.7 |
| Decrease inflation, pension increases by 0.25%, decreases pension liability and reduces pension cost by | 27.5 | 0.6 |
| Increase life expectancy by one year, increases pension liability and increases pension cost by | 34.0 | 0.7 |

As highlighted above, the defined benefit scheme exposes the Group to actuarial risks such as longevity, interest rate, inflation and investment risks. The LDI portfolio 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. The leverage within the LDI portfolio means the equivalent of 75% of the value of the assets is sensitive to changes in interest rates and inflation and mitigates the equivalent movement in the liabilities.

In accordance with the pension regulations, a triennial actuarial review of the Costain defined benefit pension scheme was carried out as at 31 March 2019. In March 2020, the valuation and an updated deficit recovery plan were agreed with the scheme Trustee resulting in cash contributions of £10.2 million for each year commencing 1 April 2020 (increasing annually with inflation) until the deficit is cleared, which would be in 2029 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 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 £10.4 million (2018: £9.8 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.

# Notes to the Financial Statements continued

## 22 Employee benefits continued

### Share-based payments continued

#### Deferred Share Bonus Plan (DSBP)

Prior to 2014, executive directors and other senior management were eligible to participate in the Company's Deferred Share Bonus Plan which allowed for conditional awards with a face value of up to 50% of base salary with a performance condition based on adjusted EBIT (Earnings before interest, tax and other items). The deferred bonus award was satisfied by shares purchased by a trust on behalf of the Group, so did not dilute shareholder interests. The last grant under the DSBP was made in 2014 and vested on 31 March 2016.

#### Save As You Earn 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 £0.5 million (2018: £2.9 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 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 |
| Outstanding at 1 January 2019 | **1.3** | **0.1** | **1.0** | **3.1** | **326.1** |
| Adjusted during the year | **0.1** | **–** | **(0.1)** | **–** | **–** |
| Forfeited during the year | **–** | **–** | **(0.2)** | **(1.0)** | **325.8** |
| Exercised during the year | **(0.4)** | **–** | **(0.2)** | **(0.2)** | **310.3** |
| Granted during the year | **0.6** | **–** | **–** | **1.3** | **118.4** |
| **Outstanding at 31 December 2019** | **1.6** | **0.1** | **0.5** | **3.2** | **243.0** |
| **Exercisable at the end of the period** | **0.2** | **–** | **–** | **0.6** | **279.0** |

Share options outstanding at the end of the year had a weighted average remaining contractual life of 4.9 years (2018: 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 £2.5 million (2018: £3.6 million). The assumptions used in valuing the grants were:

| | 2019 | 2018 |
|---|---|---|
| Expected volatility | **20%** | 20% |
| Expected life (years) | **3.0** | 3.0 |
| Risk-free interest rate | **1.3%** | 1.8% |
| Expected dividend yield | **3.0%** | 3.0% |

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.

## 23 Share capital

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | 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 | **107.0** | **53.5** | 105.5 | 52.8 |
| Issued in year (see below) | **1.3** | **0.6** | 1.5 | 0.7 |
| Shares in issue at end of year – ordinary shares of 50p each, fully paid | **108.3** | **54.1** | 107.0 | 53.5 |

The Company's issued share capital comprised 108,283,074 ordinary shares of 50 pence each as at 31 December 2019.

On 17 May 2019, pursuant to the Scrip Dividend Scheme, shareholders elected to receive 197,710 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 2018, and shareholders elected to receive a further 376,569 ordinary shares in the Company in lieu of cash in respect of all or part of their interim dividend for the year ended 31 December 2019.

During 2019, the Company issued 124,947 shares on exercise of options granted under the 2015 three-year SAYE scheme.

During 2019, the Company issued nil shares on exercise of options granted under the 2016 three-year SAYE scheme, these options being 'underwater' at the time of maturity.

During 2019, the Company issued 570,000 shares on 8 April 2019 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 22. Details of the performance conditions and the options granted to executive directors are given in the Directors' Remuneration Report.

## 24 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 2019, the asset was £4.9 million (2018: liability of £4.2 million) on an IAS 19 basis and is included in these financial statements as disclosed in note 22.

# Notes to the Financial Statements continued

## 25 Other financial commitments

### Group

#### Operating lease commitments

From 1 January 2019, the Group has recognised right-of-use assets for these leases, except for short-term and low-value leases, see note 12 and note 28 for further information.

Disclosure under IAS 17 and IFRIC 4, as applicable for the prior period, is as follows:

| | 2019 | | 2018 | |
|---|---|---|---|---|
| **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 |
| Between one and five years | – | – | 11.4 | 4.2 |
| Later than five years | – | – | 2.5 | – |
| | – | – | 18.1 | 9.0 |

| | Land and buildings | |
|---|---|---|
| **Leases as lessor** | **2019 £m** | **2018 £m** |
| Future aggregate minimum lease income under non-cancellable leases: | | |
| Within one year | – | 0.1 |
| Between one and five years | – | 0.4 |
| | – | 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 (2018: £nil).

## 26 Subsidiary undertakings, joint ventures, associates and joint operations

| | Activity | Percentage of equity held | Registered office/principal place of business |
|---|---|---|---|
| **Principal subsidiary undertakings** | | | |
| Alcaidesa Holding S.A.U. | Golf Course and Marina Operations (sold during year) | 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.

| | 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-Vinci Construction Joint Venture – Shieldhall | Civil Engineering | 50 | UK |
| CVB Joint Venture – Thames Tideway Tunnel East | Civil Engineering | 40 | 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 |

# Notes to the Financial Statements continued

## 26 Subsidiary undertakings, joint ventures, associates and joint operations continued

In accordance with Section 409 of the Companies Act 2006 a full list of subsidiaries, associates, joint ventures and joint arrangements is required:

| | Status | Percentage of equity held | Registered office/principal place of business |
|---|---|---|---|
| **Other subsidiaries owned directly by Costain Group PLC** | | | |
| 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 | Dissolved February 2020 | 100 | (1) |
| Alcaidesa Golf S.L.U. | Disposed 2019 | 0 | (5) |
| Alcaidesa Servicios S.A.U. | Trading | 100 | (5) |
| Alway Associates (London) Limited | Dissolved February 2020 | 100 | (1) |
| Brunswick Infrastructure Services Limited | Trading | 100 | (1) |
| Calvert & Russell Limited | Trading | 100 | (1) |
| C-in-A Limited | Dissolved February 2020 | 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 | (20) |
| 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 | Dissolved 2019 | 0 | (7) |
| Costain Holdings (Malaysia) Sdn Bhd | Dissolved 2019 | 0 | (8) |
| Costain International Limited | Dormant | 100 | (1) |
| Costain (Malaysia) Sdn Bhd | Dissolved 2019 | 0 | (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 | Dissolved 2019 | 0 | (8) |
| Costain Oil, Gas & Process (Nigeria) Limited | Dormant | 95 | (21) |
| Costain Oil, Gas & Process (Overseas) Limited | Dormant | 100 | (1) |
| Costain Process Construction Limited | Dormant | 100 | (1) |

| | Status | Percentage of equity held | Registered office/principal place of business |
|---|---|---|---|
| EPC Offshore Limited | Dissolved March 2020 | 100 | (2) |
| JBCC Rhead PTE Limited | Trading | 100 | (17) |
| L.R.R. Holdings Limited | Dissolved February 2020 | 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 Holdings Limited | Holding Company | 100 | (1) |
| Southview Holdings (Private) Limited | Trading | 100 | (22) |
| Southview Investments (Private) Limited | Trading | 100 | (22) |
| 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 | (19) |
| China Harbour-Costain Mexico S de RL de CV | Dormant | 50 | (18) |
| 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.

# Notes to the Financial Statements continued

## 26 Subsidiary undertakings, joint ventures, associates and joint operations continued

| | Activity | Percentage interest | Country of business |
|---|---|---|---|
| **Other joint operations, including completed** | | | |
| ACTUS Joint Venture – Trawsfynydd nuclear power station active waste retrieval | Civil Engineering | 25 | UK |
| Amec-Costain-Jacobs Joint Venture – Magnox ILW Management Programme | Civil Engineering | 33.3 | UK |
| A-one+ Integrated Highway Services – MAC 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 – Paddington Station Bakerloo Line Link Project | Civil Engineering | 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-Vinci Joint Venture – M4 corridor around Newport | Civil Engineering | 50 | UK |
| Costain-VWS Joint Venture – Mersey Valley Processing Centre (Shell Green) Extension Project Stage 2 | Engineering | 50 | UK |
| Educo UK Joint Venture – Bradford Schools | Building | 50 | UK |
| Galliford-Costain-Atkins Joint Venture – United Utilities | Engineering | 42.5 | UK |
| Lagan-Ferrovial-Costain – A8 | Civil Engineering | 45 | UK |
| The e5 Joint Alliance Severn Trent Framework | Engineering | 25 | UK |
| TSIF-ILW Joint Venture – Trawsfynydd nuclear power station decommissioning | Civil Engineering | 33.3 | UK |

## 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) | Calle Delfines No. 268 – 2, Frac. Playa Ensenada, Ensenada, B.C., CP. 22880, Mexico |
| (19) | Marszałkowska 82, Warsaw, Mazowieckie, 00-517, Poland |
| (20) | Dormant company – Venezuela, no record of address |
| (21) | Dormant company – Nigeria, no record of address |
| (22) | 10th Floor, Club Chambers Building, Corner Nelson Mandela Avenue / 3rd Street, Harare, Zimbabwe |

# Notes to the Financial Statements continued

## 27 Related party transactions

### Group

A related party relationship exists with its subsidiaries, joint ventures and associates, joint operations, The Costain Pension Scheme and with its directors and executive officers.

#### Sales of goods and services

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Joint ventures and associates £m | Joint operations £m | Total £m | Joint ventures and associates £m | Joint operations £m | Total £m |
| Services of Group employees | **2.9** | **177.8** | **180.7** | 7.2 | 204.6 | 211.8 |
| Construction services and materials | **–** | **37.8** | **37.8** | – | 43.5 | 43.5 |
| | **2.9** | **215.6** | **218.5** | 7.2 | 248.1 | 255.3 |

Balances with joint ventures and associates are disclosed in notes 15 and 20. 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 22.

#### 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% (2018: 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, DSBP, AIP and SAYE plans, which are detailed in note 22.

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

| | Group | |
|---|---|---|
| | 2019 £m | 2018 £m |
| Directors' emoluments | **1.4** | 2.8 |
| Executive officers' emoluments | **1.7** | 2.2 |
| Post-employment benefits | **0.2** | 0.2 |
| Share-based payments | **1.3** | 1.3 |
| | **4.6** | 6.5 |

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 in 2018 to terminate the 25 year lease on 28 June 2019. The aggregate rent is under £0.1 million per annum.

### Company

The Company has no transactions with related parties other than the charge in relation to share-based payments (note 22) (2018: none).

## 28 Impact of adoption of new accounting standards and change in accounting policy

### IFRS 16 'Leases' – impact of adoption

The Group has adopted IFRS 16 'Leases' using the modified retrospective approach as described in the standard. Comparative information has not been restated and continues to be reported under IAS 17 Leases and IFRIC 4 Determining whether an arrangement contains a lease.

The accounting policy set out in note 1 replaces the following policy applicable before 1 January 2019:

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.

### Lease liabilities

On adoption of IFRS 16, the Group recognised liabilities in relation to leases which had previously been classified as operating leases and short-term cancellable leases under the principles of IAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 January 2019. The weighted average incremental borrowing rate applied to the Group's lease assets was 3.2%.

The following is a reconciliation of total operating lease commitments (2018 annual report note 24) at 31 December 2018 to the lease liabilities recognised at 1 January 2019:

| | Land and buildings | | Other operating leases | | Total | |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| **Total committed operating lease commitments disclosed at 31 December 2018** | | 18.1 | | 9.0 | | 27.1 |
| Discounted using incremental borrowing rate equity | (1.6) | | (0.4) | | (2.0) | |
| Recognition exemptions: | | | | | | |
| – Leases of low value assets | – | | (1.6) | | (1.6) | |
| – Hindsight adjustment of lease length | 3.5 | | (0.2) | | 3.3 | |
| Lease payments not recognised | 1.9 | | (2.2) | | (0.3) | |
| Non-committed operating leases recognised | – | | 6.2 | | 6.2 | |
| **Operating lease liabilities before discounting** | | 20.0 | | 13.0 | | 33.0 |
| Discounted using incremental borrowing rate quity | | (1.3) | | (0.2) | | (1.5) |
| **Total lease liabilities recognised under IFRS 16 at 1 January 2019** | | **19.6** | | **13.4** | | **33.0** |
| Comprising: | | | | | | |
| Current lease liabilities | | | | | | **13.4** |
| Non-current lease liabilities | | | | | | **19.6** |
| **Total lease liabilities** | | | | | | **33.0** |

There was no impact on the operating leases commitments as lessor disclosure.

# Notes to the Financial Statements continued

## 28 Impact of adoption of new accounting standards and change in accounting policy continued

### IFRS 16 'Leases' – impact of adoption continued

#### Right-of-use assets

The associated right-of-use assets were measured at amounts equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to the lease recognised in the statement of financial position as at 31 December 2018.

| | 2018 £m |
|---|---|
| Land and buildings | 19.6 |
| Plant and equipment | 13.4 |
| **Total right-of-use assets** | 33.0 |

The recognised right-of-use assets are included in note 12.

#### Adjustment to balance sheet items

The change in accounting policy increased tangible fixed assets at 1 January 2019 (right-of-use assets) as above by £33.0 million and increased liabilities by a matching credit (current liabilities: £13.4 million and non-current liabilities £19.6 million).

## 29 Disposal of Alcaidesa subsidiaries

On 10 December 2019, the Group disposed of its investment in Alcaidesa Holding S.A.U. and its wholly owned subsidiairy Alcaidesa Golf SLU for a net consideration of £11.8 million.

| | 2019 £m |
|---|---|
| Property, plant and equipment | 18.5 |
| Inventories | 0.1 |
| Trade and other receivables | 0.2 |
| Other payables | (1.8) |
| Interest bearing loans and borrowings | (0.7) |
| | 16.3 |
| Less cash consideration | (11.8) |
| | 4.5 |
| Less translation reserve transferred to income statement | (1.5) |
| **Loss on disposal** | 3.0 |

# Five-Year Financial Summary

| | 2019 £m | 2018 £m | 2017 £m | 2016 £m | 2015 £m |
|---|---|---|---|---|---|
| **Revenue and profit** | | | | | |
| Revenue (Group and share of joint ventures and associates) | **1,162.9** | 1,489.3 | 1,728.9 | 1,658.0 | 1,316.5 |
| Less: Share of joint ventures and associates | **(7.3)** | (25.6) | (44.9) | (84.3) | (52.9) |
| **Group revenue** | **1,155.6** | 1,463.7 | 1,684.0 | 1,573.7 | 1,263.6 |
| **Group operating profit before other items** | **17.9** | 52.5 | 49.1 | 41.1 | 33.2 |
| Other items: | | | | | |
| Arbitration award on historical building project | **(9.7)** | – | – | – | – |
| Impairment of Alcaidesa marina | **(5.9)** | – | – | – | – |
| Pension GMP equalisation charge | **–** | (8.6) | – | – | – |
| RDEC grant income | **–** | 2.6 | 2.5 | – | – |
| Loss on disposal or termination of subsidiary undertakings | **(3.0)** | – | – | – | – |
| Amortisation of acquired intangible assets | **(2.3)** | (3.0) | (3.2) | (4.6) | (3.2) |
| Employment related and other deferred consideration | **(0.2)** | (0.4) | (1.2) | (1.6) | (0.4) |
| **Group operating (loss)/profit** | **(3.2)** | 43.1 | 47.2 | 34.9 | 29.6 |
| Share of results of joint ventures and associates | **0.3** | 0.3 | 0.3 | 0.2 | (0.1) |
| **(Loss)/profit from operations** | **(2.9)** | 43.4 | 47.5 | 35.1 | 29.5 |
| Finance income | **1.0** | 0.4 | 0.4 | 0.6 | 0.8 |
| Finance expense | **(4.7)** | (3.6) | (6.1) | (4.8) | (4.3) |
| **Net finance expense** | **(3.7)** | (3.2) | (5.7) | (4.2) | (3.5) |
| **(Loss)/profit before tax** | **(6.6)** | 40.2 | 41.8 | 30.9 | 26.0 |
| Taxation | **3.7** | (7.4) | (9.2) | (4.5) | (3.8) |
| **(Loss)/profit for the year attributable to equity holders of the Parent** | **(2.9)** | 32.8 | 32.6 | 26.4 | 22.2 |
| (Loss)/earnings per share – basic | **(2.7)p** | 30.9p | 31.1p | 25.7p | 21.8p |
| (Loss)/earnings per share – diluted | **(2.7)p** | 30.2p | 30.6p | 25.0p | 21.2p |
| **Dividends per ordinary share** | | | | | |
| Final | **–** | 10.00p | 9.25p | 8.40p | 7.25p |
| Interim | **3.80p** | 5.15p | 4.75p | 4.30p | 3.75p |
| | | | | | |
| **Summarised consolidated statement of financial position** | | | | | |
| Intangible assets | **59.0** | 58.5 | 62.5 | 65.9 | 52.3 |
| Property, plant and equipment | **44.1** | 40.0 | 43.0 | 42.2 | 37.3 |
| Investments in and loans to equity accounted joint ventures and associates | **2.5** | 2.5 | 2.7 | 2.6 | 2.6 |
| Retirement benefit asset | **4.9** | – | – | – | – |
| Other non-current assets | **6.7** | 6.3 | 15.0 | 22.6 | 18.8 |
| Total non-current assets | **117.2** | 107.3 | 123.2 | 133.3 | 111.0 |
| Current assets | **435.3** | 467.3 | 539.8 | 512.9 | 421.4 |
| **Total assets** | **552.5** | 574.6 | 663.0 | 646.2 | 532.4 |
| Current liabilities | **328.9** | 326.7 | 423.2 | 441.6 | 372.2 |
| Retirement benefit obligations | **–** | 4.2 | 23.9 | 73.5 | 36.7 |
| Other non-current liabilities | **65.9** | 61.4 | 61.9 | 31.5 | 2.9 |
| **Total liabilities** | **394.8** | 392.3 | 509.0 | 546.6 | 411.8 |
| | | | | | |
| **Equity attributable to equity holders of the Parent** | **157.7** | 182.3 | 154.0 | 99.6 | 120.6 |

# Financial Calendar and Other Shareholder Information

## Financial calendar[1]

| | |
|---|---|
| Full year results | 11 March 2020 |
| Annual report mailing | 2 April 2020 |
| Annual General Meeting | 7 May 2020 |
| Half-year end | 30 June 2020 |
| Half year trading update | 1 July 2020 |
| Half-year results 2020 | 19 August 2020 |
| Ex-dividend date for interim dividend | 17 September 2020 |
| Interim dividend record date | 18 September 2020 |
| Interim dividend payment date | 23 October 2020 |
| Financial year-end | 31 December 2020 |

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.

## Scrip dividend scheme

The Company will pay no final dividend in respect of the year ended 31 December 2019. A scrip dividend scheme is offered when a dividend is paid. Those shareholders who have already elected to join the scheme will automatically have their future dividends sent to them in this form.

Shareholders wishing to join the scheme for all future dividends should return a completed mandate form to the Registrar, Equiniti. 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 6 March 2020

| | Total number of holdings | Total number of shares | Percentage issued capital |
|---|---|---|---|
| Shareholdings 100,000 and more | 98 | 96,349,890 | 88.98% |
| Shareholdings 50,000–99,999 | 47 | 3,485,325 | 3.22% |
| Shareholdings 25,000–49,999 | 48 | 1,794,294 | 1.65% |
| Shareholdings 5,000–24,999 | 343 | 3,245,836 | 3.00% |
| Shareholdings 1–4,999 | 8,086 | 3,407,729 | 3.15% |
| Totals | 8,622 | 108,283,074 | 100.00% |

### Secretary

Tracey Wood

### Registered Office

Costain House, Vanwall Business Park, Maidenhead, Berkshire SL6 4UB
Telephone 01628 842 444
www.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

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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

www.costain.com

www.costain.com/investors

www.costain.com/our-culture

www.costain.com/news


www.costain.com/investors

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The purpose of this document is to provide information to the members of Costain Group PLC. This document contains certain statements that are forward-looking statements. They appear in a number of places throughout this document and include statements regarding our intentions, beliefs or current expectations and those of our officers, directors and employees concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the business we operate. By their nature, these statements involve uncertainty since future events and circumstances can cause results and developments to differ materially from those anticipated. The forward-looking statements reflect knowledge and information available at the date of preparation of this document and unless otherwise required by applicable law the Company undertakes no obligation to update or revise these forward-looking statements.

Nothing in this document should be construed as a profit forecast. The Company and its directors accept no liability to third parties in respect of this document save as would arise under English law.

Designed and produced by **emperor**
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