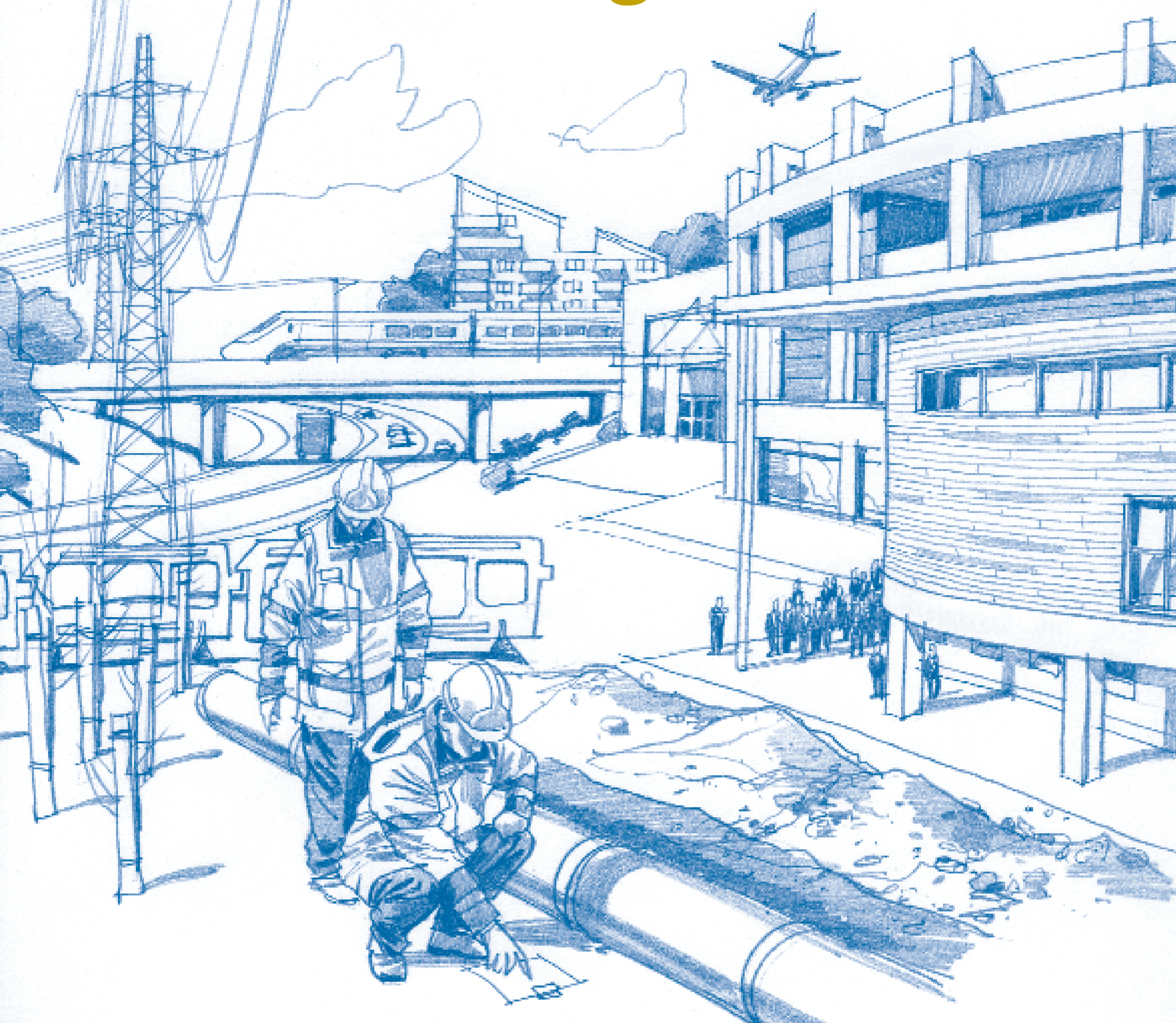
Balfour Beatty

The creation and care of essential assets

Annual report and accounts 2006

Reliable, responsible growth



Introduction

Balfour Beatty is a world-class engineering, construction, services and investment business well positioned in infrastructure markets which offer significant long-term growth.

We work in partnership with sophisticated customers who value the highest levels of quality, safety and technical expertise. Our skills are applied in appropriate combinations to meet individual customer need.

Our strategy, which is set out in the following pages, is designed to continue to deliver reliable, responsible growth in shareholder value over the long term.

2006 performance

	2006	2005	Percentage increase/ decrease
Revenue including joint ventures and associates	**£5,852m**	£4,938m	**+19%**
Pre-tax profit			
– before exceptional items and amortisation	**£152m**	£134m	**+13%**
– after exceptional items and amortisation	**£125m**	£141m	**–11%**
Earnings per share			
– adjusted*	**27.3p**	24.1p	**+13%**
– basic	**21.2p**	24.9p	**–15%**
Dividends per share	**9.1p**	8.1p	**+12%**
Order book	**£9.1bn**	£7.6bn	**+20%**
Financing			
– net cash before PPP subsidiaries (non-recourse)	**£305m**	£315m	
– net borrowings of PPP subsidiaries (non-recourse)	**(£21m)**	(£14m)	

* Before exceptional items and amortisation

Strong growth in profits* and earnings*

Strong operating cash performance

Good progress in strategic acquisition and investment programme

Record order book

Dividend increase of 12%

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Overview

What we do

Building, Building Management and Services

Balfour Beatty is an international specialist in the design, construction, equipping, maintenance and management of buildings and selected aspects of their internal environment.

Rail Engineering and Services

Balfour Beatty is an international leader in the design, construction, equipping, maintenance, management and renewal of rail assets and systems.

Civil and Specialist Engineering and Services

Balfour Beatty is a leading provider of civil and other specialist engineering, design and management services, principally in transport, energy and water.

Investments and Developments

Balfour Beatty promotes and invests in privately funded infrastructure assets and developments in selected sectors, in the UK and internationally.

Our recent track record

£5,852m
Revenue including joint ventures and associates

	£m
2006	**5,852**
2005	4,938
2004	4,239

27.3p
Adjusted earnings per share
before exceptional items and amortisation and including the results of discontinued operations

	p
2006	**27.3**
2005	24.1
2004	22.1

£152m
Pre-tax profit from continuing operations
before exceptional items and amortisation

	£m
2006	**152**
2005	134
2004	107

£9.1bn
Order book

	£bn
2006	**9.1**
2005	7.6
2004	6.8

The figures shown above for 2004 are pro forma figures including the impact of IAS 32 and IAS 39 as if the Group had adopted them for that year. Since 2000 Balfour Beatty's reported pre-tax profit from continuing operations before exceptional items and amortisation, and adjusted earnings per share have grown by compound annual rates of 11% and 18% respectively.

Where we work – revenue by destination

£4,459m
UK

£581m
US

£350m
Asia Pacific

£193m
Africa, Middle East, Near East

£257m
Continental Europe

£12m
Central and South America

Some of the asset owners for whom we work

BAA
BBC
BT
nationalgrid
defra Department for Environment Food and Rural Affairs
YOUR M&S
LandSecurities
Network Rail
Caltrans
Royal Mail
NHS
DB
UNDERGROUND
HIGHWAYS AGENCY
United Utilities
KCR 九廣鐵路

Chairman's statement

The Company in 2006

I am very pleased to report another year of good progress for Balfour Beatty plc. We have, once again, improved our profits and earnings, grown our forward order book, generated strong cash flows, enhanced the strength of our balance sheet and improved our management of non-financial matters.

We remain highly selective about what we take on. We are proud of our first-class project management, the quality of our engineering judgements and our attention to detail across the range of our activities.

We have continued to pay close attention to the quality of the processes and systems which underpin the Group's work on a day-to-day basis. Our graduate intake has increased. Our risk management processes have been further refined. Our safety and environmental management systems have produced improved performance. And we have further embedded our corporate principles, business conduct guidelines and codes of practice across the Group.

In 2005, we were voted the 20th most admired company in the UK. It was extremely gratifying to discover that, in the 2006 Management Today survey, our position had risen to sixth and we had consolidated our position of leadership in the construction sector. We were also pleased to be awarded the accolade of being the best corporate social responsibility practitioner in the construction sector in the annual Quality in Construction awards.

Performance

In 2006, our pre-tax profits before exceptional items and amortisation of intangible assets were up 13% at £152m (2005: £134m). Adjusted earnings per ordinary share before exceptional items and amortisation were also up 13% at 27.3p (2005: 24.1p). Basic earnings per share stood at 21.2p (2005: 24.9p). There were a number of exceptional items, the largest of which was a non-cash asset write-down taken at the half-year, resulting in a net exceptional charge after tax of £25m (2005: £4m profit).

Pre-tax profit for the year (after exceptional items and amortisation of intangible assets) amounted to £125m (2005: £141m).

The Board recommends a final dividend of 5.2p per ordinary share, making a total dividend for the year of 9.1p (2005: 8.1p), an increase of 12%.

Operating cash flow was, once again, strong and in line with profits. Year-end net cash stood at £305m (2005: £315m), despite acquisition expenditure of £80m, and before taking account of the consolidation of £21m non-recourse net debt held in PPP subsidiaries (2005: £14m).

The year-end order book increased by 20% to £9.1bn (2005: £7.6bn), with over £1.0bn of further work at preferred bidder stage.

Strategy

The Chief Executive and the Board committed much time and attention to a major strategic review in 2005, the output of which was reported in last year's annual report.

In 2006, we have made good progress in pursuing the strategic priorities that we identified in that review. The Board reviewed and where necessary, updated the strategy in December 2006. Ian Tyler covers the actions we have taken in UK infrastructure contracting, upstream professional services, our capital investment business and in developing our business outside the UK in his review over the following pages of this report.

The Board

Two new non-executive Directors were appointed to the Board with effect from 1 July 2006. Mike Donovan was most recently Chief Operating Officer of Marconi plc, with previous senior management experience at British Aerospace, Vickers and the Rover Group. Stephen Howard was most recently Group Chief Executive of Novar plc, having had a long and successful career with Cookson Group plc.

Jim Cohen, who has been an executive Director since 2000, retired from the Board with effect from 18 February 2007. He has played a leading role in developing the Group's capital investment and international rail businesses and left with our sincere gratitude and best wishes, as did Chalmers Carr, who was appointed a non-executive Director in 2003 and retired from the Board on 31 August 2006.

Safety and environment

The Group's accident frequency rate was reduced by a further 24% during 2006, continuing the positive trend of recent years. The safety of our people and those whom our business affects remains our highest priority. We have also made good progress in managing our environmental impacts, including our relative contribution to global warming and managing and recycling our waste.

People

Balfour Beatty is a leader in most of the markets which it serves. Market leadership not only offers the opportunity of superior financial returns, but also helps attract the best people at every level of our organisation. We cannot, however, afford to be complacent and we are constantly seeking new and better ways to recruit and retain the best people and to offer them interesting and rewarding jobs within the Group.

In 2006, we launched a new campaign for the recruitment of graduates and overhauled our general recruitment practices. 2007 will see our first Group-wide employee attitude and opinion survey which will enable us to respond with greater sensitivity to employee needs and preferences.

I am sure shareholders will wish to join me in thanking all Balfour Beatty people for their hard work and achievements in 2006.

Outlook

We have record order books and a number of preferred bidder positions on major projects, and our markets are generally healthy and continue to offer substantial opportunity.

We have also made good progress in pursuing the strategic priorities which we set out last year and have substantially added to our earning power as a result, which will serve to underpin future growth.

We believe that we will be able to make further good progress in 2007.

Sir David John KCMG Chairman

We have made good progress in pursuing the strategic priorities which we set out last year and have substantially added to our earning power as a result.

Chief Executive's review

Our strategy

In last year's annual report, I set out our strategy for continuing to deliver the reliable, responsible growth which shareholders have enjoyed over recent years.

During 2005, we undertook an in-depth analysis of our business and the markets which it served and established a clear strategic context for the future development of the Group.

Our analysis demonstrated that market leadership was critical to sustained success. We have positions of leadership in many of our markets, excellent people, a strong portfolio of long-term customer relationships, well-developed supply chains and a very substantial order book – a powerful basis on which to build. We also have the cash resources to invest in growth and to ensure that we continue to have a dynamic organisation.

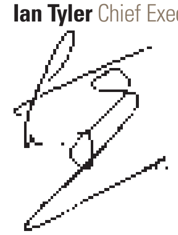
We remain confident that our growth ambitions can be satisfied over the next two to three years from the momentum inherent in the business mix as it was at the start of 2006. Double-digit compound growth is not, however, an inherent characteristic of most of our markets, which grow in line with GDP at 2-4%.

Our chosen markets are almost all experiencing steady growth – with some specific sectors developing at or above double-digit pace. We, in turn, are deliberately focusing on the faster moving segments of our markets and on strong, successful customers who, themselves, are setting the pace for expenditure in their sectors.

Last year, we identified four areas in which we intended to develop our business to ensure that we will be able to maintain our target growth rates over the medium and longer term.

These were: UK regional infrastructure contracting; professional and technical services; the extension of our investment business into new markets; and establishing strong domestic businesses in selected overseas markets based on our UK model.

Ian Tyler Chief Executive



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UK infrastructure

The majority of the businesses in which we make our best and most reliable margins are in UK infrastructure markets, many of which have strong positive growth momentum, including major public building, social housing, utilities contracting and regional civil engineering. In these areas we are already well positioned, and anticipate vigorous demand growth over the medium to longer term.

Birse acquisition strengthens our market position

In July 2006 we substantially strengthened our regional presence in UK civil engineering with the £32m acquisition of Birse Group plc.

The acquisition of Birse takes us a significant step forward in our aim to expand our UK regional presence. Birse, which has annual revenues of over £300m, provides a range of civil engineering services, with regional strengths complementary to our existing network. Integrating Birse into our regional operations, which has now been substantially achieved, will accelerate growth, improve performance, broaden our geographic coverage and take us into some specialist civil engineering markets in which we have previously had little or no presence.

It will give us greater strength in coastal engineering work for local authorities, and in civil engineering for the rail industry. It brings us additional engineering and project management skills in water and other process activities. It also gives us a successful building business focused on the education sector in the North of England, which has become a part of Mansell, our regional building business.

Strategic developments

- Birse acquired for £32m
- Strong further growth in Mansell
- Leading position in complex building market consolidated
- Other regional targets identified

Professional and technical services

There is a clear trend amongst our key customers to demand a broader and more proactive role from us, in addition to that represented by our long-established construction and maintenance services. To do this, we are building our upstream capabilities in programme management and technical consulting. We have been making good progress in this market since forming our professional services division, Balfour Beatty Management, in 2003. Progress accelerated in 2006.

Balfour Beatty Management is an increasingly important differentiator

Balfour Beatty Management is one of the UK's fastest-growing consultancies. Formed in 2003, it increased its professional staff from 200 to 350 during the year. In 2005 it was instrumental in securing a £380m alliance with National Grid to replace gas mains in Greater Manchester. In 2006 it played a key role in securing another National Grid alliance worth up to £550m to upgrade and repair the overhead electricity line network on the eastern side of England, and a major contract for United Utilities.

Balfour Beatty Management enables the Group to offer customers an integrated, high-quality consulting and contracting package. When we bid for large and complex projects, its expertise in programme and project management, alliances, value engineering and business improvement processes gives us considerable competitive advantage. Its expertise is also highly sought-after in its own right: it generates some 50% of its business independently from the rest of the Group.

Balfour Beatty Management is building a reputation for innovation with projects such as the new King's Cross St Pancras Underground Station, where it has significantly reduced project costs, and work for BAA at Heathrow Terminal 5. It is further enhancing Balfour Beatty's reputation for handling large and complex projects successfully.

Strategic developments

- King's Cross St Pancras Underground Station programme management – a key reference project
- Consultancy partners in long-term gas and electricity alliances
- Key component of airport bids and preparation of Exeter International Airport development plan

Private finance

Our UK PPP business, Balfour Beatty Capital, has substantial skills and in-built growth momentum. The experience and expertise represented in its team of over 200 professional staff put the business in a strong position to expand. The PPP market remains healthy in the UK, and new markets are emerging overseas – notably in the US, Western Europe, South-East Asia – and in the UK.

We have committed equity of over £300m in a portfolio of public sector concessions, for which we have raised over £7bn of funding. These are largely concentrated in the healthcare, education and transport sectors. Six further projects are at preferred bidder stage, with 21 bids submitted during 2006.

In education, the £40bn Building Schools for the Future (BSF) programme is providing new opportunities alongside more traditional PPP schemes. We recently secured the pathfinding project at Knowsley on Merseyside and are currently bidding more schools projects. The social housing market is growing strongly and is a significant area of opportunity in conjunction with Mansell.

We are also a major participant in PPP road projects and have been shortlisted for the £1.5bn M25 road widening and maintenance PPP scheme.

Developing the South West's airport of choice

Balfour Beatty Capital is now extending its reach into non-PPP investments. Since 1993 we have been a 25.5% shareholder in Barking Power, which owns and operates Barking Power Station. In January 2007 our specialist subsidiary Regional and City Airports acquired Exeter International Airport. We have significant experience in the design and construction of airport assets and aim to make Exeter the airport of choice for the South-West. Other airport opportunities are being pursued.

We are also pursuing PPP opportunities internationally. In the US we are part of the bbm AIRail Transfer consortium that has been shortlisted for a new rail connection between Oakland Airport and the Bay Area Regional Transport system in California. We have bid for Bremen Hospital in Germany and for an extension to a Further Education facility in Singapore.

Strategic developments
Two new UK PPP concessions and three new preferred bidder positions secured
Exeter airport acquired in January 2007
Short-listed for Oakland Airport Connector
Offices established in the US, Germany and Singapore

Overseas markets

In the longer term, maintaining our growth targets will require the development of broadly-based domestic businesses outside the UK. Our key target markets are the United States, Western Europe and South-East Asia. We will focus on the sector markets with greatest long-term potential, combining organic growth from our existing positions of strength with selective acquisitions.

Our international expansion will be judicious, and progressive. Our choice of territories is based on four key criteria:

– the markets we address must be large enough to make a substantial difference;

– they must offer an acceptable business environment which does not discriminate against foreign ownership;

– they must be sufficiently endowed with sophisticated customers who will pay for superior levels of quality, safety and innovation; and

– they must offer us the opportunity to achieve a leading market position without undue risk.

Within the territories which fit these requirements, we will apply another set of criteria for building our presence. Our businesses will have to have high-quality, long-term sustainable earnings; a market presence at the core of Balfour Beatty's existing competency range; be complementary to other Balfour Beatty businesses in the territory; have a proven, successful management team; and see project delivery, risk management and customer service as their key differentiators.

Becoming a major builder in the US

The acquisition of Centex Construction, the $2bn annual revenue US building company, agreed in February 2007, will create critical US mass in a core Balfour Beatty business and add substantial new business development opportunities, including in PPP. Centex has strong market positions in Texas, Florida, Washington DC and North Carolina and is a leading player in the military housing market. It is anticipated that this acquisition will be immediately earnings enhancing and will accelerate our penetration of US growth markets.

Strategic developments
Acquisition of Centex Construction in the US agreed
Acquisition of Charter in the US
Profit growth in Hong Kong and Dubai
Small, strategic acquisitions planned for Balfour Beatty Rail

exeter INTERNATIONAL AIRPORT

CENTEX CONSTRUCTION

Delivering on the strategy

We believe that we have a clear strategy and we are taking appropriate actions to develop it successfully. The strength of the base on which we build our strategy is, of course, equally important in determining how successful we will be in growing shareholder value, reliably and responsibly, in the long term.

The following section of the report describes some fundamental characteristics of our business which underpin the confidence we have in our long-term success.

A balanced business model

Strong long-term partnerships

The best people and processes

Comfortable with complexity

An innovative approach

Working and acting responsibly

Our contracting business is a leader across a wide range of construction and related disciplines in the UK and in selected overseas markets. It has long-term relationships with a wide range of blue-chip customers and is highly cash generative. Its order book, standing at some £9.1bn at the year-end, creates excellent forward earnings visibility. Cash flows from operating activities over the last three years have totalled more than £532m and fully match profits.

Our engineering, construction and services businesses generate the cash that Balfour Beatty Capital needs to pursue its ambitious domestic and international growth aspirations.

Our investment business, Balfour Beatty Capital, is also a leader. It creates major construction and long-term service opportunities for our contracting operations. It owns and operates 21 infrastructure projects and is preferred bidder for a further six concessions. These include road schemes, hospitals, schools, an airport, power projects and other infrastructure projects. It has committed some £341m of equity in these projects and has a strong bid pipeline. Its concessions generate stable, long-term profits.

The seamless delivery of debt and equity finance, design, construction, building services, and long-term management and maintenance is an increasingly attractive option for infrastructure procurement. This is true, not just in the UK but also increasingly in markets overseas in which Balfour Beatty has a major contracting presence – the US, Germany and Singapore, for example.

A balanced

Balfour Beatty Capital investment portfolio (March 2007)
Including preferred bidder

	Equity committed (£m)
9 hospital schemes	120
7 roads and street lighting schemes	63
6 schools schemes	50
2 complex rail schemes	70
1 airport	30
1 power scheme	5
1 waste water scheme	3
	341

New work winners 2006
Source: Contract Journal

Contract Journal

Position	Contractor	Total (£m)
1	**Balfour Beatty**	**3,519.94**
2	Skanska	1,871.40
3	Kier	1,682.47
4	Bovis Lend Lease	1,640.00
5	Laing O'Rourke	1,592.62
6	Carillion	1,572.60
7	Morgan Sindall	1,493.40
8	Sir Robert McAlpine	1,240.83

A balanced business model
Strong long-term partnerships
The best people and processes
Comfortable with complexity
An innovative approach
Working and acting responsibly

business model

Our Group comprises two distinct businesses. We are a substantial and growing infrastructure investment specialist and we are the UK's largest international engineering, construction and services contractor. These businesses, leaders in their own fields, add significant value to each other. They generate what the other needs and work together as a coherent force where the customer benefits as a result.

The range and depth of our experience and expertise is becoming an increasingly important element in the programmes and plans of major infrastructure owners as they seek to achieve their long-term objectives. An increasing proportion of our business and our forward order book derives from stable, long-term alliances and partnerships with customers who have ambitious long-term investment plans.

An increasing number of the organisations for whom we work make us an integral and indispensable part of their own processes, under long-term alliance, partnering or framework contracts. Whether they are utilities, social service providers, airport, road or rail network owners, a common theme is the need to deliver ever safer, more reliable, more efficient infrastructure for their customers.

To do this, they have to be able to rely on their supply partners to deliver absolute commitment, from Board level downwards, a broad capability base, a clear focus on and understanding of their objectives, processes and culture, a willingness to learn and a mind-set to collaborate externally and internally.

Balfour Beatty's ability to rise to these challenges is reflected in the proportion of its work now carried out under long-term collaborative contract forms, providing stability and predictability of income and an increased capacity to attract the best talent and deliver the best solutions.

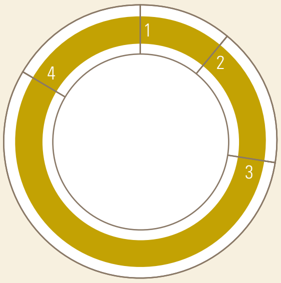
We have long-term relationships with five of the UK's eight water companies; we take care of almost one-quarter of England's strategic road network and the road systems for five major local authorities; we are the principal supplier of rail track renewal services to Network Rail and the London Underground; we look after substantial proportions of the UK gas and electricity grid systems; we are the supplier of choice for rail electrification projects in the UK, Germany and Italy; we will shortly commence running the entire office service network for the Department for Work and Pensions, nationwide; and through Public Private Partnerships we serve six NHS trusts and five local education authorities under long-term concession contracts.

Some major long-term contracts

	Duration	Potential value
Royal Mail	7 years	£650m
National Grid Electricity	5 years	£550m
United Utilities	7 years	£420m
National Grid Gas	8 years	£380m
Department for Work and Pensions	7 years	£320m

Order book by contract type

	2006
1 Alliances	£1.0bn
2 Frameworks	£1.5bn
3 Other long-term contracts	£5.1bn
4 Other	£1.5bn
	£9.1bn



Strong long-term partnerships

When customers buy Balfour Beatty, they know they are getting professionalism, carefully designed and consistently updated processes and systems, an unparalleled wealth of experience and understanding of the task of creating and caring for high-quality assets and, above all, talented people with a passion to deliver.

The best people and processes

Britain's most admired companies, 2006

Source: Management Today

Quality of management	Overall league table
1 Tesco	1 Tesco
2 Icap	2 Johnson Matthey
3 BP	3 BP
4 Man	4 GlaxoSmithKline
5 Balfour Beatty	5 Carphone Warehouse
	6 Balfour Beatty

Monitoring and analysis of incidents

We have a Group-wide managed system which enables us to learn from workplace and environmental incidents and accidents. Tr@ction is a system which facilitates root cause analysis for all actual incidents and near misses and successively improves our management of safety and our environmental impacts.

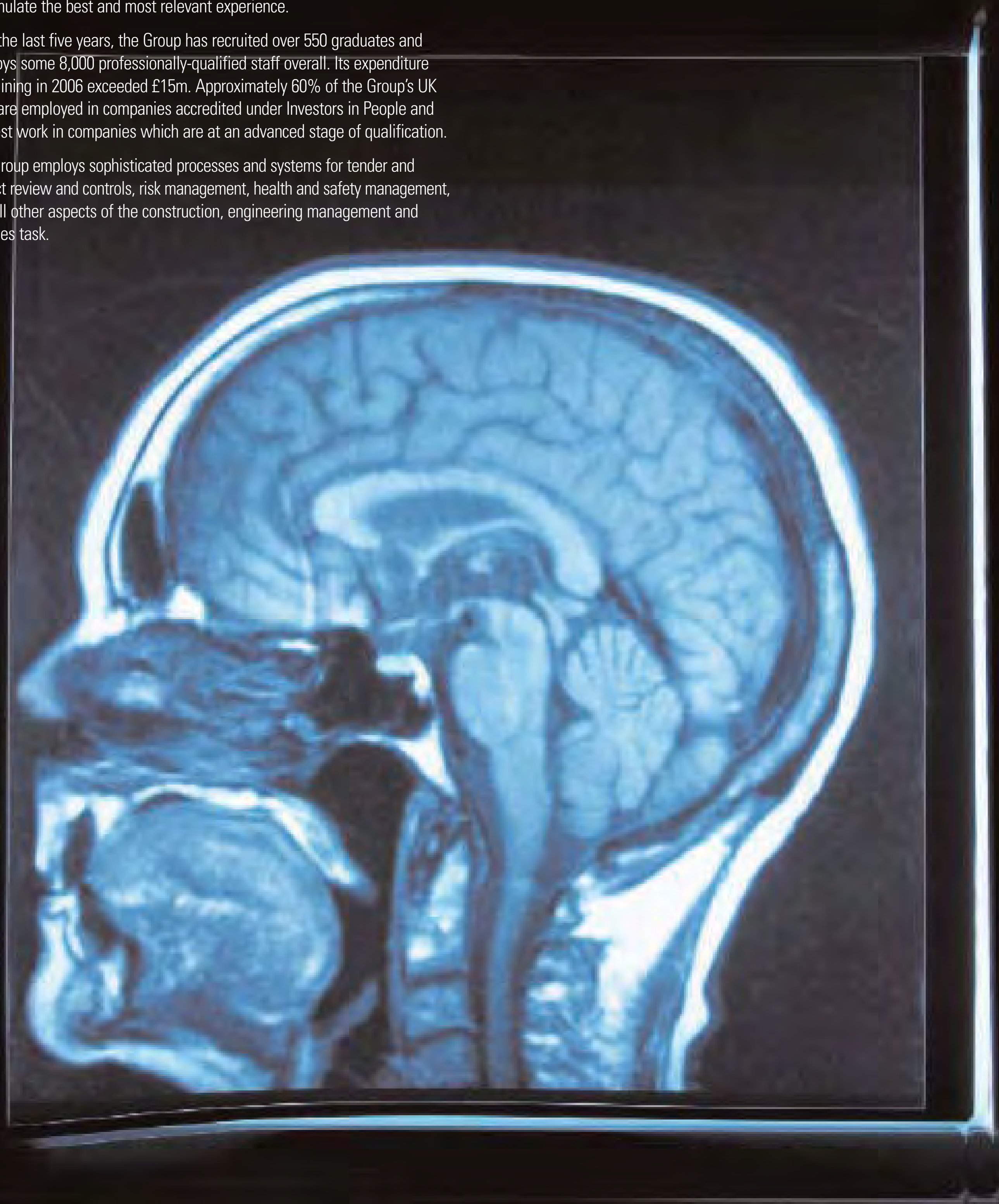
Being able to share a customer's vision for its asset base, doing what is necessary to deliver it and then ensuring that it works effectively over its whole life requires a wide range of skills, talents, techniques and processes. Balfour Beatty is staffed and organised to rise to this challenge consistently and reliably.

The Group leads the UK market in a wide range of disciplines. In complex building and building services; in civil engineering, power engineering, utilities contracting, and road construction, widening and maintenance; in fixed rail infrastructure contracting, particularly rail electrification, power supply, track renewal and track system production and installation; and in privately financed healthcare, education and road and rail transportation.

Market leaders attract the best people and, the best supply chains and accumulate the best and most relevant experience.

Over the last five years, the Group has recruited over 550 graduates and employs some 8,000 professionally-qualified staff overall. Its expenditure on training in 2006 exceeded £15m. Approximately 60% of the Group's UK staff are employed in companies accredited under Investors in People and the rest work in companies which are at an advanced stage of qualification.

The Group employs sophisticated processes and systems for tender and project review and controls, risk management, health and safety management, and all other aspects of the construction, engineering management and services task.



Large-scale infrastructure development requires a broad range of engineering, construction and service disciplines, integrated and programmed through planning and project management. Project and programme risk most frequently derives from the interfaces between suppliers and between phases.

The Group's pre-eminent position in many of its contracting markets means that customers can rely on the individual disciplinary capabilities of Balfour Beatty operating companies. Increasingly, however, they find that using these skills in combination with Balfour Beatty's own professional and technical service skills offers them the most reliable route to a successful outcome.

For example, for its long-term alliance contracts to upgrade and extend the gas and electricity networks for National Grid, Group contracting companies, Balfour Beatty Utilities and Balfour Beatty Power Networks, are working in conjunction with Balfour Beatty Management to plan the logistics, sequencing and work methods of the projects as well as deliver them.

At Heathrow Terminal 5, five Balfour Beatty companies are working together for BAA on the complex integration programme for all the new rail services, including the Track Transit System, Heathrow Express, Piccadilly Line and Terminal 5 Station complex itself.

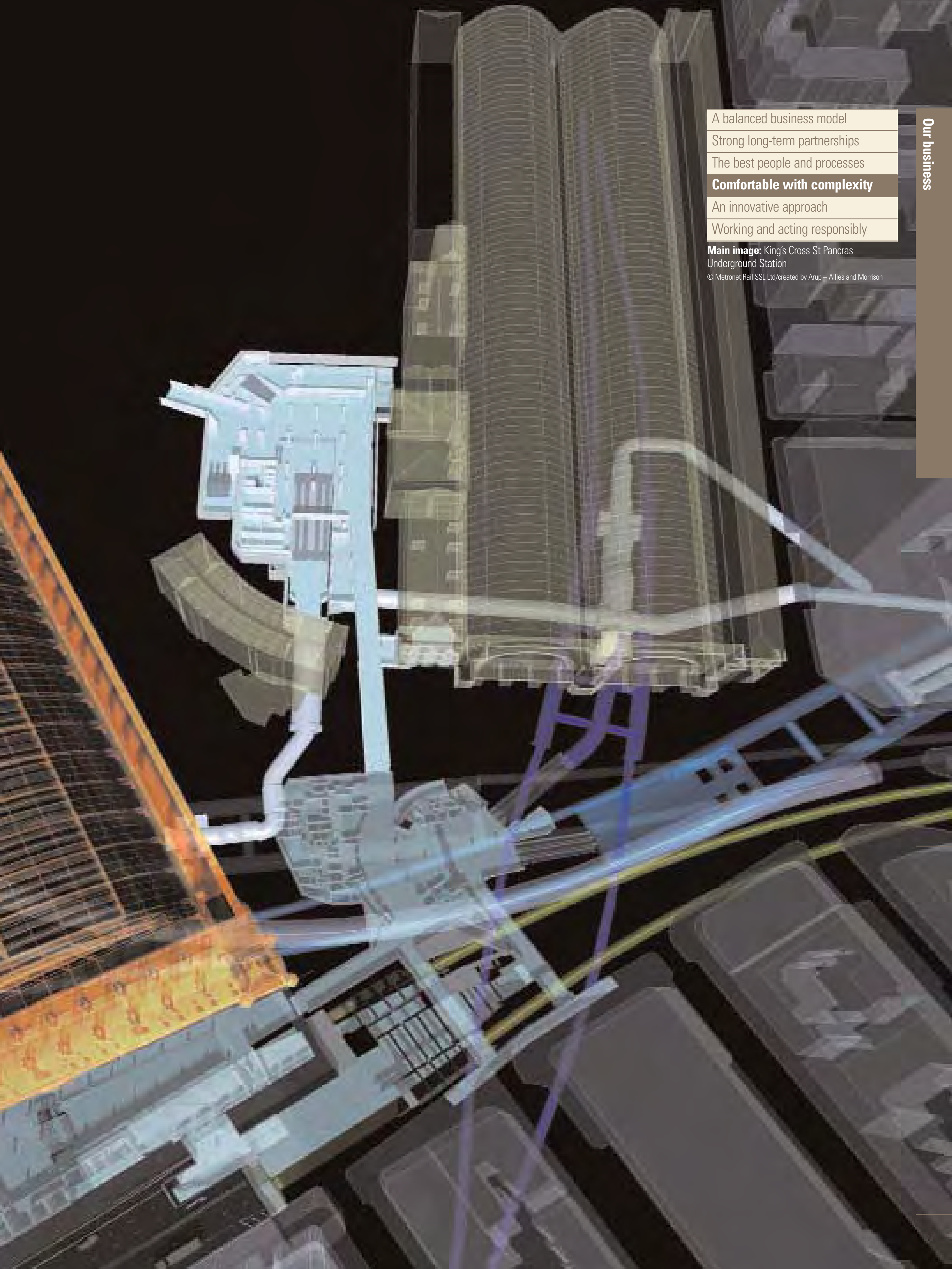
The Department for Work and Pensions recently decided that it wanted a single nationwide supplier to manage and deliver a revolution in its back office service provision with a view to saving £2bn and radically reducing overheads. Balfour Beatty was selected as the most comprehensively equipped supplier to share the 7–10 year process of creating and embedding the new service delivery model.

Comfortable with complexity

One of the Group's greatest competitive strengths – and a key to many of our long-term contractual relationships – is our proven ability to help our customers tackle the most complex challenges successfully. We have a long-standing reputation for delivering the most complex projects on time and on budget. Our capacity to manage complexity has been further enhanced by the development of Balfour Beatty Management, our professional and technical services arm.

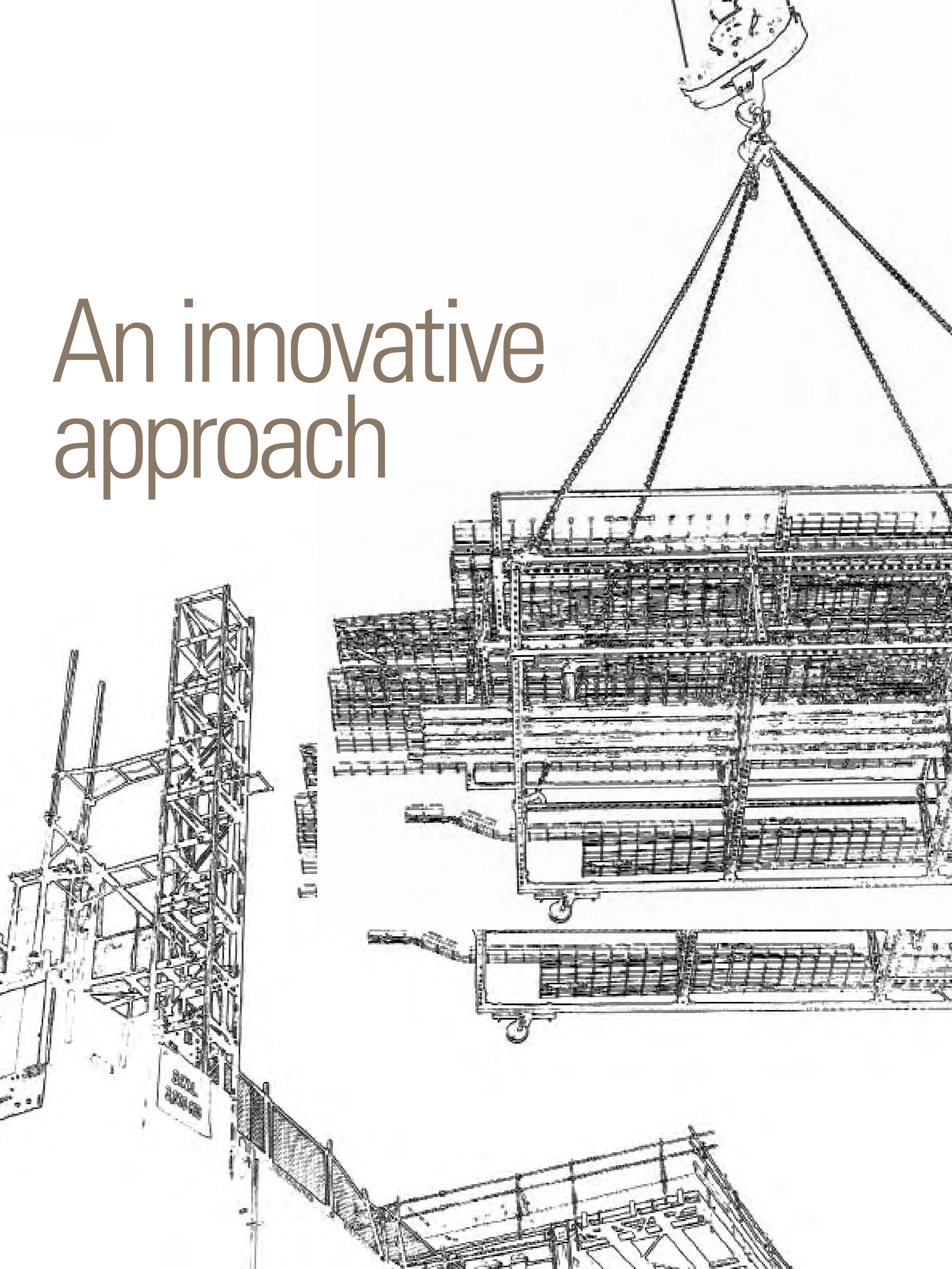
King's Cross St Pancras Underground Station

King's Cross St Pancras Underground Station is one of London's busiest, handling over 250,000 passengers per day, increasing to 365,000 over the next few years. In April 2005, Balfour Beatty Management was appointed to lead the delivery of a new station, including managing design development, procurement, construction, services and equipment installation, testing and commissioning. Phase I has been opened on time which, together with Phase II, has significantly reduced project costs for the customer.



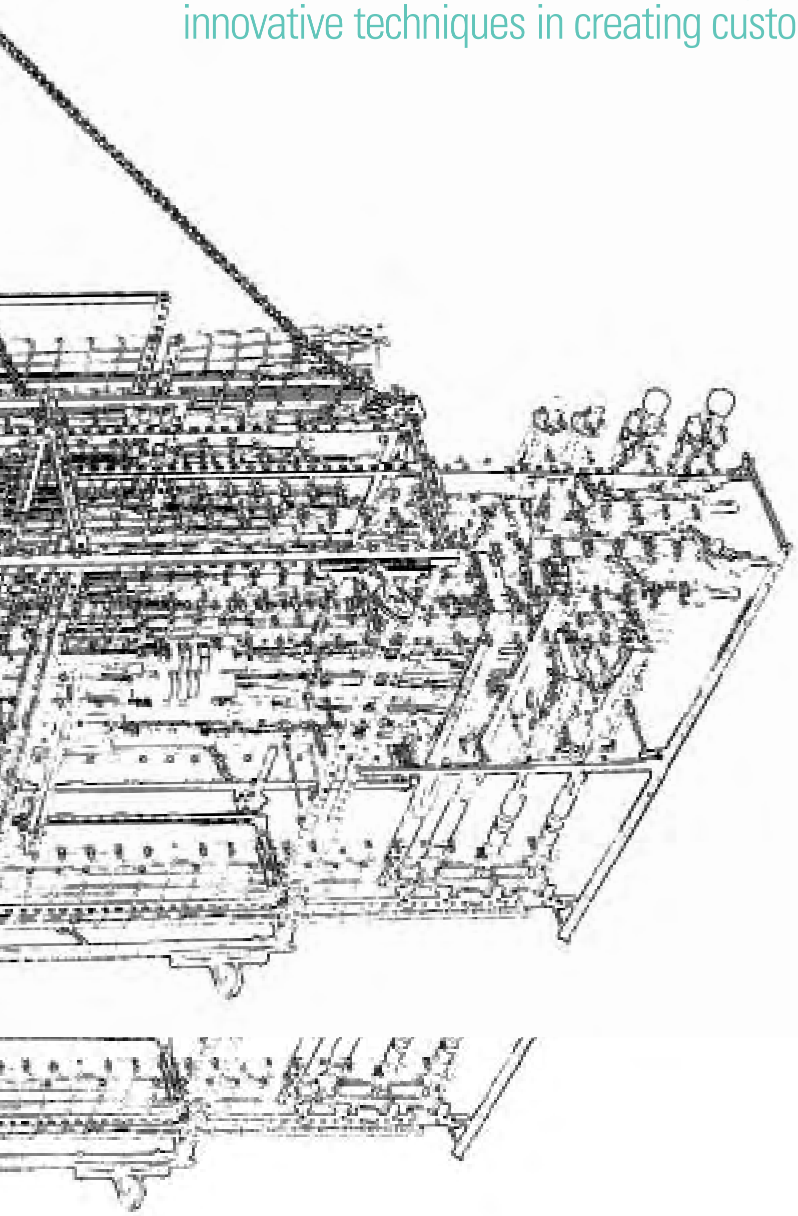
Main image: King's Cross St Pancras Underground Station

An innovative approach



Tackling the most difficult and complex projects as a matter of routine and working in long-term partnership with major customers has a big impact in determining the Group's culture. In finding solutions to one customer's challenge, the Group often finds new ways of working and new techniques which improve the solutions we can offer to others. Balfour Beatty has a learning culture and applies innovative techniques in creating customer value.

Main image:
Modular construction, Birmingham New Hospital



In Balfour Beatty, only a handful of people are specifically charged with the task of innovation because innovation is, in fact, an everyday part of the way we do things. We have our customers to thank for that. They want things built and maintained faster, for less money, but with more reliability and greater certainty of outcome.

In 2006, a company-wide innovation forum was created, which brings together managers from operating companies across the Group to capture good ideas and use them, as appropriate, across the Group's customer base.

For example, off-site modular construction is an increasing feature of our work on many major building projects. It reduces site-waste, reduces production costs, accelerates installation times, improves safety and minimises traffic movements to and from construction sites.

While upgrading signalling systems for Network Rail and Metronet, we have developed data logging and analysis software that extends the life of existing assets by improving their performance. We are also developing a computer system that mimics the existing electro-mechanical controls, while installation work is going on, to keep trains running and reduce inconvenience for passengers.

"No-Dig" technology for Yorkshire Water

Balfour Beatty Utilities has successfully introduced 'No-Dig' technology to repair water valves. Specially designed drilling rigs and taps are used to reach buried valves. Repairs are effected without disruption to supply. Time and labour costs are saved and traffic disruption and customer outages are avoided.

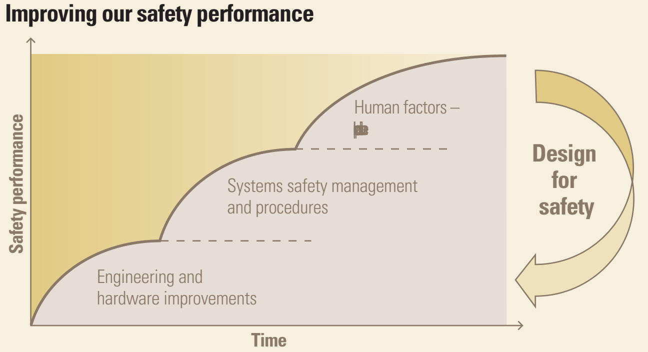
The Group has widely-communicated values and principles and sets all of its businesses and employees clear and explicit ethical and behavioural standards which all are expected to maintain.

As its principal social responsibility, the management of employee and public safety stands at the top of the Group's priority list. Over recent years, despite significant increases in employee and sub-contract numbers, the Group has been successful in successively reducing its accident frequency rates. Its systems and processes are augmented by close attention to designing hazards out of the workplace and to the development of continuous improvement in behavioural safety.

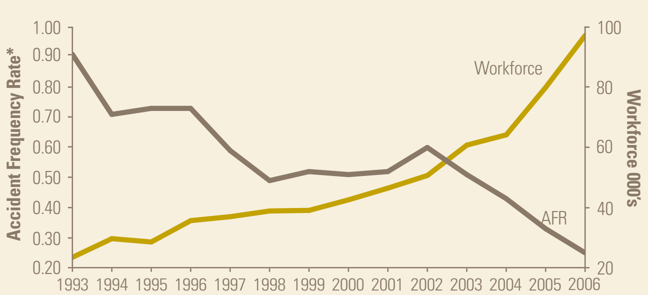
We have been measuring and managing our key environmental impacts in the areas of resource usage, energy and global warming, waste and recycling and water consumption for four years. During that time, we have significantly reduced our relative contribution to global warming, increased the proportion of our expenditure on timber that derives from sustainable sources and almost doubled our score in the annual Business in The Community environment index.

Our social performance has also been enhanced through a series of initiatives designed to add value to our long-term major project presences, including measures aimed at improved physical amenity around our projects, greater social cohesion in the communities which they serve and improvements in the quality of life and opportunities available for disadvantaged individuals.

Improving our safety performance



Safety performance Jan 1993 – Dec 2006



*reportable accidents per 100,000 man-hours worked

Working and acting responsibly

Main image: Sandford School, Stoke – with environmental grass roof.

Our customers do not just demand excellence in operational performance, technical skills and project management. They also want to be sure that their partners and suppliers meet or surpass their own high standards of responsible conduct. We set ourselves demanding targets in these areas and welcome the opportunity to differentiate ourselves in terms of safety, environmental management and wider social responsibility.

Building, Building Management and Services

Highlights

- Over £750m of long-term facilities management contracts secured
- Major hospital schemes in Birmingham and Glasgow commence
- Acquisition of Charter in the US
- Another strong year of social housing growth

Financial summary

- Revenue £2,145m (2005: £1,787m)†
- Profit £43m (2005: £35m)*
- Unexecuted orders £3.6bn (2005: £2.4bn)

†Including £115m share of joint ventures and associates (2005: £113m).
*Profit from operations before £nil exceptional items and amortisation of intangible assets (2005: £8m charges).

Companies

– Balfour Beatty Construction
– Balfour Kilpatrick
– Haden Building Management
– Haden Young
– Heery International
– Mansell

Specialist areas

– Design
– Construction
– Construction and Programme Management
– Electrical Engineering
– Mechanical Engineering
– Building and Facilities Management
– Refurbishment and Fit-out
– Social Housing

2

3

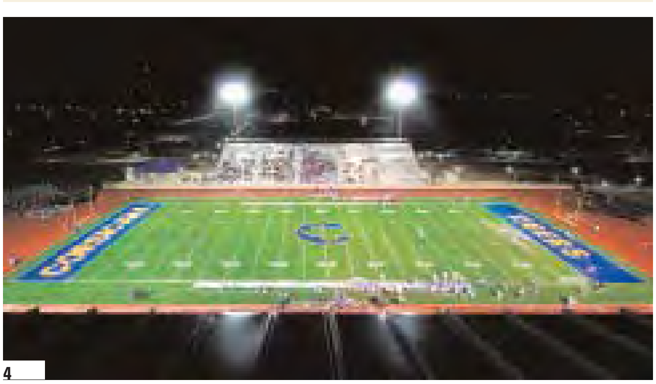
1 The Gaylord Resort and Convention Center: Centex Construction.

2 Your Homes, Newcastle: Mansell.

3 Birmingham Hospital: Balfour Beatty Construction/Haden Young joint venture.

4 Corsicana Stadium: Charter.

5 Victoria and Stobhill Hospital: Balfour Beatty Construction.



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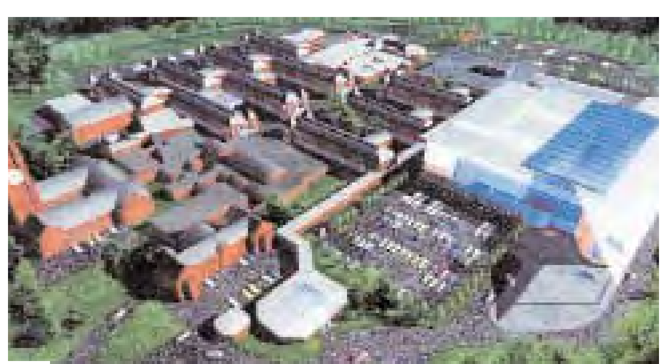

5

6 Castle Hill Hospital: Haden Young.

7 Royal Mail: Haden Building Management.

8 Whitelee Wind Farms: Balfour Kilpatrick.

9 St. Andrew's High School, North Lanarkshire: Balfour Beatty Construction.

2006 performance

Profit from operations before exceptional items and amortisation of intangible assets in the building sector improved by 23% to £43m (2005: £35m). This represented a good all round performance in strong markets. There was particularly good progress achieved in UK building construction and a first contribution from Charter in the US, offset by the impact of some issues related to the delivery programme under the London Underground PPP, which also had an effect in the engineering sector.

Review of operations

In **Balfour Beatty Construction**, profits moved ahead, despite the adverse impact of issues relating to the stations delivery programme under the London Underground PPP.

Progress on major projects was good, with work on York College now well advanced, a successful start to a major new office building in Holborn, London and a flying start to the Birmingham Hospital project following substantial advanced works prior to its financial close in June. Work on the rail station and interchange at Heathrow Terminal 5 also progressed well. The Victoria and Stobhill Hospitals project in Glasgow began in August.

In the schools sector, new build programmes in Stoke and Rotherham were completed on time, the schemes at Bassetlaw and in Birmingham proceeded satisfactorily and eight new schools have now been delivered in North Lanarkshire.

There was a particularly strong performance in the London refurbishment market, including successful completion of the Grosvenor House Hotel project. A major new swimming pool in Sunderland and the Paradise Street development in Liverpool, were also commenced during the year.

The delayed stations programme, part of the London Underground PPP, continued to accelerate, with 44 stations due to be completed by the end of March 2007.

Balfour Kilpatrick had another good year. The company is the building services partner on all Balfour Beatty's education PPPs, where activity levels were high and performance good.

Order intake was very satisfactory, including new work for BNFL at Sellafield, for Whitelee Wind Farms in Scotland and for a number of data centre projects for BT. It will also carry out more than £20m of work on the King's Cross St Pancras Underground Station Northern Ticket Hall project, which was awarded in May.

Good progress was made on the project to strengthen the main power ring around Edinburgh and on a £20m upgrade for the renewable energy transmission system in Scotland. Work on the substations programme for London Underground progressed well, with a further tranche of work now in the process of final agreement.

Balfour Kilpatrick plays a key part in the extensive rail works at Heathrow Terminal 5, which progressed well during the year. The works include mechanical and electrical engineering in the rail tunnels, the station and the track transit system.

Building, Building Management and Services (continued)

Haden Building Management's profits were in line with 2005 after absorbing the impact of a reduction in scope of work and slower than anticipated cost reductions in Romec, in which it has a 49% interest. Romec is responsible for facilities management for all the Royal Mail premises.

2006 was, however, a year of very significant progress for Haden Building Management. The company secured over £750m of new orders. Most notable were the £320m nationwide support services contract for the Department for Work and Pensions and the £150m facilities management contract for the Metropolitan Police Authority, both with a seven-year duration and options to extend. Under the former, Haden will deliver a comprehensive range of office support services as part of the modernisation of the organisation. The latter involves a full facilities management service covering over 500 properties in north London.

Other new work won during the year included the facilities management portion of the Group's new PPP schemes in Birmingham, the extension of a major contract for BT and a new contract for the Ministry of Defence at HMS Nelson. The company now has a very significant portfolio in support of the Group's PPP projects, with four more major schemes at preferred bidder stage.

In **Haden Young**, profits held steady during the year despite a decrease in revenues as major projects at Birmingham, Pinderfields and Northern Batched Hospitals took longer than anticipated to reach financial close. Haden Young remains a clear market leader in large, complex M&E schemes, particularly in the healthcare sector.

The new projects in Birmingham and Glasgow commenced towards the end of the year, as did the Highland Schools scheme. The £20m project at the new Liverpool Arena progressed well. The company was successful under the Procure 21 initiative, with a number of small and medium-sized schemes beginning during the year. Work on Castle Hill Hospital in Hull and Queen Margaret College in Edinburgh progressed satisfactorily.

Haden Young has a very strong commercial workload in London, including the major Ludgate West development.

Heery International, the US engineering, architectural and programme management business, had another good year of progress, assisted by a first-time contribution from Charter, the Texas-based construction management business acquired in March 2006.

Although there is some public sector market uncertainty as federal expenditure comes under pressure, Heery's base workload from the K-12 schools programme, from justice, from healthcare and from the private sector has remained strong and its order book has grown.

Work secured during the year included the Veterans Medical Center at San Juan and major schools schemes in Palm Beach, California and Charleston, North Carolina. HLM and JCM, the two businesses acquired by Heery in 2004 and 2005 respectively, both performed well during the year. Charter has brought some £100m of additional revenues to Heery and has added over £20m of fee work to its order book since it joined the Group, including for the renovation and expansion of the Cotton Bowl which will create a state-of-the-art 84,000 seater stadium in Dallas, Texas. Substantial synergies are emerging between Heery and Charter and the integration process has been successfully completed.

Mansell continued to make excellent progress and was further augmented by the addition of the building business of Birse, acquired as part of the broader Birse transaction in July 2006. Mansell has a broad portfolio of small and medium-sized building projects. Amongst the most notable are Argyll and Bute Schools, Brentwood Hospital, USAF accommodation at Lakenheath in Suffolk and work arising from participation in the Ministry of Defence Prime Contracts for Scotland, and the East and South-East of England.

Amongst its long-term framework contracts are the Job Centre Plus programme for the Department for Work and Pensions and substantial on-going programmes for BT, BAA, the BBC and Hampshire County Council.

It was another very strong year for the company in the social housing market. The value of framework contracts in this market now exceeds £800m, including relationships with Catalyst, Riverside, Your Homes in Newcastle and Metropolitan Housing in the Midlands. In April, the company won a five-year contract to upgrade all council housing at Sandwell in Birmingham.

Outlook

With order books continuing to grow, we expect very good progress in this sector in 2007, accelerated by the additional benefit of the acquisition of Centex.

Civil and Specialist Engineering and Services

Highlights

- Acquisition of UK regional civil engineer, Birse
- Preferred partner for National Grid Eastern Overhead Line and Cable Alliance
- Northern Gas Networks utilities contract secured
- Improved performance in Hong Kong and Dubai

Financial summary

- Revenue £2,382m (2005: £1,920m)†
- Profit £55m (2005: £49m)*
- Unexecuted orders £4.5bn (2005: £4.0bn)

†Including £705m share of joint ventures and associates (2005: £554m).
*Profit from operations before £21m exceptional charges and £1m amortisation of intangible assets (2005: £nil).

Companies

- Balfour Beatty Civil Engineering
- Balfour Beatty Construction Inc
- Balfour Beatty Infrastructure Services
- Balfour Beatty Management
- Balfour Beatty Power Networks
- Balfour Beatty Utilities
- Stent Foundations
- Devonport Management Ltd (24.5%)
- Balfour Beatty Sakti (49%)
- Dutco Balfour Beatty (49%)
- BK Gulf (49%)
- Gammon (50%)

Specialist areas

- Design
- Construction
- Project Management
- Foundations, Strengthening, Testing
- Civil Engineering
- Electrical Engineering
- Transmission Lines
- Road Management and Maintenance
- Utility Upgrade and Maintenance
- Professional and Technical Services

1

2

1 National Power: Balfour Beatty Power Networks.

2 Roseville Water Treatment Plant: Balfour Beatty Construction Inc.

3 Palm Island, Dubai: BK Gulf.

4 North Yorkshire Road Maintenance: Balfour Beatty Infrastructure Services.

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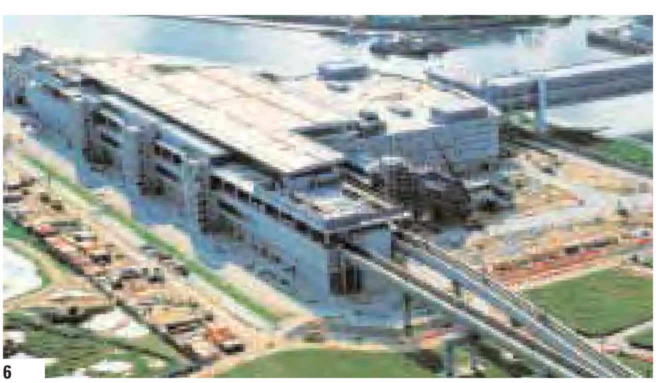
Civil and Specialist Engineering and Services (continued)

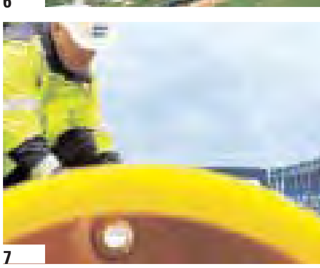
5 Sumburgh Airport: Balfour Beatty Civil Engineering.

6 Lok Ma Chau Rail Terminus: Gammon Construction.

7 Greater Manchester Gas Alliance: Balfour Beatty Utilities.

8 King's Cross St Pancras Underground Station: Balfour Beatty Management.





2006 performance

Profit from operations before exceptional items and amortisation of intangible assets in the engineering sector increased by 12% to £55m (2005: £49m). This reflected a good all round UK performance, with strong growth from Balfour Beatty Utilities and Balfour Beatty Management. Outside the UK, there were improved performances from our businesses in Hong Kong and Dubai. In the US, although underlying performance improved, there were some further losses in the central division, which is in the process of closure.

Review of operations

Underlying performance in **Balfour Beatty Civil Engineering** was in line with the previous year, although there was an adverse impact from the infrastructure upgrade programmes under the London Underground PPP.

In major projects, the Steg Raron tunnelling project was completed and progress was good on the widening project for Junctions 6-10 of the M1.

The £115m contract to construct a new Northern Ticket Hall at King's Cross St Pancras Underground Station was secured, and in conjunction with Balfour Beatty Rail, the company won the £363m contract to create the new East London rail line. During 2006, two Early Contractor Involvement, Highways Agency schemes, the A3 project at Hindhead, and the A1 between Bramham and Wetherby, were given the go-ahead to proceed.

In the regional civil engineering business, the acquisition of Birse in July has substantially widened the company's regional coverage. Birse contributed in line with expectations and the integration process is proceeding well. The framework contract for Durham County Council was extended for two years and work at Sumburgh Airport in the Shetlands was completed ahead of schedule. The business has a strong order book and excellent tendering opportunities.

The performance of **Balfour Beatty Construction Inc** continued to disappoint, with contract losses in the central division offsetting good performances in the businesses serving the West Coast and Texas and in tunnelling. Appropriate action has been taken to address the central division's issues. The company's underlying quality of earnings is on an improving trend, with closer supervision from UK management and more rigorously-applied control mechanisms.

In Texas, progress on the $1.3bn SH130 project was good. The future market flow of major road work in Texas will be very significant, some of it let under PPP arrangements.

On the West Coast, project progress has been good and substantial new work was won at good margins, including the $193m I-5 highway project in Orange County, the $120m Freeport water treatment plant and the Roseville Water Treatment plant in Sacramento.

The specialist tunnelling business is close to completing a water project in Rhode Island and has secured a major new tunnel contract in nearby North Dorchester.

During 2006, RCS, the Group's road management and maintenance company, was renamed **Balfour Beatty Infrastructure Services**. Profits in 2006 were in line with the strong performance achieved in 2005. Steady progress was made in Highways Agency Areas 2, 3 and 4, with one-year extensions being awarded in Areas 3 and 4.

In January 2006, the company secured new work with a potential total value of over £300m. In Scotland, it won the management and maintenance of major trunk roads in the North-West. In England, it won the contract for county roads in Mid and East Essex. In May, its contracts for both North Yorkshire County Council and Hampshire County Council were extended, taking its order book to approximately £750m. The project to maintain roads in the London Borough of Westminster progressed well.

Balfour Beatty Management made excellent progress in 2006 in terms of both market penetration and profitability. Already an integral part of the Greater Manchester Gas Alliance for National Grid, it was instrumental with Balfour Beatty Power Networks in securing the Eastern Overhead Line and Cable Alliance partnership with the same customer, and the £420m Northern Gas Networks contract through United Utilities.

The company has led the successful delivery of the new London Underground Western Ticket Hall and other facilities at King's Cross St Pancras Station for London Underground where its programme management work is on-going.

Amongst its other customers are BAA, the Blood Transfusion Service and the Natural History Museum.

Balfour Beatty Power Networks' results were in line with those of the previous year, with the impact of some issues on its Central Networks contract offsetting good progress elsewhere. A power line project between East Anglia and the East Midlands is nearing completion and projects for the expansion of the Australian power transmission network are proceeding well. In Scotland, the company continued to be active on contracts for Scottish Power.

Work on the Sunderland and South Tyneside Street Lighting projects continued satisfactorily. Preferred bidder status has been achieved in Derby.

In October, the company was appointed preferred partner for a five-year alliance contract with National Grid, likely to be worth up to £550m, to upgrade and develop the electricity transmission network in the eastern half of England. The project, which was converted to contract in March 2007, will involve the connection of new generating capacity to the national grid, and the enhancement and replacement of existing assets.

In the gas and water sectors, **Balfour Beatty Utilities'** revenues and profits continued to improve as its substantial portfolio of long-term contracts won in 2004 and 2005 became fully operational. The company has achieved a leading position in the clean water sector with long-term contracts with United Utilities, Anglian Water, Severn Trent Water and South-West Water amongst others. A bid to extend its successful existing relationship with Yorkshire Water is currently under adjudication.

Last year's good progress on the Greater Manchester Gas Alliance continued. In June, Balfour Beatty was appointed preferred bidder for the seven-year gas mains replacement contract, to be operated by United Utilities for northern England by Northern Gas Networks with a total value likely to be approximately £420m.

Stent, the Group's specialist foundations and ground treatment specialist, had a good year, helped by a first full-year's contribution from Pennine, the specialist ground treatment and preparation contractor, which has been integrated successfully into the business.

Revenues continued to increase. Work at the major White City development in London accelerated and piling work in support of the M1 Junctions 6-10 widening project was intense. The company's penetration of the fast-growing Dubai market also increased. Stent is also carrying out work on the London Underground.

Workload at **Devonport Management Ltd,** in which the Group has a 24.5% interest, was steady. Devonport Royal Dockyard continues to be the mainstay of strategic support for the UK nuclear submarine fleet and has a second business stream in large, bespoke, commercial yachts.

Discussions are underway which seem likely to result in a change in the structure of ownership of the supply base to the Royal Navy.

Dutco Balfour Beatty, the Group's civil engineering and building joint venture in Dubai, improved its performance, significantly, in a fast-growing market.

Good progress has been achieved on the Burj Mall, the world's largest shopping mall, with fitting out due to begin this year.

The Palm Island Interchange and Sheikh Zayed road widening projects were completed, as was the Business Bay Development and the Royal Airwing at Dubai Airport.

Two major new road schemes were secured for the construction of the Jumeirah Lake Towers Interchange on the Sheikh Zayed road, and a widening scheme for 35 km of the Emirates Road.

BK Gulf, also had a very busy and successful year, winning the Atlantis project and making good progress on work for new hotels, theme parks and other facilities.

The performance of **Gammon** in Hong Kong improved significantly. The Shenzhen Western Corridor and Deep Bay Link projects were completed, and good progress was made on the Venetian Hotel and Casino project in Macau, the 70-storey office development at One Island East, and the railway station and immigration centre on the Chinese border at Lok Ma Chau.

The civil engineering works at Kowloon Southern Loop Station for KCRC also progressed satisfactorily. The refurbishment of the Mandarin Hotel was completed to time and budget. While the Hong Kong market remains flat, tendering activity in Macau for the hotel and casino development programme is intense.

In Singapore, the market is accelerating and bidding activity is high.

Outlook

Our engineering markets, particularly in the UK, Dubai and Singapore, remain strong and, with further recovery in the US, we expect to make substantial progress in this sector in 2007.

Rail Engineering and Services

Highlights

- Waterloo and City Line upgrade completed on time
- East London Line contract secured
- Nuremberg-Ingolstadt Line opened on time
- Good progress on major works at Heathrow Terminal 5

Financial summary

- Revenue £770m (2005: £766m)†
- Profit £38m (2005: £32m)*
- Order book £1.0bn (2005: £1.2bn)

†Including £4m share of joint ventures and associates (2005: £3m).
*Profit from operations before £2m exceptional profit (2005: £12m charges).

Companies

- Balfour Beatty Rail UK
  - Infrastructure Services
  - Projects
  - London Underground Services
  - Track Systems
  - Plant
  - Technologies
- Balfour Beatty Rail Germany
- Balfour Beatty Rail Italy
- Balfour Beatty Rail International
- Balfour Beatty Rail Inc

Specialist areas

- Design
- Construction
- Project Management
- Maintenance
- Track Renewals
- Specialist Plant, Products and Systems
- Electrification and Power Supplies
- Signalling

1

1 Metro do Porto: Balfour Beatty Rail Italy.

2 Greenbush Commuter Line, US: Balfour Beatty Rail Inc.

3 Ingolstadt to Nuremberg electrification: Balfour Beatty Rail Germany.

2

3

4 Heathrow Terminal 5: Balfour Beatty Rail Projects/Balfour Kilpatrick.

5 Waterloo and City Line: Balfour Beatty Rail – London Underground Services.

6 Botniabanan, Sweden: Balfour Beatty Rail International.

7 Berlin Tunnel: Balfour Beatty Rail Germany.

2006 performance

Profit from operations before exceptional items in the rail sector rose by 19% to £38m (2005: £32m). This reflected an excellent recovery in the second half of the year, with good settlements on projects in the UK, Europe and Asia and steady progress on major works, including those for Metronet and BAA.

Review of operations

Balfour Beatty Rail UK

Balfour Beatty Rail Infrastructure Services' underlying performance was in line with that of the previous year, with similar track renewals workloads for Network Rail. A satisfactory settlement was achieved in respect of work carried out in previous years. Work is undertaken in a very demanding environment and the company has developed a new programme to increase assurance of track quality and reliability. Network Rail has announced its intention to reduce its renewals suppliers from six to four in 2007.

In **Balfour Beatty Rail Projects**, the major works for the West Coast Main Line were completed, as was the final stage of the Watford-Bletchley infrastructure upgrade. Settlement of these projects is currently in the process of finalisation with Network Rail. Work on the £110m programme to deliver 13 feeder stations and 620 miles of high voltage feeder cable progressed well. The project for the Santiago Metro in Chile was completed and commissioned.

Good progress was made on the track-laying project between Sydney and Brisbane in Australia. The major rail integration project at Heathrow Terminal 5 also proceeded well, with the Piccadilly Line put back into full service on schedule.

In October, Balfour Beatty was awarded the £363m contract by Transport for London to create the new East London Line between Dalston Junction in the north and West Croydon in the south. The project, which is the first of two phases, is due for completion in 2010. The project involves track, signalling, telecommunications and electrification.

The company is currently bidding the €300m project for the track and electrification work for the new Gothard rail tunnel, in conjunction with Balfour Beatty Rail International.

During the course of 2006, a new operating division, **Balfour Beatty Rail – London Underground Services**, was created from within Balfour Beatty Rail Projects to service the needs of London Underground under the PPP scheme. This organisation made good progress on the LUL track replacement programme in an extremely challenging operating environment.

In the four months to September 2006, BBR-LUS successfully completed the complex upgrade and refurbishment of the Waterloo and City Line. It also continues to increase the efficiency of delivery under the Metronet track renewal contract.

Rail Engineering and Services (continued)

Performance in **Balfour Beatty Rail Track Systems** improved from the previous year, largely as a result of the acquisition of Edgar Allen, completed in March 2006. Edgar Allen manufactures switches, cast manganese crossings and other rail track products, and augments and broadens Balfour Beatty Rail Track Systems' product range. The integration of Edgar Allen is well advanced.

Early in 2006, Balfour Beatty Rail Track Systems continued its programme of plant investment, with the installation of new forging machines. Demand under its contracts for the London Underground continued to grow, as did its export sales.

In **Balfour Beatty Rail Plant**, profits improved after a disappointing performance in 2005. Investment in new high output plant continues and a programme to improve the reliability and availability of the on-track fleet is being implemented.

Contracts for tamping and ballast regulation, won in late 2005, have developed satisfactorily in their early stages.

Balfour Beatty Rail Technologies continued to develop concepts and products aimed at improving network safety and reliability. A number of new UK sites were secured for XiTRACK, a polymer-based stabilisation technology for track and other infrastructure.

Further development work was undertaken on the CGI system, an extension of solid state interlocking signalling particularly relevant to low-speed lines. A new joint venture for signalling technology was progressed with Alstom in the UK, significantly increasing Balfour Beatty's capability to deliver advanced interlocking signal systems.

Balfour Beatty Rail Germany

In Germany, market conditions were steady, with some further signs of growth as Deutsche Bahn's investment programme continued to recover. The technically complex Ingolstadt to Nuremberg turnkey electrification project was completed to time and budget, as was the contract in the new Berlin main station to project manage, supply and design the infrastructure for the Berlin tunnel.

During the year, the company won the €40m electrification and power supply contract for the line between Hamburg and Lübeck – the largest electrification project tendered in Germany in 2006.

Following the acquisition of SBB, the specialist signalling contractor, in 2005, the company has formed a signalling co-operation with Bombardier, has had some early successes and is currently bidding on a number of new electronic interlocking signalling projects.

Balfour Beatty Rail Italy

In Italy, the company, as part of the joint venture Saturno, completed the new line from Malpensa to Turin, in time for the Winter Olympics. The Rome-Naples line was successfully tested and commissioned and is now also in full service. This is the first fully radio-signalled line in the world and is seen as an important reference project.

Work is underway on three further major high-speed line projects – Malpensa to Milan, Bologna to Milan and Florence to Bologna, as the ambitious Italian high-speed investment programme continues.

Early in the year, the Metro do Porto project in Portugal was successfully commissioned. It is now fully operational and bonus payments for on-time, on-budget delivery have been secured.

Balfour Beatty Rail International

The operation in Spain continued to progress major mass transit projects in both Madrid and Barcelona. In early 2006, an export project for the electrification work on the Tianjin to Shenyang Line was secured – the latest in a series of projects in China with future tenders submitted.

In Sweden, the second year's work on the Botniabanan track project was completed on time and budget. The electrification and track modernisation project on the Blekinge coastline is also proceeding satisfactorily.

In Austria, performance was very satisfactory, and the business secured its first ever sub-station project.

In Malaysia, the electrification project for the main North-South line between Rawang and Ipoh made good progress, with the first section of 20 km handed over to the customer at the end of the year.

In Ireland, the electrification project for the Dash system was concluded successfully. Prequalification was achieved for the rail electrification programme in Israel, while the company has, as part of a group of four, bid for the rail equipment contract for the Gothard Rail Tunnel at 57 kilometres, the world's longest.

Balfour Beatty Rail Inc

Performance in the United States improved significantly, although progress was held back by an unexpectedly adverse settlement on a legacy project completed some years ago in Texas. The signalling contract in Philadelphia, which has been the source of problems, is now performing in line with forecast.

Major project work on the Goldline in California and on the Greenbush commuter line in Boston both progressed well.

The regional services business has performed well. Its customers include the mineral extraction industry in Wyoming and a range of goods and shunting yards on the US heavy freight network. The Class 1 railway companies who operate on this system are beginning to generate some significant projects, for which Balfour Beatty Rail Inc is well placed.

Outlook

We do not expect an upturn in overall spending in our major markets in the short term. However, steady growth in the world rail infrastructure market is predicted for the longer term.

Investments and Developments

Highlights

- Birmingham Hospital and Schools schemes reach financial close
- Exeter International Airport acquired for £60m in January 2007
- Preferred bidder appointments for Knowsley Schools, Derby Street Lighting, and in January 2007, Fife Hospital
- PPP investment businesses established in the US, Germany and Singapore

Financial summary

- Revenue £555m (2005: £465m)†
- Profit £32m (2005: £20m)*
- Concessions 20 (2005: 18)

†Including £541m share of joint ventures and associates (2005: £431m).
*Profit from operations before £nil exceptional items (2005: £36m profits).

Companies

– Balfour Beatty Capital
  – Aberdeen Environmental Services
  – Connect Roads
  – Consort Healthcare
  – Health Management (UCLH)
  – Metronet
  – Powerlink
  – Transform Schools
– Barking Power
– Exeter International Airport (from January 2007)

Specialist areas

– Healthcare
– Education
– Roads
– Rail
– Integrated Transport
– Power Systems
– Water
– Airports

1

2

1 Exeter International Airport: Regional and City Airports.

2 Birmingham Hospital: Consort Healthcare.

3 Fife Hospital: Consort Healthcare.

4 Knowsley Schools: Transform Schools.

3

4

Investments and Developments (continued)

The market

UK PPP markets remain robust, with the current proportion of total government capital spend to be sourced through this procurement method expected to stay steady at around 15%. The continuing flow of opportunities is coming most notably: in schools, through the Building Schools for the Future initiative; in hospitals, most particularly in Northern Ireland; and in the affordable housing sector.

There are also a number of projects in transport infrastructure including currently, the New Tyne Crossing and the M25 widening projects, where PPP has been chosen as the optimum procurement route.

The sale of other UK infrastructure assets, such as regional airports and utility systems is also offering Balfour Beatty Capital a range of opportunities outside PPP.

PPP markets are also developing in other countries. A number of US states have enacted primary legislation to allow PPP for infrastructure development. In Western Europe a number of countries, including Germany, are also using the technique. There is also an emerging market in South East Asia, most notably in Singapore and Hong Kong. With a substantial existing Balfour Beatty Group presence in each of these markets, Balfour Beatty Capital is well-placed to take advantage as these PPP markets develop.

Strategy

Balfour Beatty's skills, experience and successful track record in the UK healthcare, education and road transport markets give it significant competitive advantage and it will continue to seek to build on its existing PPP portfolios in these sectors. In territories where Balfour Beatty already has a substantial local presence and existing market knowledge, the Group will seek to establish an appropriate concession base as PPP markets emerge.

The expertise residing in Balfour Beatty Capital's team of over 200 professionals, built up over 10 years as a leading participant in the UK PPP market is clearly relevant to the fast emerging market for non-PPP infrastructure investment in the UK. The targeted asset classes will be those where Balfour Beatty has established contracting expertise – such as airports and utility systems.

While Balfour Beatty Capital has clearly positioned itself as a long-term holder and operator of assets, the potential to take advantage of refinancing opportunities and carefully targeted acquisitions and divestments in the secondary PPP market will continue to be evaluated. Balfour Beatty Capital will use its skills to pursue these opportunities where appropriate.

2006 performance

Profit from operations before exceptional items in the investments sector rose by 60% to £32m (2005: £20m). This reflected significantly better profits in Barking Power, good performance in mature concessions, a reclassification of Connect Roads from subsidiary to joint venture and an increased shareholding in Consort Edinburgh. Performance of the Metronet concessions was less satisfactory as a result of the complexity of the delivery issues, which are the subject of close attention.

During the year, two concessions – Birmingham Hospital and Birmingham Schools – were converted to contract from preferred bidder status. Three new concessions have reached preferred bidder stage, namely Derby Street Lighting, Knowsley Schools and, in January 2007, Fife Hospital. Exeter International Airport was acquired for £60m in January 2007.

Outlook

In 2007 profits will be impacted both by significantly increased bid costs and overheads as we grow the business overseas and the performance of Metronet where further action is being taken to secure the long-term success of the concessions.

We anticipate that the financial performance of our healthcare, education, road and general infrastructure concessions will continue to meet or exceed expectations and that our preferred bidder projects and a strong bid pipeline will see our portfolio continue to grow. We will also continue to increase our presence in overseas PPP markets.

Consort healthcare

Transform schools

Healthcare

Consort Healthcare continued to perform well in 2006, contributing profit and generating cash at anticipated levels.

At 31 December 2006 its portfolio comprised interests in eight major hospital schemes and a committed equity investment of £113m, £28m of which is at preferred bidder stage.

In January 2007, Consort was appointed preferred bidder for the £152m Fife Hospital project in Scotland, which will involve a £7.5m equity commitment. It is expected that this scheme will reach financial close in 2007.

North Durham, Edinburgh Royal Infirmary and University College London Hospital entered 2006 fully operational. Blackburn began full service provision on schedule in July.

In June, Consort achieved financial close on the £553m project for acute and adult psychiatric hospitals for the University Hospital Birmingham NHS Foundation Trust and the Birmingham and Solihull Mental Health NHS Trust.

Consort has continued to progress the Pinderfields and Pontefract hospitals scheme, with a currently anticipated capital value of £300m, and the £200m Northern Batched Hospitals Project, which comprises two hospitals, at Salford and at Tameside. These projects are expected to reach financial close during 2007.

Consort Healthcare remains a clear market leader in UK PPP hospitals with a proven track record, a differentiated approach and high levels of client satisfaction.

Bids are in preparation for hospitals in Enniskillen, Blackpool, and Bremen in Germany, with a total value of approximately £400m.

University Hospital of North Durham	50%
Edinburgh Royal Infirmary	73.9%
University College London Hospital	33.3%
Royal Blackburn Hospital	50%
Birmingham Hospitals	40%
Fife Hospital†*	50%
Pinderfields and Pontefract Hospitals†	50%
Salford Hope Hospital†	50%
Tameside Hospital†	50%

†Preferred bidder *Appointed in January 2007

Education

Balfour Beatty's market leading brand in the UK education market, Transform Schools, continued to perform well in 2006. Its portfolio consists of six large-scale schools schemes covering some 154 schools in total, with £50m of committed equity investment, £21m of which is at preferred bidder stage. The Stoke concession, which commenced in 2000, remains the largest grouped schools scheme in England, covering 98 schools.

Construction programmes and operations are proceeding well at all our schools schemes, with 20 new schools completed during the year and 34 more currently under construction.

In March 2006, Transform reached financial close for the £89m scheme in Birmingham. This concession will provide 12 new and refurbished schools, including two secondary schools, nine primary schools and an early years centre.

In December, Transform was appointed preferred bidder for the £157m Building Schools for the Future PPP concession at Knowsley on Merseyside. Under this 25-year concession seven new state-of-the-art learning centres will be created, which will replace all of the borough's existing secondary schools over a three year period. This project is due to reach financial close in 2007.

Bids are in preparation for schools schemes in West Dunbartonshire, Islington and Nottingham, with an aggregate capital value of approximately £270m.

A bid is also in preparation for the Institute of Technical Education in Singapore through our newly established business there. This concession has an approximate capital value of £70m.

Stoke Schools	50%
Rotherham Schools	50%
North Lanarkshire Schools	50%
Bassetlaw Schools	50%
Birmingham Schools	50%
Knowsley Schools†	100%

†Preferred bidder

Investments and Developments (continued)

Connect roads

Roads and street lighting

Connect Roads, the brand for the Group's road and street lighting concessions, continued to perform in line with expectations. With the exception of the Derby street lighting project which is at preferred bidder stage, all the concessions are fully operational.

The total committed equity in the roads sector is £63m, of which £2m is at preferred bidder stage.

During 2006, Balfour Beatty acted as an intermediary when I^2 acquired the 50% shareholding of the Group's previous partner in Connect M1-A1, through Balfour Beatty exercising its pre-emption rights over its partner's interest and selling it on to I^2.

The street lighting schemes in Sunderland and South Tyneside are the only Balfour Beatty Capital PPP concessions to remain 100% owned and whose non-recourse debt appears on the Group's balance sheet.

During 2006, Balfour Beatty Capital's new US business, based in Atlanta, was one of twelve organisations which submitted a prequalification for a road scheme concession (SH161) in Dallas, Texas.

In the UK, bids are in preparation for the Surrey street lighting scheme, the New Tyne Crossing, the M80 and the M25 widening project.

The capital value of these bids, in aggregate is approximately £2,100m, of which the M25 scheme is at £1,500m.

M1-A1	50%
A50 Stoke/Derby link	85%
A30/A35	85%
M77/Glasgow Southern Orbital	85%
Sunderland Street Lighting	100%
South Tyneside Street Lighting	100%
Derby Street Lighting†	100%

†Preferred bidder

METRONET

London Underground

Since April 2003, Metronet, in which Balfour Beatty is a 20% shareholder, has operated and maintained the Bakerloo, Central and Victoria lines and the sub-surface lines for London Underground and is undertaking a £17bn investment and upgrade programme under the 30-year concession. Balfour Beatty is investing £70m in these concessions.

The underlying operational performance of the assets inherited by Metronet from London Underground continues on an improving trend with December 2006 the best ever month for reliability.

In November 2006, the report of the independent Arbiter, appointed under the contract at Metronet's request, rated Metronet's average performance over the first three years of the contract as not to be economic and efficient and not to meet best industry practice in some areas. Many of the actions necessary to address this situation were already in hand at the time of the Arbiter's report. Further changes in the procurement and delivery system have been finalised recently.

Metronet subsequently asked the Arbiter to produce an opinion on where responsibility for certain unforeseen and uncontracted costs incurred under the projects would lie between Metronet and London Underground. Commercial negotiations with London Underground continue. In the event of the failure of those negotiations, these and other matters can be dealt with under an extraordinary review process, should Metronet so choose.

Metronet BCV	20%
Metronet SSL	20%


Infrastructure
projects

Other infrastructure concessions

Powerlink and PADCO, which operate and maintain London Underground's high voltage power system, have continued negotiations with the customer about restructuring the project following the completion of the initial capital works and with the developing needs of the London Underground PPPs becoming clearer. Concession performance was satisfactory, as it was at Aberdeen Environmental Services, which is responsible for wastewater treatment in Aberdeen.

Balfour Beatty has committed £8m of equity to these concessions.

In September, a Balfour Beatty Capital-led concession company was short-listed for the Oakland Connector project in California, a rail line which will connect the airport to the Bay Area Rapid Transit system. The project has an anticipated capital value of $300m.

Non-PPP asset investments

Barking Power had an excellent year with profit from operations before exceptional items well ahead of last year's results, itself a major improvement on the previous year. The 1000 MW gas-fired station operated with high reliability, efficiency and consistency. The 28% of station output which is sold on the open market attracted increasingly good returns as gas fuel prices fell and electricity prices increased.

In January 2007, Balfour Beatty Capital, through Regional and City Airports, reached financial close on its acquisition of Exeter International Airport from Devon County Council for £60m, of which half has been financed with equity.

Exeter International Airport is one of the fastest growing regional airports in the UK and will handle over 1m passengers in the financial year to March 2007. Continuing strong growth in passenger numbers is anticipated and a clear operational and development plan is in place for the airport's future. The airport serves a strong local economy, and is expected both to increase its market share and benefit from an increasing propensity for the local population to use the airport.

The airport will be redeveloped with new terminal facilities, new aircraft stands and taxiway extensions on a phased basis to meet increasing demand. Regional and City Airports has subsequently submitted a bid for Leeds Bradford Airport.

PPP outside the UK

During the year new businesses were established to pursue PPP opportunities in the US, Germany and Singapore. In each case the new bidding teams will build on the local knowledge of Balfour Beatty's existing contracting business and seek opportunities in which the chances of success will be increased by their participation.

Powerlink/PADCO	10%/25%
Aberdeen Environmental Services	45%

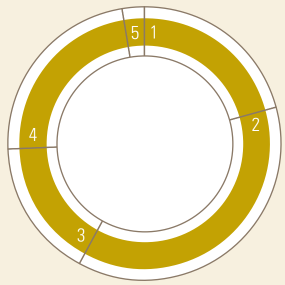
Barking Power	25.5%
Exeter International Airport*	100%

*Acquired January 2007

Directors' valuation of PPP concessions

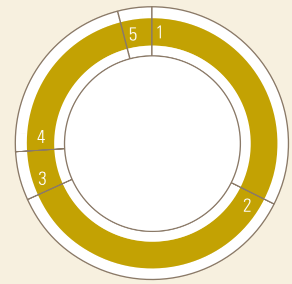
Our portfolio
Total equity committed by sector

		2006	2005
1	Connect: 7 projects	**£63m**	£61m
2	Consort: 8 projects	**£113m**	£112m
3	Transform: 6 projects	**£50m**	£30m
4	Metronet: 2 projects	**£70m**	£70m
5	Other: 2 projects	**£8m**	£10m
		£304m	£283m



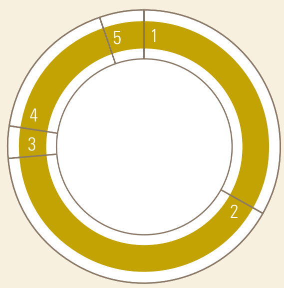
Our portfolio
Cash invested by December

		2006	2005
1	Connect: 7 projects	**£56m**	£56m
2	Consort: 8 projects	**£62m**	£59m
3	Transform: 6 projects	**£10m**	–
4	[illegible]	**£38m**	[illegible]
5	[illegible]	**£7m**	[illegible]
		£173m	[illegible]



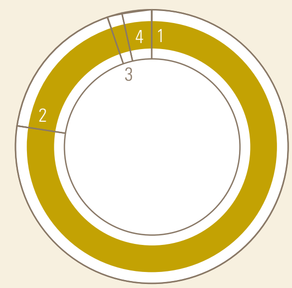
Portfolio valuation
Value by sector

		2006	2005
1	Connect	**£113m**	£123m
2	Consort	**£138m**	£116m
3	Transform	**£13m**	£3m
4	Metronet	**£59m**	£33m
5	Other	**£18m**	£14m
		£341m	£289m



Portfolio valuation
Value by phase

		2006	2005
1	Operations	**£264m**	£243m
2	Metronet	**£59m**	£33m
3	Preferred bidder	**£6m**	£7m
4	Construction	**£12m**	£6m
		£341m	£289m



Movement in value 2005/2006 (£m)

2005	Equity invested	Distributions	Unwind of discount	Rebased	New projects at preferred bidder	Preferred bidder projects achieving financial close	Reserve movements on book projects	Operational performance gains	2006	Growth
289	21	(28)	25	**307**	2	4	18	10	**341**	11.0%

Introduction

Balfour Beatty's PPP concession portfolio has grown in recent years to become a very significant part of the Group's business and a major driver of shareholder value. At 31 December 2006, Balfour Beatty had total committed equity and subordinated debt of £304m across 25 projects, five of which were at preferred bidder stage. At that date, £173m had already been invested and £131m is due over the next six years.

Valuations of PPP equity often rely on the use of multiples to produce a proxy cash flow valuation. This produces somewhat crude benchmarks as such an approach takes no account of the time value of money, expected rate of return of the asset, the performance of the asset or the potential for capital restructuring.

In order to provide a more reliable indicator of value, Balfour Beatty has decided to publish its own valuation benchmark for the Group's PPP investments, based largely on discounting expected future cash flows but without taking into account potential refinancing gains.

2006 valuation

At 31 December 2006, the Directors' valuation of Balfour Beatty's portfolio stood at £341m, at a weighted average, post-tax nominal discount rate of 8.1%; compared with £289m at the end of 2005 (8.2%). The movement in value arises both through shareholder cash inflows and outflows and through underlying growth in the portfolio arising from the unwinding of the discount from year to year. A 1% change in the discount rate impacts value by approximately £35m.

The valuation method

The valuation does not set out to estimate the market value of the investments in the portfolio, but rather, through the application of a consistent methodology, illustrates movements in underlying values between periods and highlights the impact of intervening transactions. The valuation covers 20 concessions that have reached financial close and five at preferred bidder stage. One of two methods has been used to establish the value of individual concessions.

DCF

The principal method used to value the portfolio is discounted cash flow (DCF). This is applied to the future forecast cash flows to which Balfour Beatty as a shareholder and a holder of subordinated debt is entitled in order to create a net present value (NPV). DCF has been used on 22 of the 25 investments. For projects which have reached financial close, forecast future cash flows are extracted from detailed financial models, updated in line with operational experience and lenders' requirements. For projects at preferred bidder stage, the current financial model has been used.

The DCF methodology discounts forecast cash flows at differing discount rates depending on the project phase, and therefore the risk associated with the cash flows.

– Any investment cash flows occurring during the construction period are rolled forward at a risk free rate (5%) to the final injection of equity at construction completion.
– Cash flows anticipated to occur during the operations period are discounted back to the beginning of the operations phase at 8%.
– A net present value is calculated at the end of the construction period by deducting the investment cash flows that occur at this time from the value of the discounted cash flows at the beginning of operations.
– The net present value at the end of the construction period is then discounted back to financial close at 12%.
– Any projects at preferred bidder have a scaling factor of 50% applied to the NPV at financial close.

A diagrammatic illustration of the process is shown above.

Book value

For the other three concessions, the current carrying value in the accounts (book value) has been used. Metronet is at too early a stage in its 30-year concessions to forecast cash flows with the same degree of certainty as the majority of the Group's concessions. In the case of Powerlink, discussions are currently in hand with London Underground over restructuring the concession framework.

Assurance

The calculations underpinning the valuation have been independently checked to ensure that the valuation has been accurately carried out in accordance with the specified methodology. However, the detailed financial models have not been audited.

Financial review

Pre-tax profit before exceptional items and amortisation increased from £134m to £152m (13%).

Results

Revenue in 2006, including the Group's share of the revenue of joint ventures and associates, increased by 19%, of which 5% was attributable to the acquisitions of Charter and Edgar Allen in March 2006 and Birse in July 2006.

Profit from operations before exceptional items and amortisation of intangible assets increased from £115m to £144m (25%). In the building and building services sector, there was particularly good progress in UK building construction and a first contribution from Charter in the US, offset by the impact of delivery issues for the London Underground PPP, which also had an effect in the civil and specialist engineering sector. The latter sector had a good all round UK performance, with strong growth from the utility services business and professional services, together with improved performances in Hong Kong and Dubai. Further contract losses were incurred in Balfour Beatty Construction Inc in the US. In our rail sector, there was an excellent recovery in the second half of 2006, with good settlements on projects in the UK, Europe and Asia and steady progress on major works. Profit in the investments sector reflected significantly better profits in Barking Power, good performance in mature concessions, a reclassification of Connect Roads from subsidiary to joint venture and an increased interest in Consort Edinburgh, but was affected by a less satisfactory performance from the Metronet concessions.

Acquisitions and goodwill

During July 2006, the Group acquired Birse for £34m, including costs. The Group also acquired Charter and Edgar Allen in March 2006 for consideration totalling £33m, including costs. Goodwill arising on these acquisitions amounted to £167m, and a further £10m intangible assets were recognised in respect of brand names and customer contracts and relationships.

An exceptional charge of £16m has been made in 2006 for impairment to goodwill in respect of National Engineering & Contracting Company (2005: Balfour Beatty Rail Inc £4m), resulting in £427m goodwill on the Group's balance sheet at 31 December 2006 (2005: £284m).

Our business

Exceptional items

The Group has recorded a net exceptional charge of £25m post tax. These comprise: £3m integration costs following the acquisition of the Birse Group; £18m goodwill impairment charges and reorganisation costs for the central division of Balfour Beatty Construction Inc; a credit of £2m arising from the reduction in the fine (less associated costs) imposed in respect of the Hatfield derailment in October 2000; and £7m premium on the purchase of preference shares. These items, along with other prior year tax adjustments relating to exceptional items, have given rise to a £1m net tax credit.

Taxation

The Group's effective tax rate in 2006 was 39% (2005: 35%) of profit before taxation, exceptional items and amortisation of intangible assets, excluding the Group's share of the results of joint ventures and associates. Eliminating the finance cost of the preference shares, which does not attract tax relief, the Group's effective tax rate would be 35% (2005: 31%). The increase in the effective tax rate follows the recognition of a prior year credit in 2005, partly offset by a reduction in 2006 of overseas losses not recognised for tax purposes. The Group has continued to benefit from the use of brought forward tax losses in Germany.

Pre-tax profits and earnings

Profits before taxation, exceptional items and amortisation of intangible assets amounted to £152m (2005: £134m), an increase of 13%, and adjusted earnings per share were 27.3p (2005: 24.1p), an increase of 13%.

Cash

The Group has again benefited from a strong cash flow from operations and improvements in working capital management.

	2006 £m	2005 £m
Group operating profit	**61**	58
Depreciation	**43**	41
Impairment and amortisation	**17**	12
Other items	**3**	(5)
Working capital decrease	**93**	61
Cash generated from operations	**217**	167

Cash flow from operations provided further capacity to grow the Group's core activities through acquisitions (£80m outflow). The level of the Group's net cash at 31 December 2006 reduced to £305m (2005: £315m), before taking into account the consolidation of £21m (2005: £14m) of non-recourse net debt held in wholly-owned PPP project companies.

Pensions

Valuation
The last formal actuarial valuation of the Balfour Beatty Pension Fund was carried out at 31 March 2004 and showed a funding position for the defined benefit section of 102%. A formal actuarial valuation of the Railways Pension Scheme was carried out at 31 December 2004 and showed a funding position of 92%. The last formal actuarial valuations of the Mansell schemes were carried out at 31 March 2005 and 31 July 2005 for the Hall & Tawse Retirement Benefit Plan and the Mansell plc Pension Scheme and showed funding positions of 79% and 78% respectively. The last formal actuarial valuation of the Birse scheme was carried out at 5 April 2004 and showed a funding position of 66%.

The position of each of the funds has been updated by the actuaries at 31 December 2006 to review ongoing funding levels and details are included in Note 25.2. The Group contributed £24m to the defined benefit section of the Balfour Beatty Pension Fund for the year ended 31 December 2006 (2005: £25m).

Charges
Pension charges of £52m (2005: £49m) have been made to the income statement in accordance with IAS 19, including £32m (2005: £33m) for the defined benefit section of the Balfour Beatty Pension Fund.

Balance sheet impact
The Group's balance sheet includes the deficits of £288m (2005: £280m) for the Group's funds as required by IAS 19 on the assumptions set out in Note 25.1. The Group recorded net actuarial gains for 2006 on those funds totalling £26m (2005: £21m losses) due to better than expected returns on the assets held by the funds, with the effects of the higher discount rates applied to the funds' liabilities countered by adverse experience movements.

Public Private Partnerships (PPP)

During 2006, the Group invested £24m in a combination of equity in and shareholder loans to its PPP project companies. At 31 December 2006, the Group had invested a total of £173m in equity in and subordinated loans to its project companies and had committed to provide a further £80m over the period 2007 to 2011. The Group had also been appointed preferred bidder for a further five projects to which it is expected at financial close to commit to provide approximately £51m funding.

At 31 December 2006, the Group's share of non-recourse net debt within project companies amounted to £1,281m (2005: £928m), comprising £1,260m (2005: £914m) in relation to joint ventures and associates as disclosed in Note 15.2 and £21m (2005: £14m) on the Group balance sheet in relation to wholly-owned project companies as disclosed in Note 23.1.

The Directors have carried out a valuation of the Group's PPP concessions and this is set out on pages 36 and 37.

Financial review (continued)

Treasury

The Group's policy remains to carry no significant net debt, other than the non-recourse borrowings of project companies.

The Group's financial instruments, other than derivatives, comprise cash and liquid investments, and borrowings. The Group enters into derivatives transactions (principally forward foreign currency contracts and interest rate swaps) to manage the currency and interest rate risks arising from the Group's operations and its sources of finance.

It is, and has been throughout the period under review, the Group's policy that no speculative trading in financial instruments shall be undertaken. Compliance with policy is monitored through regular reporting and internal audits. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Finance and liquidity risk
Balfour Beatty's cash and liquid investments comprise cash, term deposits and the use of liquidity funds. Counterparty risk is monitored regularly and mitigated by limiting deposits in value and duration to reflect the credit rating of the counterparty. Additionally, the Group has a series of bilateral facilities which total £396m, the bulk of which mature in 2011. The purpose of these facilities is to provide liquidity from a group of core relationship banks to support Balfour Beatty in its current and future activities.

Bonds
In the normal course of its business, the Group arranges for financial institutions to provide customers with guarantees in connection with its contracting activities (commonly referred to as "bonds"). Such bonds provide a customer with a level of financial protection in the event that a contractor fails to meet its commitments under the terms of a contract. In return for issuing the bonds, the financial institutions receive a fee and a counter-indemnity from Balfour Beatty plc. As at 31 December 2006, contract bonds in issue by financial institutions covered £1.2bn (2005: £1.1bn) of contract commitments of the Group.

Currency risk
The Group's businesses hedge their known foreign currency transactional exposures by taking out forward foreign exchange contracts. The Group has decided not to adopt hedge accounting for its foreign currency transactional exposures. As a result, there was a charge to profit of less than £1m which would otherwise have been charged to equity.

Balfour Beatty also faces currency exposures on the translation into sterling of the profits and net assets of overseas subsidiaries and associates, primarily in the US and Europe, and on its overseas trading transactions.

Balfour Beatty does not hedge these profit translation exposures as these are an accounting rather than cash exposure. However, the effect of volatile short-term currency movements on profits is reduced because the Group accounts for currency profits using average exchange rates.

Balfour Beatty's balance sheet translation exposure is managed by matching approximately 90% of significant net assets denominated in currencies other than sterling by way of currency borrowings and forward foreign exchange contracts. Details of the position and fair values at the year end are shown in Note 20.1.

Interest rate risk
The Group has no fixed rate borrowings (excluding PFI/PPP non-recourse term loans).

Going concern

The Directors, having made appropriate enquiries, consider it reasonable to assume that the Group and the Company have adequate resources to continue for the foreseeable future and, for this reason, have continued to adopt the going concern basis in preparing the accounts.

Anthony Rabin Finance Director

Principal risks and risk management

The identification, assessment, pursuit and management of opportunities and the associated risks is an integral element of activity throughout the Group.

In the pursuit of opportunities the Group is particularly sensitive to the potential for importing risk whether by way of winning new contracts, forming joint ventures, acquiring businesses or investment. Rigorous processes are therefore in place for managing the exposure within a specified opportunity and risk management framework that applies to all operating companies and Group functions, as follows:

Bidding risk
The Group's operating companies bid selectively for a large number of contracts each year and a more limited number of concession opportunities. Tenders and investment appraisals are developed in accordance with thorough processes for estimating and risk identification and assessment, with particular attention to new or unique characteristics. They are subject to formal review and approval by tender review and investment committees established at Board, sector or operating company level depending upon the value and nature of the contract.

Delivery risk
The delivery of contracts is controlled and managed through the Group's operating structure. The Group's procedures embrace regular and frequent reviews with an agenda centred on health and safety performance, issues affecting delivery and the impact on costs to completion and the forecast revenue. This approach is underpinned by a continuing focus on assurance as to the effectiveness of the relevant controls.

Joint venture risk
Joint ventures are formed for contracts where the operating company and the Group believe that to do so will strengthen the quality of the bid and prospects of delivering a contract successfully. Procedures are in place to ensure that the joint venture partners bring skills, experience and resources that complement and add to those provided from within the Group and that the service partner risk is mitigated.

Acquisition risk
Potential acquisitions are identified by the operating companies and subject to review with Group management who project manage the due diligence by the operating company drawing on its own resources and those from other parts of the Group in order to ensure that the most appropriate personnel with relevant experience and knowledge conduct the detailed due diligence. Where necessary, specialist external resources are engaged. Post-acquisition integration is closely managed, drawing on the detailed due diligence material and integration tracker system for each functional activity, with reviews conducted formally at prescribed periods following the acquisition.

Investment risk
The Group's basic approach is the pursuit of investment opportunities on a limited recourse finance basis in a limited number of sectors where it has appropriate experience. It uses this platform as a basis for moving incrementally into new sectors with appropriate partners. The degree of leverage associated with such investments reinforces the need for the application of a rigorous risk management process drawing on standard operating procedures. Such activity is conducted by a discrete group of personnel with extensive experience in the relevant fields of activity. The consequent delivery risk arising on investment activities is managed and mitigated by the careful selection of delivery and service partners.

On a broader related front the Group addresses continually the impact of the external business environment. Areas of focus include the following:

Changing Government policies and funding priorities
A significant proportion of the Group's revenues flows from contracts founded upon Government policy and/or public funding, both in the UK and overseas. The Group seeks to mitigate the exposure to an adverse change in national policy or funding by broadening incrementally the portfolio of dependency and by diversifying on a measured and controlled basis into other areas of activity.

Customer requirements
There has been a continuing and increasing demand from customers for the provision of professional services, whether as a discrete contract or as a component in a contract. The Group has in place its own specialist operating company with such skills and is developing further the capabilities in selected operating companies.

In addition the emerging trends in risk perception across the Group are formally monitored and an aggregation review of lower-level risks, to identify the extent to which further Group-led initiatives are required, is conducted, for example, to develop risk management capability and mitigation measures.

In addressing the pursuit and delivery of opportunities, the Group relies on a series of clear policies, along with associated expectations or controls which provide a basic operating fabric and culture, that is fundamental to managing risks, for example, in respect of staffing, health, safety and environmental matters and financial controls.

Corporate responsibility

Balfour Beatty has been formally reporting its safety, environmental and social performance through independently audited reports since 2001.

During that time, the Group has very substantially reduced its accident frequency rate, greatly improved the management of its environmental impacts and made significant progress in all aspects of corporate citizenship.

This progress was recognised when the Company won the top award for corporate social responsibility in 2006's "Quality in Construction" awards.

Governance and management

The Board
The Balfour Beatty Board sets policy and takes responsibility for the Group's performance in safety, health, the environment, business ethics, risk management, human rights and other social issues. In early 2001, the Business Practices Committee of the Board was established to review policy, practice and performance in these areas.

The Committee, which comprises non-executive Directors under the Chairmanship of Sir David John, receives reports from the Chief Executive and from the director of Safety, Health and the Environment. It meets four times a year.

Guiding principles
Balfour Beatty first produced a coherent set of "Company Principles" in 1986. Since then, they have been regularly reviewed and updated, most recently in 2006.

Two companion codes were also developed at that time. "Business Conduct Guidelines" explains to all employees what is expected of them in terms of behaviour, procedures and attitudes. In 2007, all employees will receive on-line training in respect of these guidelines.

"Stakeholder Codes of Practice" sets key operating principles and minimum standards for the Group's operating companies when engaging with employees, customers, suppliers and the wider community.

Together, these documents constitute a comprehensive system of ethical governance.

Specific policies
Balfour Beatty has clearly-stated policies for risk management, safety, health, environment, human rights, drugs and alcohol, equal opportunities and whistle-blowing. Within this framework, operating companies are required to develop policies and practices relevant to their particular circumstances.

Management systems
The Group-wide risk management framework provides a common system for reporting and escalating risks of all types. Each operating company, division and project is subject to rigorous risk analysis, evaluation and management. Major risks are reviewed regularly at senior management levels.

Safety and health issues are reviewed by the Group Health and Safety Council, with each main segment of the business having its own equivalent body. Balfour Beatty requires all its operating companies to have formal safety management systems, which are subject to external audit.

Environmental issues are reviewed at the Environmental Strategy Group comprised of representatives of the operating companies under the chairmanship of the director of Safety, Health and the Environment.

Environmental performance is audited regularly and Group-wide statistics are collated in respect of the Group's major environmental impacts.

Safety

The Group's stated aim is to operate in such a way as to have zero fatalities, zero permanent disabling injuries and to be accident free overall.

Over recent years, the Group has made good progress in reducing accidents. In 2006, its Accident Frequency Rate was reduced by 24%, the fourth consecutive year of improvement, and stood at 0.25 reportable accidents per 100,000 man-hours worked. This has been achieved despite very significant increases in numbers employed. The Group's safety statistics are subject to independent external audit.

Performance is benchmarked against industry norms in the UK, Germany, US and Hong Kong. The Group's performance compares favourably with these external benchmarks.

Quality in construction

In 2006, Balfour Beatty received the Quality in Construction award for the best Corporate Social Responsibility Policies and Programme in the sector.

Guiding principles

The Group has a comprehensive system of ethical governance.

Regrettably, there were eight fatalities during the year, all outside the UK. Significant effort is being made to improve safety management standards in the Group's overseas operations to match the high standards that are achieved in the UK.

All fatalities and serious incidents are fully investigated and reviewed at senior management level. Root cause analyses are undertaken and logged to enable detection of system causes, and for appropriate programmes to be developed in response.

Health

The rigorous standards which the Group applies to safety management are increasingly now being applied to occupational health. Occupational ill-health is often the result of prolonged exposure to substance, condition, process or activity and is not, therefore, easily tractable in the short term.

The Group's approach is to identify the potential causes of ill-health and develop specific policies and programmes for each one. Active programmes exist for hand-arm vibration syndrome, disorders arising from manual handling, alcohol and drug abuse, and substances hazardous to health. The Group is improving its programmes for stress.

Environment

Balfour Beatty works systematically to prevent negative environmental impact from its activities and to improve its environmental performance at every stage of its work. The Group's approach is structured and risk based, with formal environmental management systems, independently audited. It continues to take the necessary steps to embed environmental management systems into the business both in the UK and overseas.

The progress made in improving the Group's environmental performance over recent years is illustrated by improving scores and league table positions in the Business in the Community environment index.

The Group reviews and maintains progress by monitoring trends and performance in five specific areas. These are energy use and global warming; resource usage; waste and recycling; water consumption; and impact on environmentally-sensitive areas. The robustness of the Group's environmental management systems, is also measured.

Validation and external audit of 2006 data will not be complete until after the date of publication of this report and data will appear on the Balfour Beatty website in May.

Resource usage
There is an increasingly systematic focus on sourcing of materials, usage of non-renewable resources, and evaluating and managing the Group's supply chain in respect of environmental issues.

Waste
The construction process typically generates large volumes of waste. Over the last five years, Balfour Beatty has raised the awareness of this problem across the business, and has improved its measurement of construction waste – aided by the use of national waste contractors who are able to provide accurate data on waste volumes and recycling.

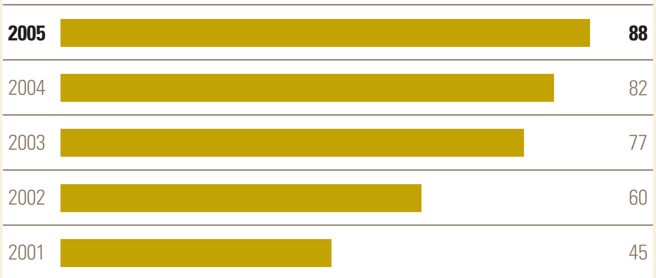
The Group has significantly reduced waste generated on site (down 30% per £million net sales value in the UK in 2005, compared with 2004), and has seriously increased the amount of waste sent for recycling and its use of recycled products. For example, in the UK in 2005 the Group recycled 27% more metals, 44% more plastics, and 10 times more packaging than in 2004.

Energy usage
Balfour Beatty has reduced its relative contribution to global warming by 28% over the period 2002-2005. The Group invests in new and emerging technologies for vehicle emission reduction. Most particularly, significant improvements have been achieved by the use of GPS and vehicle tracking systems in more economical vehicle routeing.

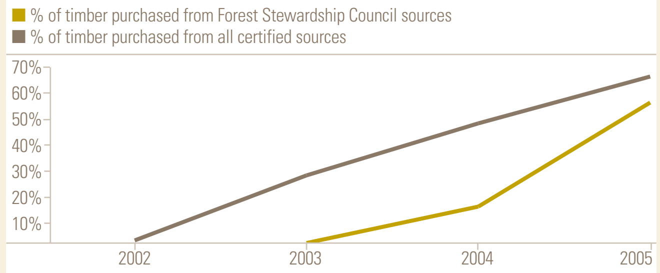
Water consumption
The Group's consumption of water, up by 90% in 2005, is increasing in line with the rapid growth in the incidence of contract vehicle cleaning and increased availability of meter readings to replace estimates. The Group is seeking ways to improve the efficiency of its water consumption.

Environmentally sensitive areas
The Group has extended its range of key indicators to include positive and negative effects on environmentally sensitive sites and is developing its thinking on biodiversity. All operating companies have reviewed their responsibilities for contaminated land. Archaeological aspects of sites are explored thoroughly before commencement of use.

Business in the Community environment index
Score %



UK timber spend



Social performance

Balfour Beatty's business is in the creation and improvement of social capital – schools, hospitals, transport systems, buildings for example. In so doing it makes a substantial contribution to society.

The following key principles guide Balfour Beatty's approach to managing its community and wider social responsibilities beyond safety, health and the environment. These are:

- to engage, positively, with all its stakeholders and to answer to them for its policies and programmes;
- to engage fully with the communities and individuals directly impacted by its project work and to keep them appropriately informed of progress and any issues which might affect them; and
- to add value to its work in creating and caring for infrastructure assets by delivering added community benefits and offering opportunity to disadvantaged individuals.

Stakeholder engagement

Employees
There is a comprehensive corporate and operating company-based communications programme aimed at ensuring that all employees have access to the information they need. Most operating companies conduct regular employee attitude and opinion surveys. In 2007, the first Group-wide survey of employee opinion is planned. The Group has an active whistle-blowing policy through which eight issues were raised in 2006 (14 in 2005).

The Group's equal opportunities performance is measured annually. In 2006, 17% of employees were women and 6.2% were of ethnic minority origin. These statistics are considerably improved from when measurement first took place in 1999. At graduate intake level, the proportion of women is 23% and of ethnic minorities is 7%.

Shareholders
Balfour Beatty runs an active shareholder engagement programme involving regular roadshows and one-to-one meetings. During 2006, senior executives held over 100 meetings with shareholders, representing, in aggregate, approximately 60% of the issued ordinary share capital. All financial presentations are webcast in order to ensure that they are accessible to all shareholder groups, and other interested parties.

Customers
Most of the Group's operating companies run regular customer attitude and opinion surveys. A substantial proportion of the Group's business is conducted with organisations with which its operating companies have long-term relationships.

Suppliers
An increasing proportion of the Group's supply base is retained in long-term relationships based on the compatibility of their values and behaviour as well as product quality and price. The Group has developed and implemented a "Supply Chain Environmental Risk and Impact Grading Tool" to assess supply chain risks.

Government and regulators
Over half of Balfour Beatty's work is carried out for governments. The Group seeks active and positive relationships with governments, their officers and advisers and relevant industry regulators to ensure its policies and activities align with their key requirements.

Communities and our projects
It is Balfour Beatty's policy that all of its major projects have a dedicated community relations team. Typically, major projects will be preceded by exhibitions, and regular newsletters and letter drops will keep interested parties informed at key project milestones. There will be regular visits to schools and other local institutions. Key stakeholders are offered direct access and, when necessary, there will be liaison with local police and other emergency services, and help lines.

Building better communities

Balfour Beatty seeks to enhance the communities impacted by its operating companies and infrastructure projects. For example:

Stoke Football Action
Over £100,000 of funding and substantial management support from Balfour Beatty has unlocked public sector funds to create a £320,000 three-year football coaching programme in Stoke, where Balfour Beatty is the PPP schools concession company. This programme has already proved extremely effective in reducing vandalism and other anti-social behaviour amongst pupils at risk of social exclusion. The programme was officially launched by Richard Caborn, Minister for Sport, in December 2006.


1

2

3

1 Rt Hon Richard Caborn MP, Minister for Sport opens the Group's football coaching programme in Stoke-on-Trent.

2 Rt Hon Tessa Jowell MP, Secretary of State for Culture, Media and Sport opens the 2006 London Youth Games.

3 Balfour Beatty is a founding sponsor of the Prince's Trust scheme to offer training and employment to disadvantaged individuals.

Groundwork UK
Balfour Beatty is working on a number of projects with the network of trusts and volunteer organisations which make up Groundwork UK. These projects, which are all close to long-term local Balfour Beatty work sites or completed PPP projects are aimed at improving local amenities and facilities for local people.

For example, the Group has helped to create new footpath access to the PPP hospital in Blackburn, renovated an old castle for educational purposes close to the PPP hospital in Birmingham and has refurbished and upgraded a children's play area close to the site of Pinderfields Hospital where Balfour Beatty Capital is preferred bidder.

London Youth Games
As the 2006 and 2007 corporate partner to the London Youth Games, in which over 20,000 London school children participate every year, Balfour Beatty is improving sporting facilities and encouraging sporting achievement amongst young people across the capital, where a significant proportion of the Group's infrastructure work is conducted. Balfour Beatty is also providing a sports development grant for all the London boroughs to accelerate investment in new and improved sporting facilities.

Building better lives

Get Into Construction
In pursuing its business objectives, Balfour Beatty offers opportunity to disadvantaged individuals.

The Group is a founding sponsor of the Prince's Trust initiative – "Get Into Construction" – which offers training and employment in the construction industry to disadvantaged young people. Following a successful pilot exercise in 2006, 23 courses are planned for 2007 across the UK.

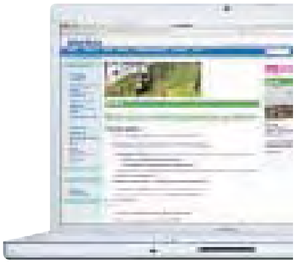
NCH
The Group's charity of the year for 2007 and 2008 is NCH, the nationwide children's charity. In addition to its corporate donations, Balfour Beatty offers matched funding to groups or individual employees engaged in fundraising for the charity.

In 2005 and 2006, Balfour Beatty raised over £200,000 for its previous charity of the year, the Marie Curie Foundation.

Employment of released offenders
Working in conjunction with one of its largest customers, National Grid plc, Balfour Beatty offers convicted offenders due to be released back into the community, the chance to be trained and employed in its infrastructure refurbishment and upgrade work on the gas and electricity networks.

Being able to pursue a specific job opportunity while still detained significantly increases the chances of a successful re-entry into society and decreases the likelihood of recidivism.

To see our full Corporate Responsibility report visit:
www.balfourbeatty.co.uk/bbeatty/responsibility



Board of Directors

Sir David John KCMG
Non-Executive Chairman
Age 68. Appointed a Director in 2000 and became Chairman in 2003. He is chairman of Premier Oil plc and The BSI Group. He was non-executive chairman of BOC Group plc until January 2002, having been a director of Inchcape plc. He is a member of the CBI's International Advisory Board, and a governor of the School of Oriental and African Studies.

Ian Tyler
Chief Executive
Age 46. A chartered accountant. A Director since 1999, he became Chief Executive in January 2005, having been Chief Operating Officer since 2002 and prior to that, Finance Director. He joined Balfour Beatty in 1996 from the Hanson Group where he was finance director of ARC Ltd, one of its principal subsidiaries. He has been president of CRASH, the construction and property industry charity for the homeless, since September 2006.

Anthony Rabin
Finance Director
Age 51. A chartered accountant and a barrister. A Director since 2002, he is also responsible for the Group's Investments and Developments interests, having previously been managing director of Balfour Beatty Capital. Prior to joining Balfour Beatty, Mr Rabin was a partner at Coopers & Lybrand and before that, a senior assistant director at Morgan Grenfell.

Jim Cohen
Managing Director, Rail Engineering and Services
Age 65. An economist. A Director since 2000 having joined the Group in 1993. Prior to joining Balfour Beatty, he held senior management positions with GTE and GEC and prior to those, he was a senior civil servant at the Department of Energy. He is senior independent non-executive director of office2office plc, the office solutions and supplies group. Mr Cohen retired as a Director on 18 February 2007 on his 65th birthday.

Peter Zinkin
Planning and Development Director
Age 53. Joined the Group in 1981 and became Planning and Development Director in 1991 after a series of senior positions in the finance function. Previously, he worked at the London Business School and UMIST.

Remuneration Committee

Robert Walvis (Chair)
Chalmers Carr†
Stephen Howard*
Steven Marshall
Gordon Sage*
Christoph von Rohr

Audit Committee

Steven Marshall (Chair)
Chalmers Carr†
Mike Donovan*
Stephen Howard*
Gordon Sage
Christoph von Rohr

Nomination Committee

Sir David John (Chair)
Mike Donovan*
Stephen Howard*
Steven Marshall
Gordon Sage
Ian Tyler
Robert Walvis

Business Practices Committee

Sir David John (Chair)
Chalmers Carr†
Mike Donovan*
Gordon Sage**
Christoph von Rohr
Robert Walvis

†Until 31 August 2006 *From 1 July 2006 **Until 1 July 2006

Mike Donovan
Non-Executive Director
Age 53. Appointed a Director in 2006. He has an engineering background and was most recently chief operating officer of Marconi plc from 2001 to 2005. Prior to that he was chief executive officer of Marconi Systems and was previously responsible for managing major divisions of British Aerospace, Vickers and the Rover Group.

Stephen Howard
Non-Executive Director
Age 54. Appointed a Director in July 2006. He is a lawyer by background and was most recently group chief executive of Novar plc. Prior to that he was chief executive of Cookson Group plc. He is also a non-executive director of Slough Estates plc and is managing director of Business in the Community.

Steven Marshall
Non-Executive Director
Age 50. Appointed a Director in 2005. A Fellow of the Chartered Institute of Management Accountants. He was executive chairman of Queens' Moat Houses plc until November 2004, having been chief executive of Railtrack Group plc, and prior to that group finance director, between 1999 and 2002. Previously, he was group chief executive of Thorn plc, having joined as finance director in 1995. He is currently non-executive chairman of Delta plc and Torex Retail plc, and also a non-executive director of Southern Water.

Gordon Sage
Non-Executive Director
Age 60. Appointed a Director in 2003. A chemical engineer, he is a non-executive director of Merrill Lynch World Mining Trust plc. Between 1970 and 2001 he held a series of increasingly senior positions in Rio Tinto plc, finally as executive director responsible for its industrial minerals and diamonds businesses.

Hans Christoph von Rohr
Non-Executive Director
Age 68. Appointed a Director in 2003. He is a partner of the international law firm TaylorWessing, a member of the Advisory Council of Deutsche Bank AG, a member, and past chairman, of the supervisory board of the Industrial Investment Council, a member of the supervisory board of SWB AG, and a member of the board of Underwriters Laboratories Inc. He is also chairman of the German Institute for Market Economy and Competition. Previously, he was chief executive officer of the German manufacturing group, Klöckner-Werke AG.

Robert Walvis
Non-Executive Director
Age 60. Appointed a Director in 2001. Previously with the Royal Dutch Shell Group, latterly as chairman of the Global Corporate Centre of the Royal Dutch Shell Group of Companies. He is a non-executive director of Johnson Matthey plc and chairman of the supervisory board of Allianz Nederland Groep NV. He is the senior independent Director.

Directors' report

Activities
The Chairman's statement on pages 4 and 5, the Chief Executive's strategy review on pages 6 to 8, the Operating review on pages 22 to 37 and the Financial review on pages 38 to 40, report on the principal activities of the Group, its operations during 2006 and future developments in its businesses.

Dividends
The Directors recommend a final dividend on ordinary shares of 5.2p (net) per share, making, with the interim dividend of 3.9p, a total dividend for 2006 of 9.1p (net). Preference dividends totalling 10.75p (gross) per preference share have been paid for 2006.

Directors' interests
No Director had any material interest in any contract of significance with the Group during the period under review. The interests of Directors in the share capital of the Company and its subsidiary undertakings and their interests under the long-term incentive schemes (the Performance Share Plans 2001 and 2006), the deferred bonus plan and in respect of options, are set out in the tables in the Remuneration report beginning on page 54.

During the year, the Company has provided a qualifying third party indemnity to each of the Directors, which indemnities remain in force.

Share capital and major shareholders
Details of the share capital of the Company as at 31 December 2006 are set out in Note 27 on pages 94 to 96. During the year to 31 December 2006 no ordinary shares were repurchased for cancellation and 12,012,640 preference shares (representing 9% of the preference share capital) were repurchased for cancellation for a total consideration of £18,836,111 at an average price of 156.8p. 1,375,582 ordinary shares were issued following the exercise of options held under the Company's Savings-Related Share Option Scheme and 1,999,231 ordinary shares were issued following the exercise of options held under the Company's Executive Share Option Schemes. No other shares were issued during the year.

At 31 December 2006, the Directors had authority, under the shareholders' resolutions of 12 May 2006, to purchase through the market 42,768,741 ordinary shares and 17,739,032 preference shares at prices set out in those resolutions. This authority expires at the conclusion of the separate Class meeting which follows the 2007 Annual General Meeting.

As at 6 March 2007, the Company had been notified in accordance with the Disclosure and Transparency Rules of the Financial Services Authority of the following interests in its ordinary share capital:

Standard Life Investments Ltd	7.75%
Schroders plc	6.73%
Legal and General Group plc	3.44%

Corporate governance and the Combined Code

Overview

The Board continues to endorse and apply the principles of good corporate governance reflected in the Combined Code (the "Code"), as appended to the Listing Rules of the UK Listing Authority.

The governance of the Company through the year in the light of the principles and supporting principles and provisions of the Code is described in the following paragraphs. Throughout the year ended 31 December 2006 and save as otherwise explained in the paragraph headed "Compliance with the Code" on page 53, the Board believes that the Company was in compliance with the provisions of the Code.

Honorary President

Viscount Weir is Honorary President of the Company, having been appointed to this position in May 2003 following his retirement as Chairman.

The Board

The Board currently comprises 10 Directors, of whom seven, including the Chairman, are non-executive. Details of appointments and retirements during the year can be found under the heading "Directors" below. Jim Cohen, an executive Director throughout 2006, retired on 18 February 2007. The Directors believe that the Board continues to include an appropriate balance of skills and, with them, the ability to provide effective leadership for the Group.

Throughout 2006 and as at the date of this report, the Chairman was Sir David John, the Chief Executive was Ian Tyler and the senior independent Director was Robert Walvis. The chairman of the Audit Committee in 2006 was Steven Marshall. Sir David John continued as chairman of each of the Nomination Committee and the Business Practices Committee, and Robert Walvis continued as chairman of the Remuneration Committee, throughout the year.

The Board operates both formally, through Board and Board Committee meetings, and informally through regular contact between Directors as required. Decisions on a list of specific matters, including the approval of financial statements, major tenders and capital expenditure, and most acquisitions and disposals, are reserved to the Board or Board Committees. Matters falling outside the list are delegated to management. The list of these reserved matters is reviewed by the Board from time to time, most recently in December 2006.

Meetings of the Board are normally held in London, but meetings are on occasions held in other parts of the UK and overseas. Some meetings are combined with visits to the Group's businesses or major projects. On the evening before the July 2006 meeting, which was held in London, the Directors visited a station refurbishment project being carried out by Metronet and visited the Waterloo and City line, then in the middle of major refurbishment work also being carried out by Metronet. The November 2006 meeting was held in Berlin, for which Deutsche Bahn kindly made meeting facilities available, and Directors were able to see the new Potsdamerplatz main line station in central Berlin, a project in which the Group was involved.

Procedures for Board meetings remain unchanged. Papers are generally sent out at least three days in advance of the meeting. These include a written report from each of the Chief Executive, the Finance Director, the director of Health, Safety and the Environment, and the group managing directors. At the meetings, oral reports are made on issues arising from the written reports, and both those and other matters of immediate interest or concern are discussed by the Board. Apart from the meetings that approve the interim and final results respectively, and the meeting prior to the Annual General Meeting, a separate presentation on a topic of interest or concern, such as the operations of a particular business, is normally made to the Board. Each meeting lasts about four hours, but can be longer.

The Board met on 11 occasions in the course of 2006. One of the meetings was called at short notice to consider the Company's proposed cash offer for Birse Group plc. As a result of the short notice, three non-executive Directors were unable to attend this meeting due to other commitments. Each was briefed separately.

A table showing attendance at Board meetings, and at meetings of the Audit Committee, the Nomination Committee, the Remuneration Committee and the Business Practices Committee, is set out on page 50. In addition, the non-executive Directors held two separate meetings during the year, one being attended by the Chairman and one taking place without the Chairman.

Chairman
Sir David John became Chairman in May 2003, having joined the Board in August 2000. Sir David spends an average of two days per week on the business of the Company. He has other significant commitments as non-executive chairman of The BSI Group and of Premier Oil plc. The Board considers that his other commitments are not of such a nature as to hinder his activities as chairman of the Company or those as chairman of the Nomination and Business Practices Committees.

Directors
Brief biographical details of the Directors, including the Chairman, are given on pages 46 and 47. All the Directors shown served throughout the year save for Mike Donovan and Stephen Howard who were appointed on 1 July. In addition, Chalmers Carr, who is not pictured, served as a Director until 31 August when he retired on completion of his three year term. The Board considers that all the non-executive Directors continue to be independent.

From September 2003, non-executive Directors have been appointed for specific three year terms, and it is part of the terms of reference of the Nomination Committee to review all appointments of non-executive Directors at three year intervals and make recommendations to the Board accordingly. Mr Sage's and Dr von Rohr's appointments were each reviewed during 2006 and their appointment for a further three years was confirmed, subject to re-election as required by the Articles of Association.

Rotation of Directors, election and re-election
The Articles of Association of the Company provide that each Director shall retire from office in the third year following the year in which last elected or re-elected, and shall be eligible for re-election. This year, the Directors who retire are Sir David John, Gordon Sage, Christoph von Rohr and Robert Walvis. Each is seeking re-election, being eligible. In addition, Mike Donovan and Stephen Howard, who were each appointed on 1 July 2006, seek election.

Board Committees
The main Board Committees, the membership of which is either wholly or substantially comprised of non-executive Directors, continue to be the Audit Committee, the Nomination Committee, the Remuneration Committee and the Business Practices Committee.

Reports on the workings of three of these Committees are set out below. The report of the Remuneration Committee can be found in the Remuneration report beginning on page 54.

– The Audit Committee
The terms of reference for the Committee, based on the Smith report and the requirements of the Code, were approved by the Board in October 2003. They are subject to regular review but remain unchanged. The main responsibilities of the Audit Committee are as stated in previous reports. In summary they are:

(1) to monitor the integrity of the financial statements of the Group and any formal announcements relating to the Group's financial performance;

(2) to review the Group's internal financial controls established to identify, assess, manage and monitor financial risks, and receive reports from management on the effectiveness of the systems they have established and the conclusions of any testing carried out by the internal and external auditors;

(3) to monitor and review the effectiveness of the internal audit function;

(4) to make recommendations to the Board in relation to the appointment of the external auditor and to approve the remuneration and terms of engagement of the external auditor;

(5) to assess the independence, objectivity and effectiveness of the external auditor and to develop and implement policy on the engagement of the external auditor to supply non-audit services; and

(6) to review arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting.

The membership of the Committee currently comprises Steven Marshall (the Committee chairman), Mike Donovan, Stephen Howard, Christoph von Rohr and Gordon Sage. Christopher Pearson, the Company Secretary, remains secretary of the Committee. The Committee was chaired throughout 2006 by Steven Marshall. Chalmers Carr, who retired on 31 August, also served on the Committee until his retirement. All of the members have extensive experience of management in large international organisations. The Committee chairman, Steven Marshall, is an accountant and a former group finance director and group chief executive of Thorn plc. He later held both these appointments at Railtrack plc.

Appointments to the Committee are made by the Board for a period of up to three years, extendable by no more than two additional three year periods, so long as members continue to be independent. At the Board meeting following each meeting of the Committee, the Committee chairman provides an oral report on the work of the Committee and any significant issues that may have arisen. The minutes of Committee meetings are circulated to all members of the Board.

Four meetings of the Committee were held in 2006. At the invitation of the Committee, partners from the external auditor, the Head of Internal Audit, the Finance Director and the Company Chairman regularly attend each meeting. In addition, any independent non-executive Director who is not a Committee member has an open invitation to attend meetings.

Directors' report (continued)

In 2006, as in previous years, the main purpose of the March and August meetings of the Committee was to consider the final and interim results respectively, a process which is well established. At each of these meetings, the Committee reviewed significant accounting policies, financial reporting issues and judgements, and reports from internal financial management and internal and external auditors.

The May and November meetings of the Committee are not driven by financial results and at these meetings the Committee was able to review a wider range of matters in addition to its usual business. For example, in May, the Committee considered a report on progress in the Group's enterprise resource plan – the introduction of new software for accounting, HR and procurement systems, and in November, the Committee considered a paper on the Group's funding.

Throughout 2006, the Committee has continued to review the Group's financial risk management processes. This review has encompassed reports from the Head of Internal Audit on the Group's internal controls and on the work of the internal auditors, a consideration of the effectiveness both of the internal audit function and of the external audit process, a review of the resources of the external and internal auditor, and a consideration of the external auditor's management letter in respect of accounting procedures and internal financial controls. As a result of this continuing process, the Committee felt able to recommend to the Board that it might properly conclude that the Company continued to maintain a sound system of internal financial control, and that a proper review of the effectiveness of the Company's systems of internal financial controls had been completed.

The Committee has also considered the independence of the external auditor and received confirmation that, in its view, it remained independent of the Company. Consideration of the independence of the external auditor included the non-audit work carried out by the external auditor during the year, which continues to be covered by the policy approved by the Board in June 2003 (an analysis of non-audit fees incurred is set out in Note 4.2 on page 73). The Committee has carried out a review of the proposal by the external auditor of the audit fees and terms of engagement for the 2006 audit and has recommended to the Board that it proposes to shareholders that Deloitte & Touche LLP continues as the Company's external auditor.

The administrative procedures of the Committee were unchanged through the year. The Head of Internal Audit continues to have direct access to the Chairman of the Committee. Separate meetings between the Committee Chairman, and the Finance Director, the Head of Internal Audit and the external auditor, took place after the March and August meetings.

– The Nomination Committee

The Committee was established by the Board in November 2003. Its terms of reference are available on the Company's website.

The Committee continues to be chaired by Sir David John. Its other members, currently, are Mike Donovan, Stephen Howard, Gordon Sage, Robert Walvis, Ian Tyler and Steven Marshall. The secretary of the Committee is Paul Raby, human resources director.

The Committee held two meetings in 2006. The first meeting was held in May. The main item for consideration at this meeting was the proposed appointment of Mike Donovan and Stephen Howard as non-executive Directors. Both had been recommended to the Committee by an external recruitment firm as having appropriate skills and experience for the job. The Committee agreed with this and recommended to the Board that they each be appointed. At this meeting the Committee also considered and approved a proposal (Dr von Rohr being absent) to appoint Dr von Rohr for a second three year term as a non-executive Director, recognising his contribution to the Board and the continuing need for his particular skills, experience and knowledge. His re-appointment was agreed by the Board.

A second meeting was held in July. At this meeting, the Committee considered and approved a proposal to re-appoint Gordon Sage (Mr Sage being absent) to a second three year term as a non-executive Director. The Committee concluded that Mr Sage's combination of experience and knowledge was a valuable asset to the Group, and his re-appointment was agreed by the Board.

– The Remuneration Committee

Information about the working and membership of this Committee is contained in the Remuneration report beginning on page 54.

– The Business Practices Committee

The Business Practices Committee was chaired through the year by Sir David John, its other members being Chalmers Carr (until his retirement), Mike Donovan (from 1 July), Christoph von Rohr, Gordon Sage (until 1 July) and Robert Walvis. Christopher Pearson, the Company Secretary, was secretary to the Committee. Its terms of reference cover matters of business conduct, ethics, reputation, health, safety and the environment and matters of corporate social responsibility generally. It is also charged with reviewing the effectiveness of the whistle-blowing procedures established in the Group.

The Committee met four times in 2006. As usual, the main topics considered by the Committee throughout the year related to health, safety and the environment, including approval of the final version of the Group's fifth SES report, sent out in May 2006. The Committee also considered the question of safety from a long-term perspective, the importance of a safety culture, progress in safety generally given the Group's expansion, and the practical difficulties of applying common safety standards in different jurisdictions. Regular reports were received by the Committee on the Group's charitable activities and about the whistle-blowing procedures.

– Table of attendance at meetings

Details of the number of meetings of, and attendances at, the Board meetings and meetings of the Audit, Nomination, Remuneration and Business Practices Committees during the year are set out in the table following. The relevant total number of meetings held in 2006 in each case is included in brackets after the name of the Board or Committee. It should be noted in reviewing attendance of Board and Committee meetings that:

(1) Chalmers Carr retired on 31 August 2006;

(2) Mike Donovan and Stephen Howard were appointed Directors on 1 July 2006. From that date, Mr Donovan was appointed to the Audit, Nomination and Business Practices Committees and Mr Howard was appointed to the Audit, Remuneration and Nomination Committees;

(3) Gordon Sage was appointed to the Remuneration Committee from 1 July 2006 and resigned from the Business Practices Committee at the same date;

(4) there were no Remuneration Committee meetings after June 2006; and

(5) one meeting of the Board was called at short notice and, as a result of other commitments, a number of Directors were unable to attend it (see the reference at the top of page 49).

Name of Director	Board (11)	Audit (4)	Nomination (2)	Remuneration (3)	Business Practices (4)
M J Donovan	5	2			2
S L Howard	6	2			
C Carr	7	3		2	3
J L Cohen	10				
Sir David John	11		2		4
S Marshall	11	4	2	2	
A L P Rabin	10				
Dr H C von Rohr	9	2		2	1
G H Sage	11	2	1		
I P Tyler	11		1		
R J W Walvis	10		2	3	2
P J L Zinkin	11				

Board, Committee and individual director evaluation
The Board as a whole and its main Committees were the subject of an evaluation exercise carried out in 2004 by an external consultant. The actions agreed which arose from the report were implemented through 2005.

No further external evaluation exercise has been carried out in 2006 because of the number of Board changes at the end of 2005 and through 2006. A full Board evaluation is planned for 2007.

Dialogue with shareholders
The Company has continued its long-established programme of communication with institutional investors and brokers throughout 2006. Presentations of the half year and full year results were made in accordance with the practice of previous years, and other meetings have been held at regular intervals through the year with institutional shareholders, brokers, and analysts including presentations in Edinburgh, Paris and the United States. This programme will be continued and expanded where appropriate, subject to the constraints of regulation and practice.

Reports to the Board on meetings or other contact with shareholders or their representatives are made by executive Directors on a regular basis. During the year a presentation was made to the Board by the Group's Head of Corporate Communications on the subject of "Investor Relations". On occasion the Chairman attends meetings with shareholders and any non-executive Director is welcome to do so. The non-executive Directors believe that, through their direct and ready access to, and contact with, the Chairman, through Mr Walvis, the senior independent Director, and through regular reports to the Board, they are kept fully aware of the views of the larger shareholders and the investment community generally.

Risk management
The Board takes ultimate responsibility for the Group's systems of risk management and internal control and reviews their effectiveness. The Group's Principal Risks and how they are mitigated are summarised on page 41 of the main report. The Board has continued to assess the effectiveness of the risk management processes and internal controls during 2006 and to the date of this report. Such assessment is based on reports made to the Board, the Audit Committee and the Business Practices Committee, including:

- the results of internal audit's reviews of internal financial controls;
- a Group-wide certification that effective internal controls had been maintained, or, where any significant non-compliance or breakdown had occurred with or without loss, the status of corrective action; and
- a paper prepared by management on the nature, extent and mitigation of significant risks and on the systems of internal controls.

The Group's systems and controls are designed to ensure that the Group's exposure to significant risk is properly managed, but the Board recognises that any system of internal control is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. In addition, not all the material joint ventures in which the Group is involved are treated, for these purposes, as part of the Group. Where they are not, systems of internal control are applied as agreed between the parties to the venture.

Central to the Group's systems of internal control are its processes and framework for risk management. These accord with the revised Turnbull Guidance on internal controls and were in place throughout the year and up to the date of signing this report.

The Group's systems of internal control operate through a number of different processes, some of which are interlinked. These include:

- the annual review of the strategy and plans of each operating company and of the Group as a whole in order to identify, inter alia, the risks to the Group's achievement of its overall objectives and, where appropriate, any relevant mitigating actions;
- monthly financial reporting against budgets and the review of results and forecasts by executive Directors and line management, including particular areas of business or project risk. This is used to update both management's understanding of the environment in which the Group operates and the methods used to mitigate and control the risks identified;
- individual tender and project review procedures commencing at operating company level and progressing to Board Committee level if value or perceived exposure breaches certain thresholds;
- regular reporting, monitoring and review of health, safety and environmental matters;
- the review and authorisation of proposed investment, divestment and capital expenditure through the Board's Committees and the Board itself;
- the review of specific material areas of Group-wide risk and the formulation and monitoring of risk mitigating actions;
- the formulation and review of properly documented policies and procedures, updated through the free and regular flow of information to address the changing risks of the business;
- specific policies set out in the Group Finance Manual, covering the financial management of the Group, including arrangements with the Group's bankers and bond providers, controls on foreign exchange dealings and management of currency and interest rate exposures, insurance, capital expenditure procedures, application of accounting policies and financial controls;
- a Group-wide risk management framework which is applied to all functions in the Group, whether operational, financial or support. Under it, the key risks facing each part of the Group are regularly reviewed and assessed, together with the steps to avoid or mitigate those risks. The results of those reviews are placed on risk registers and, where necessary, specific action plans are developed;
- reviews and tests by the internal audit team of critical business financial processes and controls and spot checks in areas of perceived high business risk; and
- the Group's whistle-blowing policy.

Annual General Meeting
Sir David John, who chairs the Nomination and Business Practices Committees, Steven Marshall, who chairs the Audit Committee, and Robert Walvis, who chairs the Remuneration Committee, will be available at the Annual General Meeting to answer any questions arising from the work of these committees. The Board regards the Annual General Meeting as an important occasion on which to communicate with shareholders, and research into subjects of likely interest to shareholders is undertaken so that questions can be answered during the meeting for the benefit of all shareholders present. Shareholders may also put questions in advance of the Annual General Meeting by writing to the Company Secretary. The business to be put to the Annual General Meeting is set out in the separate circular to shareholders.

Political donations
Under the current law, shareholder authority is required for political donations to be made or political expenditure to be incurred by the Company or its subsidiaries in the EU. In common with previous years, no such donations or expenditure were made or incurred in 2006, and there is no intention to do so in the future. Because, however, the current law is so widely drafted, it remains unclear whether, for example, granting paid time off for local government or trade union activity could be regarded as political expenditure. Although not yet in force, the Companies Act 2006 clarifies that trade unions are not to be regarded as political organisations for these purposes, but (as we are advised) the position regarding local government remains unclear. Given the penalties for breaching the law, the Company has sought, and will continue to seek, limited authority from shareholders to incur "political expenditure" in the EU.

Corporate responsibility
Details of our approach to the subject of corporate responsibility appear on pages 42 to 45 of this report. These include more information about the Group's charitable activities, which are described below.

Written report
For the sixth year we are publishing a separate report on safety, social and environmental issues. A copy will be available to shareholders attending the Annual General Meeting and to preference shareholders attending the separate class meeting.

Group policies
Our published policies on health and safety, the environment, ethics and human rights remain in place and are subject to regular reviews. Our progress in the areas of health and safety and the environment is described in the separate report.

Employment
As the Group operates across a number of business sectors in different environments, it has a decentralised management structure, with employment policies designed to suit the needs of individual businesses. However, each employing company is expected to comply with certain key principles in its design and practice of employment policy.

These are:

- to provide an open, challenging and participative environment;
- to enable all employees to utilise their talents and skills to the full, through appropriate encouragement, training and development;
- to communicate a full understanding of the objectives and performance of the Group and the opportunities and challenges facing it;
- to provide pay and other benefits which reflect good local practices and reward individual and collective performance; and
- to ensure that all applicants and employees receive equal treatment regardless of age, origin, gender, disability, sexual orientation, marital status, religion or belief.

Individual businesses use a variety of methods to communicate key business goals and issues to employees and also consult and involve their employees through local publications, briefing groups, consultative meetings, training programmes and working groups to assist the process of continuous improvement in the way they operate and do business. Regular publications inform employees of major business and technical achievements. Most of our UK based businesses have either attained or have committed to attain the UK Investors in People standard.

Regular communication is maintained with the in-service and pensioner members of the Group's Pension Funds.

Charitable activities
During 2006 the Group has continued to help raise funds for charity and has also continued to provide donations in cash and kind to charitable organisations. The total amount of funds raised and donated during the year was £306,400.

As in previous years, the Group's main efforts have been directed to a small number of charities with Marie Curie again being the focus of employee fundraising efforts. A total of £90,700 was raised in the year by employees in a wide variety of ways, including the London Marathon, the Fields of Hope daffodil planting scheme and numerous quizzes, walks and other events. The Company added a further £31,500 to this sum, under a matching agreement with Marie Curie, making a total for the year for Marie Curie of £122,200.

The Company donated £60,000 to the charity London Youth Games, and a further £30,000 to the regeneration charity Groundwork UK for three specific projects. A further £10,000 was donated to the Building Better Lives scheme under the Prince's Trust.

During the year, the Chief Executive, Ian Tyler, took over the presidency of the construction industry charity CRASH. The Company donated £2,000 to CRASH in 2006, and will become a patron of CRASH in 2007.

Other UK Group companies have contributed a total of £82,200 to a wide variety of charities.

As regards non-cash donations the Company provided, during the year, material support of an estimated value of £5,000 to the charity Engineers against Poverty

The Group continues to enable UK employees to donate through the Give-as-you-Earn scheme to various charities of their choice.

Key performance indicators
In 2006, the Group commissioned a study to identify the non-financial key performance indicators which are currently in use or would be relevant for external consideration of the Group's performance and prospects. Recommendations from this study are reflected in this annual report, for example by the inclusion of accident frequency rates, the proportion of work undertaken under long-term contracts, and the proportions of women and ethnic minorities in the workforce.

Post balance sheet events
Details of post balance sheet events are set out in Note 34 on page 103.

Taxation status
The Company is not a close company for taxation purposes.

Payment of creditors
In the UK, the Company's policy is to settle the terms of payment with suppliers when agreeing the terms for each transaction or series of transactions; to seek to ensure that suppliers are aware of the terms of payment; and to abide by these terms of payment as and when satisfied that the supplier has provided the goods or services in accordance with the agreed terms. At 31 December 2006 the year end creditors' days of the Company were 17 (2005: 21).

Financial instruments
The Group's financial risk management objectives and policies are described in the Financial review on pages 38 to 40, and its exposures to price risk, credit risk, liquidity risk and cash flow risk are included in Note 20 on page 84.

Research and development
The Group continues to be committed to investment in research and development in all its areas of activity. This covers new products and processes and innovation in areas such as information technology and asset management systems.

We continue to undertake a range of development initiatives throughout our businesses which are supported by links with selected universities.

Details of the Group's 2006 research and development expenditure are given in Note 4.1 on page 73.

Compliance with the Code
The Company believes it is compliant with the Code save in the following respects:

(a) The effectiveness of the Group's whistle-blowing procedures is reviewed by the Business Practices Committee, and not the Audit Committee. This is because, based on the Company's experience, the great majority of "whistle-blowing" type complaints arise out of non-financial matters, mainly employment-related. The Audit Committee is copied with all reports made to the Business Practices Committee on the whistle-blowing procedure; and

(b) No evaluation, either of the Board or individual Directors, has been carried out in 2006 because the number of Board changes effective at the end of 2005 and through 2006 was, the Company believes, likely to make any such process of little value. A full Board and individual Director evaluation is planned for 2007, to be conducted by an external consultant as in the last valuation in 2004. The present Board will have worked together for over a year when this evaluation process gets underway.

Statement of Directors' responsibilities
The following statement, which should be read in conjunction with the Independent Auditors' report on page 61, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the auditors in relation to the financial statements.

The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRS) and have also elected to prepare financial statements for the Company in accordance with IFRS. Company law requires the Directors to prepare such financial statements in accordance with IFRS, the Companies Act 1985 and Article 4 of the International Accounting Standard (IAS) regulation.

IAS 1 requires that financial statements present the Company's and the Group's financial position, financial performance and cash flows fairly (ie. give a true and fair view for each financial year). This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the IAS Board's "Framework for the preparation and presentation of Financial Statements". In nearly all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS. Directors are also required to:

(1) properly select and apply accounting policies;

(2) present information, including accounting policies, in a manner which provides relevant, reliable, comparable and comprehensible information: and

(3) provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's and the Group's financial position and financial performance.

The Directors consider that they have met these requirements in preparing these financial statements. The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group, and are reasonably directed at safeguarding the assets and detecting and preventing fraud and other irregularities. Directors are also responsible for the preparation of a Directors' report and a Remuneration report which comply with the requirements of the Companies Act 1985.

Disclosure of information to auditors
Each of the Directors at the date of approval of this report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 234ZA of the Companies Act 1985.

Auditors
Deloitte & Touche LLP have indicated their willingness to continue as auditors to the Company and a resolution for their reappointment will be proposed at the Annual General Meeting.

Directors' report
Signed by order of the Board

C R O'N Pearson
Secretary
6 March 2007

Remuneration report

Remuneration Committee

The Remuneration Committee of the Board ("RemCo") is primarily responsible for determining the remuneration policy and conditions of service for executive Directors and the Chairman of the Company. It also reviews and monitors the level and structure of remuneration for senior management immediately below the level of the Board. The terms of reference of the RemCo can be found on the Company's website.

The RemCo consists entirely of independent non-executive Directors and has been chaired by Robert Walvis since November 2003. Its other members are Stephen Howard, Steven Marshall, Christoph von Rohr and Gordon Sage. Sir David John attends meetings by invitation. Chalmers Carr was also a member of the RemCo until his retirement on 31 August 2006. No member of the RemCo has any personal financial interest, other than as a shareholder, in the matters to be decided by the RemCo, nor potential conflicts of interest arising from cross-directorships, and no member of the RemCo has any day-to-day involvement in the executive management of the Group.

During 2006 the Chief Executive, Ian Tyler, was invited to join meetings of the RemCo when appropriate. Paul Raby, the human resources director, has acted as secretary of the RemCo during the year. No Director has any involvement in discussions relating to his own remuneration.

The RemCo is responsible for appointing external independent consultants to advise on executive remuneration matters. This advice and assistance has been provided to the RemCo throughout the year by New Bridge Street Consultants LLP ("NBSC") and PricewaterhouseCoopers LLP ("PwC"). The human resources director has also provided advice to the RemCo. The terms of reference of the independent consultants are available on the Company's website. During the year PwC also provided other tax and consultancy services to the Company. The RemCo is satisfied that no conflict of interest arises from the provision of this advice.

Executive Directors' remuneration

General policy

It is the policy of the RemCo to provide an overall remuneration package that is competitive and which facilitates the recruitment and retention of high calibre management. The annual and long-term incentive plans make up an important part of each executive Director's remuneration and are structured so as to motivate senior managers to deliver high standards of performance, without encouraging excessive risk taking. It is intended that the share-based elements of the package will not only drive performance over the long term but will also assist in aligning the interests of senior management with those of shareholders.

A major review of remuneration was undertaken in 2005. As a result of this review, a new Performance Share Plan (the "Plan") was designed and was approved by shareholders at the AGM in May 2006. No further changes have been made to the structure of remuneration during 2006 and no significant changes to the existing remuneration policy are currently envisaged for 2007. Under the current arrangements, if target performance is achieved, basic salary will represent around one-half of total earnings. If maximum performance is achieved, which would involve a superior level of performance substantially in excess of business plan, basic salary will represent around one-third of total earnings.

Executive Directors can join the Balfour Beatty Pension Fund. The policy regarding pension provision was reviewed in the light of the changes to the taxation of pensions, and the policy in place from April 2006 is described below.

Basic salaries

It is the policy of the RemCo to set basic salaries at levels which it believes are competitive given the size and complexity of the Company, as well as the broad business sectors in which it operates. To assist in this, NBSC and PwC provide data and independent advice on remuneration levels in companies considered to be comparable in terms of annual sales, market capitalisation and industry sector. The RemCo looks to set basic salaries at around the median of the market, but also takes into account its own judgement of the performance of the Group's businesses and the performance of individual Directors. The RemCo intends to continue to use this approach in the foreseeable future.

The basic salaries of executive Directors are reviewed annually at 1 July and the basic salaries following the review at 1 July 2006 are shown in the table below. The average increase was 7.3%.

Name of Director	Salary at 1 July 2006
J L Cohen	£330,000
A L P Rabin	£355,000
I P Tyler	£517,000
P J L Zinkin	£355,000

Annual incentive plan

Each executive Director participates in an annual incentive plan, under which predetermined financial targets must be achieved before any payment is earned. The maximum potential bonus which could have been earned by executive Directors for 2006 was 80% of basic salary and the performance indicator chosen was profit before tax and exceptional items ("profit"). A bonus of 40% of basic salary would have been earned for the achievement of performance in line with target. Two-thirds of these bonuses are payable in cash, while the remaining one-third is deferred in the form of ordinary shares of the Company under the Deferred Bonus Plan (the "DBP"). These shares, along with shares awarded in lieu of dividends paid during the deferral period, will be released to the Directors after three years, providing they are still employed by the Company at that time. Bonuses are non-pensionable. The actual profit for the year ended 31 December 2006 resulted in a bonus of 65.94% of basic salary for each executive Director. Details are shown in the table on page 57.

Shares awarded under the DBP in respect of the annual incentive plan are shown in the table on page 58.

The annual incentive plan for 2007 will operate in the same way as for 2006 and the RemCo will continue to review the competitiveness and structure of the annual incentive plan in future years.

Long-term incentive scheme

The RemCo believes that performance related long-term incentives which align executives with both business strategy and shareholders interests are an important component of overall executive remuneration arrangements.

As stated above, in 2006, shareholders approved the Company's proposals for a new Performance Share Plan (the "Plan") to replace the incentive plan previously approved in 2001. Under the Plan, conditional awards of ordinary shares of the Company are made to executive Directors and other selected operational and functional senior managers. The maximum market value of any award, at the award date, will be 150% of basic salary, other than in exceptional circumstances, where the limit is 200% of basic salary. It is currently the intention of the RemCo that an award of 150% of salary will only be made to the Chief Executive, with the other executive Directors receiving conditional awards over shares with a market value of 125% of basic salary.

The awards will vest, subject to the achievement of performance conditions, three years after the date of grant. It is the intention of the RemCo to make awards under the Plan in 2007 and that the performance conditions will follow a similar format to those which apply to the award made in 2006. For this award there are two performance conditions each applying to separate parts of the award.

50% of an award is linked to an adjusted earnings per share ("EPS") growth target, and will vest as shown in the table below:

EPS growth over three years	Proportion of award vesting
Less than RPI + 15%	Zero
RPI + 15%	25%
RPI + 45%	100%
Between RPI + 15% and RPI + 45%	Between 25% and 100% pro-rata

Growth in EPS will be determined following independent verification of the calculations made internally.

The performance condition attached to the other 50% of an award is based on total shareholder return ("TSR") performance, measured against a group of UK listed companies operating in comparable markets to the Company. The companies used for the 2006 award are as follows: Aggreko, AMEC, WS Atkins, Babcock International, Capita, Carillion, Costain, Enterprise, Hanson, Interserve, Keller, Kier, John Laing, Alfred McAlpine, Morgan Sindall, Serco, Travis Perkins and Wolseley.

The TSR performance of all companies will be measured over the three year performance period, with the TSR of Balfour Beatty compared to the TSR of the other companies. This part of an award will vest (in part) if Balfour Beatty's TSR is equivalent to the company whose TSR performance is at the median, with full vesting if Balfour Beatty's TSR is equivalent to, or above, that of the company whose TSR performance is at the upper quartile. The precise scale of vesting is shown in the table below:

Total shareholder return	Proportion of award vesting
Below median	Zero
Median	25%
Upper quartile	100%
Between median and upper quartile	Between 25% and 100% pro rata

TSR will be independently calculated and verified by the RemCo.

There is no provision for the re-testing of these performance conditions.

The RemCo considers that the EPS and TSR performance conditions provide a good blend of performance metrics, with EPS growth rewarding strong financial performance and TSR rewarding stock market performance, providing a strong and direct alignment with investors.

Pensions

The Company's pension policy was reviewed in the light of the changes to the taxation of pensions which were introduced in April 2006. The Company is not compensating any member of the Balfour Beatty Pension Fund (the "Fund") (or any other pension scheme operated by the Company) for any additional tax which is payable as a result of the new legislation. In the event of a member choosing to opt out of the Fund as a result of their benefits reaching or exceeding the Lifetime Allowance, a cash supplement will be payable to them. A Fund specific earnings cap will be maintained in the Fund for those members who were subject to the HMRC earnings cap and, in line with previous policy, a discretionary cash supplement will be paid in lieu of pension provision above the Fund specific earnings cap. Members who were benefiting from contributions to a Funded Unapproved Retirement Benefit Scheme ("FURBS") were given the choice to instead receive a cash supplement of equivalent value and, as a result, the Company ceased contributing to any FURBS from April 2006.

Share ownership guidelines

To further align the interests of senior management with those of shareholders, executive Directors and other key senior managers are subject to share ownership guidelines. Executive Directors are required to build up a holding in ordinary shares of the Company to the value of 100% of their basic salary at a reference date. In order to achieve this, they will be expected to retain at least half of the shares (after payment of any taxes due) which vest from awards made under the Plan and the DBP.

Executive share options

Since 2001, when a performance share plan was introduced, it has been the RemCo's policy only to make grants of executive share options to executive Directors and other participants in the Plan (or its predecessor, the 2001 Performance Share Plan) in exceptional circumstances, for example to recruit a high calibre individual. No grants of options have been made under the Executive Share Option Scheme 2001 since 31 December 2004. It remains the intention of the RemCo that no further grants of executive share options will be made to any level of management, other than in exceptional circumstances.

Savings-related share option scheme

Executive Directors are eligible to participate in a HMRC approved savings-related share option scheme ("SAYE") under which employees based in the UK are granted an option to purchase shares in the Company in either three or five years time, dependent on their entering into a contract to make monthly contributions to a savings account over the relevant period. The exercise price for the SAYE options granted in 2006 was at a 20% discount to the market value at the date of invitation.

Service contracts

Since 1999, it has been the Company's policy and practice to include in executive Directors' contracts a 12 month rolling notice period from the Company and six months' notice on the part of the Director. This policy will continue in the future.

Details of the service contracts of the executive Directors are shown in the table below.

Name of Director	Date of contract	Notice period from Company (months)
J L Cohen	11 February 2000	12
A L P Rabin	28 August 2002	12
I P Tyler	22 December 2004	12
P J L Zinkin	10 December 1991	12

Service contracts of executive Directors do not include provision for specific payment in the event of early termination, nor do they provide for extended notice periods or compensation in the event of a change of control. It is not the RemCo's intention to introduce such provisions. If any existing contract of employment is breached by the Company in the event of termination, the Company would be liable to pay, as damages, an amount approximating to the net loss of salary and contractual benefits for the unexpired notice period. The RemCo will seek to ensure that the Director fulfils his obligation to mitigate his losses and will also give consideration to phased payments where appropriate.

Remuneration report (continued)

External appointments
The RemCo recognises that benefits can arise from allowing executive Directors to take a non-executive role elsewhere. With approval of the Board in each case, executive Directors may therefore accept one external appointment and retain any related fees. Jim Cohen was appointed as a non-executive Director of office2office plc on 29 June 2004 and fees of £34,171 were paid to him for his services during the year ended 31 December 2006.

Non-executive Directors
Non-executive Directors are appointed by the full Board following recommendations from the Nomination Committee. The Chairman's remuneration falls within the remit of the RemCo and the Board determines the terms on which the services of other non-executive Directors are provided. All non-executive Directors are elected for a term of three years and must retire and if eligible seek re-election at the AGM in the third calendar year following the year in which they were elected (or last re-elected). They are not eligible to join any pension scheme operated by the Company and cannot participate in any of the Company's share option, annual incentive or long-term incentive schemes. None of the appointment letters for non-executive Directors contain provision for specific payment in the event of termination for whatever cause.

The dates of the letters of appointment or last election (or last re-election) of the non-executive Directors are shown in the table below.

Name of Director	Date of appointment or last election	Unexpired period at 31 December 2006 (months)
C Carr*	13 May 2004	n/a
M Donovan	1 July 2006	30
S Howard	1 July 2006	30
Sir David John	13 May 2004	5
S Marshall	11 May 2006	29
G H Sage	13 May 2004	5
Dr H C von Rohr	13 May 2004	5
R J W Walvis	13 May 2004	5

*Retired on 31 August 2006

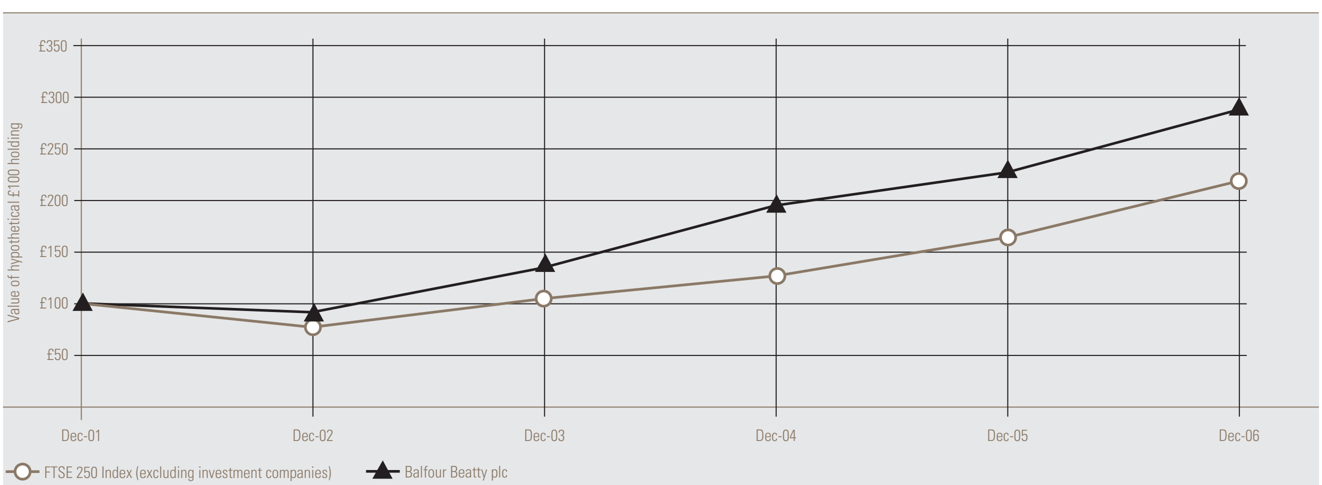
The fees of the non-executive Directors are reviewed from time to time, the last review taking place in 2006, when the Board agreed an increase in the annual fee for the non-executive Directors (excluding the Chairman) from £33,000 to £42,000 with effect from 1 July 2006. This increase reflects the requirement of each non-executive Director to spend an additional four days per annum within the Group operating companies. The RemCo approved an increase from £173,000 to £190,000 per annum in the fees for the Chairman with effect from 1 July 2006.

Additional fees are payable to Robert Walvis and Steven Marshall for their chairmanship of the RemCo and Audit Committees respectively. These fees were increased from £6,000 to £7,000 per annum with effect from 1 July 2006. A fee of €30,000 per annum is payable to Christoph von Rohr for his chairmanship of the supervisory board of Balfour Beatty Rail GmbH.

Performance graph
The graph below shows Balfour Beatty's Total Shareholder Return ("TSR") performance compared to the FTSE 250 Index (excluding investment companies) TSR over the five financial years ended 31 December 2006.

The values indicated in the graph show the share price growth plus reinvested dividends from a £100 hypothetical holding of ordinary shares in Balfour Beatty plc and in the index at the start of the period and have been calculated using 30 trading day average values.

As in previous reports, the RemCo has elected to compare the TSR on the Company's ordinary shares against the FTSE 250 Index (excluding investment companies) principally because this is a broad index of which the Company is a constituent member.



The detailed information about the Directors' remuneration, set out on pages 57 to 60, has been reported on by the Company's independent auditors, Deloitte & Touche LLP.

Directors' remuneration earned in 2006

Name of Director	Basic salary £	Fees £	Pension supplement £	Benefits in kind £	Annual cash bonus £	Total remuneration 2006 £	Total remuneration 2005 £
C Carr	–	23,500	–	–	–	23,500	33,000
J L Cohen	322,500	–	28,519	18,402	217,602	587,023	422,867
M Donovan	–	22,500	–	–	–	22,500	–
S Howard	–	21,000	–	–	–	21,000	–
Sir David John	–	181,500	–	–	–	181,500	173,000
S Marshall	–	44,000	–	–	–	44,000	5,500
A L P Rabin	340,000	–	45,152	20,718	156,058	561,928	434,055
G H Sage	–	37,500	–	–	–	37,500	33,000
I P Tyler	493,500	–	44,706	27,808	227,273	793,287	626,317
Dr H C von Rohr	–	58,048	–	–	–	58,048	53,548
R J W Walvis	–	44,000	–	–	–	44,000	39,000
P J L Zinkin	346,500	–	–	18,743	156,058	521,301	452,939
Former Directors	–	–	–	–	–	–	547,882
Total	1,502,500	432,048	118,377	85,671	756,991	2,895,587	2,821,108

Notes:
(i) Basic salary and fees were those paid in respect of the period of the year during which individuals were Directors.
(ii) Jim Cohen, Anthony Rabin and Ian Tyler received taxable cash supplements in lieu of pension provision on their salary above the Balfour Beatty Pension Fund specific earnings cap, from April 2006. Prior to this date the Company contributed to a Funded Unapproved Retirement Benefit Scheme ("FURBS") for each of them. Details of contributions made to FURBS during the year can be found under the second table on page 60.
(iii) The performance target for annual bonus was profit before tax and exceptional items ("profit"). The profit for the year ended 31 December 2006 resulted in a bonus of 65.94% of basic salary for each executive Director. For Anthony Rabin, Ian Tyler and Peter Zinkin two-thirds of this bonus is payable in cash and these are the amounts shown in the table above. The remaining one-third will be deferred in the form of ordinary shares of the Company which will be released to the Director on 31 March 2010, providing he is still employed by the Company at that time. The number of shares comprising the deferred element will be determined based on the share price at the award date of 30 March 2007. As Jim Cohen retired on 18 February 2007, the entire bonus is payable in cash in March 2007 and this amount is shown in the table above.
(iv) Christoph von Rohr receives a fee of €30,000 per annum for his chairmanship of the supervisory board of Balfour Beatty Rail GmbH.
(v) Benefits in kind are calculated in terms of UK taxable values. For the executive Directors they comprise: a fully expensed car, a fuel card, private medical insurance for the Director and his immediate family and independent financial advice.
(vi) No Director receives any expense allowance.

Directors' interests

The interests of the Directors and their immediate families in the share capital of Balfour Beatty plc and its subsidiary undertakings during the year are set out below.

	Number of ordinary shares	
Name of Director	At 1 January 2006	At 31 December 2006
J L Cohen	120,922	166,194
Sir David John	5,000	5,000
S Marshall	–	5,000
A L P Rabin	56,331	101,153
G H Sage	5,000	5,000
I P Tyler	85,515	113,005
R J W Walvis	10,000	10,000
P J L Zinkin	75,343	102,110

Notes:
(i) In common with other employees of the Balfour Beatty Group, the executive Directors have an interest, as potential beneficiaries, in the entire shareholding of the Balfour Beatty Employee Share Ownership Trust, which at 31 December 2006 amounted to 1.595m ordinary shares of Balfour Beatty plc.
(ii) All interests at the dates shown are beneficial and are in respect of 50p ordinary shares of Balfour Beatty plc. There were no changes between 31 December 2006 and 6 March 2007.
(iii) Peter Zinkin was also interested at 1 January 2006 and 31 December 2006 in 325 cumulative convertible redeemable preference shares of 1p each of Balfour Beatty plc.

Directors' long-term incentives: the Performance Share Plan

Name of Director	Date awarded	Maximum number of shares subject to award: At 1 January 2006	Awarded during the year	Lapsed during the year	Vested during the year	**At 31 December 2006**	Exercisable from
J L Cohen	16 April 2003	156,376	–	79,643	76,733	**–**	
	19 April 2004	109,439	–	–	–	**109,439**	April 2007
	18 April 2005	98,226	–	–	–	**98,226**	April 2008
A L P Rabin	16 April 2003	150,584	–	76,693	73,891	**–**	
	19 April 2004	107,519	–	–	–	**107,519**	April 2007
	18 April 2005	99,863	–	–	–	**99,863**	April 2008
	13 June 2006	–	131,721	–	–	**131,721**	June 2009
I P Tyler	16 April 2003	179,543	–	91,442	88,101	**–**	
	19 April 2004	126,719	–	–	–	**126,719**	April 2007
	18 April 2005	144,065	–	–	–	**144,065**	April 2008
	13 June 2006	–	228,586	–	–	**228,586**	June 2009
P J L Zinkin	16 April 2003	167,960	–	85,543	82,417	**–**	
	19 April 2004	119,039	–	–	–	**119,039**	April 2007
	18 April 2005	106,411	–	–	–	**106,411**	April 2008
	13 June 2006	–	136,989	–	–	**136,989**	June 2009

Notes:

(i) All awards are granted for nil consideration and are in respect of 50p ordinary shares of Balfour Beatty plc.

(ii) For the awards made in April 2004 and April 2005, the performance periods are the three years ending 31 December 2006 and 31 December 2007 respectively. The maximum award of shares shown in the table above will vest only if earnings per share before exceptional items and amortisation of intangible assets ("EPS") grows by at least 70% over the performance period. If EPS growth is 25%, the Directors will be entitled to 30% of the maximum award of shares. If EPS growth is between 25% and 70%, the number of shares vesting will be pro rata to actual growth. No shares will vest if EPS growth is less than 25%, and there is no provision for retesting.

(iii) For the awards made in June 2006, the performance period is the three years ending 31 December 2008. 50% of each award is subject to an EPS growth target. The maximum number of shares subject to this performance condition will only vest if EPS growth exceeds the retail prices index ("RPI") by 45%. If EPS growth exceeds RPI by 15% then 25% of this part of the award will vest. For growth in EPS between these points, vesting will be on a pro rata basis. No shares will vest from this part of the award if EPS growth exceeds RPI by less than 15%. The other 50% of each award is subject to a total shareholder return ("TSR") target under which the TSR of the Company is compared to that of a comparator group of 18 UK listed companies. The maximum number of shares subject to this performance condition will only vest if the Company's TSR is at the upper quartile of the comparator group. If the Company's TSR is equal to that of the median of the comparator group then 25% of this part of the award will vest. No shares from this part of the award will vest if the Company's TSR is below that of the median of the comparator group. For TSR performance between median and upper quartile, vesting will be on a pro rata basis. There is no provision for retesting of either of the performance conditions.

(iv) The performance period for the awards made in April 2004 was completed on 31 December 2006. The growth in EPS for this period was 40.33% and as a result, 53.85% of each participant's conditional award will vest on 19 April 2007.

(v) The performance period for the awards made in April 2003 was completed on 31 December 2005. The growth in EPS for this period was 49.07% and as a result, 49.07% of each participant's conditional award vested on 18 April 2006. The closing middle market price of ordinary shares on the vesting date was 370.5p.

(vi) The average middle market price of ordinary shares in the Company for the three dealing dates before the award dates which was used for calculating the number of awards granted, was 172.66p for the 2003 award, 260.417p for the 2004 award, 305.417p for the 2005 award and for the 2006 award was 308.417p. The closing middle market price of ordinary shares on the date of the awards was 170.5p, 260p, 290p and 301.25p respectively.

Directors' Deferred Bonus Plan awards

Name of Director	Date of initial award	Number of shares subject to award: At 1 January 2006	Awarded during the year	Awarded in lieu of dividends: 3 July 2006	Awarded in lieu of dividends: 13 December 2006	Lapsed during the year	**At 31 December 2006**	Vesting date
J L Cohen	31 March 2006	–	13,155	174	119	–	**13,448**	31 March 2009
A L P Rabin	31 March 2006	–	13,573	179	122	–	**13,874**	31 March 2009
I P Tyler	31 March 2006	–	19,629	260	177	–	**20,066**	31 March 2009
P J L Zinkin	31 March 2006	–	14,116	187	127	–	**14,430**	31 March 2009

(i) All awards are granted for nil consideration and are in respect of 50p ordinary shares of Balfour Beatty plc.

(ii) The awards made in 2006 will vest on 31 March 2009, providing the Director is still employed by the Company at that date.

(iii) The shares awarded on 31 March 2006 were purchased at an average price of 374.641p.

(iv) The shares awarded on 3 July 2006 in lieu of dividends payable were purchased at an average price of 347p.

(v) The shares awarded on 13 December 2006 in lieu of dividends payable were purchased at an average price of 436.25p.

(vi) Jim Cohen retired from the Company on 18 February 2007. Under the rules of the Deferred Bonus Plan, the award made to him in March 2006, along with the subsequent awards in lieu of dividends, vested on 18 February 2007.

Directors' share options

Name of Director	Date granted	Number of options: At 1 January 2006	Granted during the year	Exercised during the year	Lapsed during the year	**At 31 December 2006**	Exercise price	Exercisable from	Exercisable to
J L Cohen									
Savings-Related Options	5 May 2004	646	–	–	–	**646**	210.0p	July 2007	December 2007
	4 May 2005	803	–	–	–	**803**	250.0p	July 2008	December 2008
A L P Rabin									
Executive Share Options	17 April 1996	10,227	–	(10,227)	–	**–**	344.2p	April 1999	April 2006
Savings-Related Options	19 July 2001	1,227	–	(1,227)	–	**–**	154.0p	October 2006	March 2007
	8 May 2002	575	–	–	–	**575**	184.0p	July 2007	December 2007
	7 May 2003	444	–	–	–	**444**	133.0p	July 2008	December 2008
	5 May 2004	903	–	–	–	**903**	210.0p	July 2009	December 2009
	4 May 2005	1,031	–	–	–	**1,031**	250.0p	July 2010	December 2010
	3 May 2006	–	971	–	–	**971**	305.0p	July 2011	December 2011
I P Tyler									
Savings-Related Options	7 May 2003	511	–	(511)	–	**–**	133.0p	July 2006	December 2006
	4 May 2005	1,046	–	–	–	**1,046**	250.0p	July 2008	December 2008
P J L Zinkin									
Savings-Related Options	19 July 2001	2,454	–	(2,454)	–	**–**	154.0p	October 2006	March 2007
	8 May 2002	1,151	–	–	–	**1,151**	184.0p	July 2007	December 2007
	7 May 2003	839	–	–	–	**839**	133.0p	July 2008	December 2008
	5 May 2004	716	–	–	–	**716**	210.0p	July 2009	December 2009
	4 May 2005	687	–	–	–	**687**	250.0p	July 2010	December 2010
	3 May 2006	–	717	–	–	**717**	305.0p	July 2011	December 2011

Notes:
(i) All options are granted for nil consideration on grant and are in respect of 50p ordinary shares of Balfour Beatty plc.
(ii) The closing market price of the Company's ordinary shares on 31 December 2006 was 443p. During the year the highest and lowest closing market prices were 446p and 300p.
(iii) Details of options exercised and the value realisable on exercise are shown in the table below.

Name of Director	Date granted	Date exercised	Number of options exercised	Exercise price	Closing market price on date exercised	Value realisable on exercise*
A L P Rabin						
Executive Share Options	17 April 1996	17 March 2006	10,227	344.2p	388.25p	£4,505
Savings-Related Options	19 July 2001	5 October 2006	1,227	154.0p	406.75p	£3,101
I P Tyler						
Savings-Related Options	7 May 2003	13 July 2006	511	133.0p	333.25p	£1,023
P J L Zinkin						
Savings-Related Options	19 July 2001	2 October 2006	2,454	154.0p	407.00p	£6,209

*The value realisable from shares acquired on exercise is the difference between the closing market price on the date exercised and the exercise price of the options, although the shares may have been retained, in which case they are included in the table on page 57, headed "Directors' interests".

Directors' pensions

Executive Directors participate in the Balfour Beatty Pension Fund. The scheme provides for a pension at a normal retirement age of 62 (under Balfour Beatty Pension Fund rules) and each Director pays an annual contribution equal to 5% of pensionable salary. The pension for a Director who can complete 20 or more years' pensionable service at normal retirement age is targeted at two-thirds of final pensionable salary, subject to HMRC limits. With effect from 6 April 2006, HMRC limits were changed, and as a result the earnings cap is no longer used when determining the maximum permissible benefits. However, the Balfour Beatty Pension Fund has retained a Fund specific earnings cap. The salaries of Jim Cohen, Anthony Rabin and Ian Tyler were subject to the Fund specific earnings cap for pension purposes and details of the Company's contributions to additional arrangements for them are noted underneath the second table below. Directors have the option to pay additional voluntary contributions, but neither the contributions nor the resulting benefits are included in the tables below.

The table below sets out the accrued deferred pension which would be paid annually from the scheme at normal retirement age based on each executive Director's service to 31 December 2006 as well as the additional pension benefit secured in respect of service during the year.

Name of Director	Age at 31 December 2006 years	Pensionable service at 31 December 2006 years	Accrued deferred pension at 31 December 2005 £ pa	Increase in accrued deferred pension during the year: Inflation £ pa	Increase in accrued deferred pension during the year: Increase in excess of inflation £ pa	Accrued deferred pension at 31 December 2006 £ pa	Transfer value corresponding to increase in excess of inflation at 31 December 2006 less Director's contributions (Note i) £
J L Cohen	**64**	**13**	43,019	1,162	1,359	**45,540**	**20,109**
A L P Rabin	**51**	**13**	44,069	1,190	3,489	**48,748**	**38,300**
I P Tyler	**46**	**10**	25,178	680	2,762	**28,620**	**21,259**
P J L Zinkin	**53**	**25**	152,499	4,117	9,575	**166,191**	**115,813**

Notes:

(i) The transfer value of the increase in accrued deferred pension is the present value of the increase in excess of inflation in the deferred pension and associated benefits during the period, less the Director's contributions, calculated using the transfer basis in force at 31 December 2006 and on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11.

(ii) Anthony Rabin's pensionable service includes nine years of transferred-in service from previous pension arrangements.

(iii) Jim Cohen attained normal retirement age under the Balfour Beatty Pension Fund in February 2004 but has continued in service. As at 31 December 2006 his pension had not commenced payment and it therefore continues to be determined in line with the rules of the Fund for members past normal retirement age.

The table below sets out the transfer value at 31 December 2006 of each executive Director's accrued deferred pension at that date as well as the movement in that transfer value over the period. The transfer values represent the cash equivalent values that would have been payable from the scheme had the Directors left service on the dates shown, and reflect the age of the Director, his period of membership of the scheme and his pensionable salary.

Name of Director	Age at 31 December 2006 years	Pensionable service at 31 December 2006 years	Transfer value at 31 December 2005 (Note i) £	Contributions made by Director during the year £	Increase in transfer value during the year less Director's contributions (Note ii) £	Transfer value at 31 December 2006 (Note i) £
J L Cohen	**64**	**13**	847,689	5,456	3,412	**856,557**
A L P Rabin	**51**	**13**	493,090	5,456	100,112	**598,658**
I P Tyler	**46**	**10**	218,038	5,456	49,741	**273,235**
P J L Zinkin	**53**	**25**	1,947,165	18,029	315,450	**2,280,644**

Notes:

(i) The transfer value is the present value of the accrued deferred pension and associated benefits at the relevant date, calculated using the transfer basis then in force and on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11.

(ii) The figure is the difference between the transfer value of the accrued benefits at the start and end of the period, less the Director's contributions during the period.

The salaries of Jim Cohen, Anthony Rabin and Ian Tyler were subject to the Fund specific earnings cap for pension purposes, and the Company contributed to a Funded Unapproved Retirement Benefit Scheme ("FURBS") for each of them up to 31 March 2006. In 2006, the Company's contribution to Jim Cohen's plan was £8,708, to Anthony Rabin's £14,036 and to Ian Tyler's £13,205. Benefits under these FURBS are additional to those set out in the tables above. From April 2006, the Company has paid a taxable cash supplement instead of contributions to a FURBS. Details can be found in the table on page 57.

No past Director of the Company has received or become entitled to receive retirement benefits in excess of his entitlements on the date on which those benefits first became payable, or 31 March 1997 if later.

Remuneration report

Signed by order of the Board

R J W Walvis

Director

Chairman of the Remuneration Committee

6 March 2007

Independent auditors' report to the members of Balfour Beatty plc

We have audited the Group and Company financial statements (the "financial statements") of Balfour Beatty plc for the year ended 31 December 2006 which comprise the consolidated and Company income statements, the consolidated and Company balance sheets, the consolidated and Company cash flow statements, the consolidated statement of recognised income and expense and the related notes 1 to 36. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the annual report, the Directors' remuneration report and the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union are set out in the statement of Directors' responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited, have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the operating and financial review that is cross referred from the Business review section of the Directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the annual report as described in the contents section and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the annual report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' remuneration report described as having been audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' remuneration report described as having been audited.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union, of the state of the Group's and the Company's affairs as at 31 December 2006 and of the Group's profit and the Company's profit for the year then ended;
- the financial statements and the part of the Directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the financial statements.

Separate opinion in relation to IFRS

As explained in Note 1, the Group and the Company in addition to complying with their legal obligation to comply with IFRSs adopted for use in the European Union, have also complied with the IFRSs as issued by the International Accounting Standards Board. In our opinion the financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's and the Company's affairs as at 31 December 2006 and the Group's profit and the Company's profit for the year then ended.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
6 March 2007

Group income statement

For the year ended 31 December 2006

	Notes	2006 Before exceptional items* £m	2006 Exceptional items* (Note 8) £m	2006 Total £m	2005 Before exceptional items £m	2005 Exceptional items (Note 8) £m	2005 Total £m
Revenue including share of joint ventures and associates		**5,852**	**–**	**5,852**	4,938	–	4,938
Share of revenue of joint ventures and associates	15	**(1,365)**	**–**	**(1,365)**	(1,101)	–	(1,101)
Group revenue	2	**4,487**	**–**	**4,487**	3,837	–	3,837
Cost of sales		**(4,121)**	**–**	**(4,121)**	(3,528)	(14)	(3,542)
Gross profit		**366**	**–**	**366**	309	(14)	295
Net operating expenses							
– amortisation of intangible assets		**–**	**(1)**	**(1)**	–	–	–
– other		**(285)**	**(19)**	**(304)**	(237)	–	(237)
Group operating profit		**81**	**(20)**	**61**	72	(14)	58
Share of results of joint ventures and associates	15	**63**	**–**	**63**	43	30	73
Profit from operations	4	**144**	**(20)**	**124**	115	16	131
Investment income	6	**26**	**–**	**26**	56	–	56
Finance costs	7	**(18)**	**(7)**	**(25)**	(37)	(9)	(46)
Profit before taxation		**152**	**(27)**	**125**	134	7	141
Taxation	9	**(35)**	**1**	**(34)**	(32)	(3)	(35)
Profit for the year attributable to equity shareholders		**117**	**(26)**	**91**	102	4	106

*and amortisation of intangible assets (Note 13)

	Notes	2006 pence	2005 pence
Basic earnings per ordinary share	10	**21.2**	24.9
Diluted earnings per ordinary share	10	**21.0**	24.7
Dividends per ordinary share proposed for the year	11	**9.1**	8.1

Group statement of recognised income and expense

For the year ended 31 December 2006

	Notes	2006 £m	2005 £m
Actuarial gains/(losses) on retirement benefit obligations		**36**	(14)
PFI/PPP cash flow hedges – net fair value gains/(losses)		**32**	(17)
– reclassified and reported in net profit		**–**	1
PFI/PPP financial assets – fair value revaluation		**(2)**	10
– reclassified and reported in net profit		**–**	(4)
Changes in fair value of net investment hedges		**14**	(6)
Currency translation differences		**(17)**	8
Tax on items taken directly to equity		**(26)**	9
Net income/(expense) recognised directly in equity		**37**	(13)
Profit for the year		**91**	106
Total recognised income for the year attributable to equity shareholders	28.1	**128**	93

Company income statement

For the year ended 31 December 2006

	Notes	2006 Before exceptional items £m	2006 Exceptional items (Note 8) £m	2006 Total £m	2005 Before exceptional items £m	2005 Exceptional items (Note 8) £m	2005 Total £m
Revenue	2	**93**	**–**	**93**	65	–	65
Net operating expenses		**(5)**	**–**	**(5)**	(11)	7	(4)
Profit from operations		**88**	**–**	**88**	54	7	61
Investment income	6	**21**	**–**	**21**	21	–	21
Finance costs	7	**(45)**	**(7)**	**(52)**	(41)	(9)	(50)
Profit before taxation		**64**	**(7)**	**57**	34	(2)	32
Taxation	9	**2**	**–**	**2**	9	2	11
Profit for the year attributable to equity shareholders		**66**	**(7)**	**59**	43	–	43

Our accounts

Balance sheets

At 31 December 2006

	Notes	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Non-current assets					
Intangible assets – goodwill	12	**427**	284	**–**	–
– other	13	**9**	–	**–**	–
Property, plant and equipment	14	**183**	167	**–**	–
Investments in joint ventures and associates	15	**458**	375	**–**	–
Investments	16	**46**	38	**904**	870
PFI/PPP financial assets	17	**22**	14	**–**	–
Deferred tax assets	24	**102**	83	**–**	1
Derivative financial instruments	20	**2**	2	**2**	–
Trade and other receivables	21	**50**	35	**32**	35
		1,299	998	**938**	906
Current assets					
Inventories	18	**75**	61	**–**	–
Due from customers for contract work	19	**252**	217	**–**	–
Derivative financial instruments	20	**3**	–	**3**	4
Trade and other receivables	21	**626**	619	**416**	395
Cash and cash equivalents	23	**323**	345	**167**	142
		1,279	1,242	**586**	541
Total assets		**2,578**	2,240	**1,524**	1,447
Current liabilities					
Trade and other payables	22	**(1,289)**	(1,038)	**(757)**	(693)
Due to customers for contract work	19	**(265)**	(274)	**–**	–
Derivative financial instruments	20	**(1)**	(4)	**(3)**	(4)
Current tax liabilities		**(28)**	(30)	**(2)**	(5)
Borrowings	23	**(17)**	(30)	**(13)**	(12)
		(1,600)	(1,376)	**(775)**	(714)
Non-current liabilities					
Trade and other payables	22	**(77)**	(66)	**(25)**	(25)
Derivative financial instruments	20	**–**	(2)	**(2)**	–
Borrowings – PFI/PPP non-recourse term loans	23	**(21)**	(14)	**–**	–
– other	23	**(1)**	–	**–**	–
Deferred tax liabilities	24	**(5)**	(3)	**–**	–
Liability component of preference shares	27	**(90)**	(98)	**(90)**	(98)
Retirement benefit obligations	25	**(288)**	(280)	**(8)**	(8)
Provisions	26	**(109)**	(109)	**(9)**	(9)
		(591)	(572)	**(134)**	(140)
Total liabilities		**(2,191)**	(1,948)	**(909)**	(854)
Net assets		**387**	292	**615**	593
Equity					
Called-up share capital	27	**215**	214	**215**	214
Share premium account	28	**43**	26	**43**	26
Equity component of preference shares	28	**16**	18	**16**	18
Special reserve	28	**169**	175	**169**	175
Share of joint ventures' and associates' reserves	28	**243**	182	**–**	–
Other reserves	28	**5**	5	**46**	49
Accumulated (losses)/profits	28	**(304)**	(328)	**126**	111
Total equity		**387**	292	**615**	593

On behalf of the Board

Sir David John
Director

A L P Rabin
Director
6 March 2007

Cash flow statements

For the year ended 31 December 2006

	Notes	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Cash flows from operating activities					
Cash generated from operations	35.1	**217**	167	**10**	(3)
Income taxes (paid)/received		**(24)**	(28)	**12**	18
Net cash from operating activities		**193**	139	**22**	15
Cash flows from investing activities					
Dividends received from joint ventures and associates		**24**	12	**13**	6
Dividends received from subsidiaries		**–**	–	**80**	57
Interest received		**29**	64	**21**	26
Acquisition of businesses, net of cash and cash equivalents acquired		**(80)**	(56)	**–**	–
Purchase of property, plant and equipment		**(57)**	(57)	**–**	–
Purchase of investments		**(8)**	–	**(35)**	–
Investment in and loans made to joint ventures and associates		**(22)**	(12)	**–**	(9)
Investment in and loans made to subsidiaries		**–**	–	**35**	(81)
Investment in financial assets		**(12)**	(21)	**–**	–
Disposal of businesses, net of cash and cash equivalents disposed		**–**	(15)	**–**	–
Disposal of property, plant and equipment		**9**	8	**–**	–
Disposal of investments		**–**	6	**–**	10
Net cash (used in)/from investing activities		**(117)**	(71)	**114**	9
Cash flows from financing activities					
Proceeds from issue of ordinary shares		**6**	6	**6**	6
Purchase of ordinary shares		**(3)**	(3)	**(3)**	(3)
Proceeds from new loans		**35**	6	**27**	–
Repayment of loans		**(27)**	(80)	**(27)**	(66)
Finance lease principal repayments		**(1)**	(2)	**–**	–
Buy-back of preference shares		**(19)**	(11)	**(19)**	(11)
Ordinary dividends paid		**(52)**	(28)	**(52)**	(28)
Interest paid		**(5)**	(27)	**(32)**	(29)
Premium paid on repayment of US Dollar term loan		**–**	(9)	**–**	(9)
Preference dividends paid		**(12)**	(13)	**(12)**	(13)
Net cash used in financing activities		**(78)**	(161)	**(112)**	(153)
Net (decrease)/increase in cash and cash equivalents		**(2)**	(93)	**24**	(129)
Effects of exchange rate changes		**(6)**	3	**–**	4
Cash and cash equivalents at beginning of year		**316**	406	**130**	255
Cash and cash equivalents at end of year	35.2	**308**	316	**154**	130

Notes to the accounts

1 Principal accounting policies

1.1 Basis of accounting

The annual financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union and therefore comply with Article 4 of the EU IAS Regulation and with those parts of the Companies Act 1985 that are applicable to companies reporting under IFRS. The Group has applied all accounting standards and interpretations issued by the International Accounting Standards Board and International Financial Reporting Interpretations Committee relevant to its operations and effective for accounting periods beginning on 1 January 2006. IFRS 7 Financial Instruments: Disclosures, IFRS 8 Operating Segments and IFRIC 12 Service Concession Arrangements were in issue at the date of authorisation of the financial statements but not yet effective. IFRS 7 and IFRS 8 affect only disclosures and therefore have no material impact on the financial statements of the Group. The impact of IFRIC 12, which defines the accounting for the Group's PFI/PPP concessions, is currently under review.

The financial statements have been prepared under the historical cost convention, except as described under Note 1.19. The principal accounting policies adopted, all of which have been applied consistently throughout the year and the preceding year, are set out below.

1.2 Basis of consolidation

The Group accounts include the accounts of the Company and its subsidiaries, together with the Group's share of the results of associates and joint ventures drawn up to 31 December each year.

a) Subsidiaries

Subsidiaries are entities over which the Group has control, being the power to govern the financial and operating policies of the investee entity so as to obtain benefits from its activities. The results of subsidiaries acquired or sold in the year are consolidated from the effective date of acquisition or to the effective date of disposal, as appropriate.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the fair value of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (discount on acquisition) is credited to the income statement in the period of acquisition. The interest of minority shareholders is stated at the minority's proportion of the fair value of the assets and liabilities recognised.

Accounting policies of subsidiaries are adjusted where necessary to ensure consistency with those used by the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

b) Joint ventures and associates

Joint ventures are those entities over which the Group exercises joint control through a contractual arrangement. Associates are entities over which the Group is in a position to exercise significant influence but not control or joint control, through participation in the financial and operating policy decisions of the investee. The results, assets and liabilities of joint ventures and associates are incorporated in the financial statements using the equity method of accounting except when classified as held for sale (see 1.17 below). Investments in joint ventures and associates are initially carried in the balance sheet at cost (including goodwill and intangible assets arising on acquisition) and adjusted by post-acquisition changes in the Group's share of the net assets of the joint venture or associate, less any impairment in the value of individual investments. Losses of joint ventures or associates in excess of the Group's interest in those joint ventures and associates are not recognised.

Unrealised gains and losses on transactions with joint ventures and associates are eliminated to the extent of the Group's interest in the relevant joint venture or associate.

Any excess of the fair value of consideration over the Group's share of the fair values of the identifiable net assets of the associate or joint venture entity at the date of acquisition is recognised as goodwill. Any deficiency of the fair value of consideration below the Group's share of the fair values of the identifiable net assets of the joint venture or associate at the date of acquisition (discount on acquisition) is credited to the income statement in the period of acquisition.

c) Jointly controlled operations

The Group's share of the results and net assets of contracts carried out in joint venture are included under each relevant heading in the income statement and balance sheet.

1.3 Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange prevailing at the balance sheet date.

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward contracts and swaps (see below for details of the Group's accounting policies in respect of such derivative financial instruments).

Results of overseas subsidiaries, associates and joint venture entities are translated at average rates of exchange for the year and their assets and liabilities are translated at the rates of exchange prevailing at the balance sheet date.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the rates of exchange prevailing at the balance sheet date. Exchange differences arising together with exchange differences on borrowings and other currency instruments designated as hedges of such investments are classified as equity and transferred to the Group's foreign currency translation reserve. Such exchange differences are recognised in the income statement in the period in which the relevant entity is disposed of.

1.4 Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable for goods and services provided, net of trade discounts, value added and similar sales-based taxes, after eliminating sales within the Group. Revenue is recognised as follows:

– revenue from construction and service activities represents the value of work carried out during the year, including amounts not invoiced.
– revenue from manufacturing activities is recognised when goods are delivered and title has passed.
– interest income is accrued on a time basis, by reference to the principal outstanding and the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. Dividend income is recognised when the shareholder's right to receive payment is established.

1.5 Segmental reporting

Segmental information is based on two segment formats, of which the primary format is for business areas in accordance with the Group's internal reporting structure and the secondary format is for geographical areas. Further information on the business activities of each segment is set out in the Operating review on pages 22 to 37. Segment results represent the contribution directly attributable for the different segments to corporate overheads and the profit of the Group. Transactions between segments are conducted at arm's length market prices. Segment assets and liabilities comprise those assets and liabilities directly attributable to the segments, including the subordinated loans to PFI/PPP investments. Corporate assets and liabilities include cash balances, bank borrowings, tax balances and dividends payable.

1 Principal accounting policies continued

1.6 Construction and service contracts

When the outcome of individual contracts can be foreseen with reasonable certainty and can be estimated reliably, margin is recognised by reference to the stage of completion, based on the lower of the percentage margin earned to date and that prudently forecast at completion. Full provision is made for all known or expected losses on individual contracts immediately once such losses are foreseen. Variations in contract work, claims and incentive payments are included to the extent that it is probable they will result in revenue. Gross profit for the year includes the benefit of claims settled on contracts completed in prior years.

Pre-contract costs are expensed as incurred until it is virtually certain that a contract will be awarded, from which time further pre-contract costs are recognised as an asset and charged as an expense over the period of the contract. Amounts recovered in respect of costs that have been written off are deferred and amortised over the life of the contract.

1.7 Profit from operations

Profit from operations is stated after the share of the post-tax results of equity accounted associates and joint venture entities, but before investment income and finance costs.

1.8 Finance costs

Finance costs of debt, including premiums payable on settlement and direct issue costs, are charged to the income statement on an accruals basis over the term of the instrument, using the effective interest method.

1.9 Research and development

Research expenditure is written off in the period in which it is incurred.

Internally-generated intangible assets arising from the Group's development would be recognised only if all the following conditions are met:

– an asset is created that can be identified,
– it is probable that the asset created will generate future economic benefits; and
– the development cost of the asset can be measured reliably.

1.10 Exceptional items

Material and non-recurring items of income and expense are disclosed in the income statement as "Exceptional items". Examples of items which may give rise to disclosure as "Exceptional items" include inter alia gains or losses on the disposal of businesses, investments and property, plant and equipment, costs of restructuring and reorganisation of existing businesses, integration of newly acquired businesses, litigation settlements, asset impairments and pension fund settlements and curtailments.

1.11 Taxation

The tax charge is composed of current tax and deferred tax, calculated using tax rates that have been enacted or substantively enacted by the balance sheet date. Current tax and deferred tax are charged or credited to the income statement, except when they relate to items charged or credited directly to equity, in which case the relevant tax is also dealt with in equity.

Current tax is based on the profit for the year.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax on such assets and liabilities is not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. The carrying amount of deferred tax assets is reviewed at each balance sheet date.

Deferred tax is provided on temporary differences arising on investments in subsidiaries, associates and joint venture entities, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

1.12 Intangible assets

a) Goodwill

Goodwill represents the excess of the fair value of consideration over the fair value of the identifiable assets and liabilities acquired, arising on the acquisition of subsidiaries and other business entities, joint ventures and associates. Goodwill on acquisitions of subsidiaries and other business entities is included in non-current assets. Goodwill on acquisitions of joint ventures and associates is included in investments in joint ventures and associates.

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.

Goodwill arising on acquisitions before the date of transition to IFRS (1 January 2004) has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off or negative goodwill credited to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

b) Other intangible assets

Intangible assets are stated at cost less accumulated amortisation and impairment losses. The cost of intangible assets is amortised over their expected useful lives, which range from three to five years.

1.13 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any recognised impairment loss. Cost includes expenditure associated with bringing the asset to its operating location and condition.

Certain land and buildings were revalued under UK GAAP. On transition to IFRS, the Group elected to use the revalued amount as deemed cost.

Except for land and assets in the course of construction, the cost of property, plant and equipment are depreciated over their expected useful lives, on a straight-line basis at rates of 2.5% for buildings and 4% to 33% for plant and equipment, or the life of the lease.

1.14 Leasing

Leases which transfer substantially all of the risks and rewards of ownership to the lessee are classified as finance leases. All other leases are classified as operating leases.

a) Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease, and depreciation is provided accordingly. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.

b) Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

1.15 Impairment of assets

Goodwill arising on acquisitions and other assets that have an indefinite useful life and are not subject to amortisation are reviewed at least annually for impairment. Other intangible assets and property, plant and equipment are reviewed for impairment whenever there is any indication that the carrying amount of the asset may not be recoverable. If the recoverable amount of an asset is less than its carrying amount, an impairment loss is recognised. Recoverable amount is the higher of fair value less costs to sell and value in use. Value in use is assessed by discounting the estimated future cash flows that the asset is expected to generate. For this purpose assets, including goodwill, are grouped into cash generating units representing the lowest levels for which there are separately identifiable cash flows. Impairment losses for goodwill are not reversed in subsequent periods. Reversals of other impairment losses are recognised in income when they arise.

1 Principal accounting policies continued

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

Investments are classified as either available-for-sale or held to maturity. Available-for-sale investments are measured at each reporting date at fair value. Gains and losses arising from changes in the fair value of available-for-sale investments are recognised directly in equity, until the investment is disposed of or is determined to be impaired, at which time the cumulative gain or loss is included in the net profit or loss for the period. Held to maturity investments are measured at subsequent reporting dates at amortised cost.

1.17 Non-current assets held for sale
Non-current assets and groups of assets to be disposed of are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. Held for sale assets are measured at the lower of carrying amount and fair value less costs to sell.

1.18 Inventories
Inventories are valued at the lower of cost and net realisable value. Cost, where appropriate, includes a proportion of manufacturing overheads incurred in bringing inventories to their present location and condition and is determined using the first-in first-out method. Net realisable value represents the estimated selling price less all estimated costs of completion and cost to be incurred in marketing, selling and distribution.

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

a) Cumulative convertible redeemable preference shares
The Company's cumulative convertible redeemable preference shares are regarded as a compound instrument, consisting of a liability component and an equity component. The fair value of the liability component at the date of issue was estimated using the prevailing market interest rate for a similar non-convertible instrument. The difference between the proceeds of issue of the preference shares and the fair value assigned to the liability component, representing the embedded option to convert the liability into the Company's ordinary shares, is included in equity.

The interest expense on the liability component is calculated by applying the market interest rate for similar non-convertible debt prevailing at the date of issue to the liability component of the instrument. The difference between this amount and the dividend paid is added to the carrying amount of the liability component and is included in finance charges, together with the dividend payable, in the income statement.

b) Derivative financial instruments and hedge accounting
The Group uses derivative financial instruments to manage interest rate risk and to hedge exposures to fluctuations in foreign currencies. The Group does not use derivative financial instruments for speculative purposes. A description of the Group's objectives, policies and strategies with regard to derivatives and other financial instruments is set out in the Financial review on pages 38 to 40.

Derivatives are initially recognised on the balance sheet at fair value on the date the derivative transaction is entered into and are subsequently remeasured at their fair values.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognised in the income statement together with any changes in the fair value of the hedged item that are attributable to the hedged risk.

Changes in the fair value of the effective portion of derivatives that are designated and qualify as cash flow hedges are recognised in equity. Changes in the fair value of the ineffective portion of cash flow hedges are recognised in the income statement. Amounts accumulated in equity are transferred to the income statement when the underlying transaction occurs or, if the transaction results in a non-financial asset or liability, are included in the initial cost of that asset or liability.

Changes in the fair value of the effective portion of derivatives that are designated and qualify as hedges of net investments in foreign operations are recognised in equity. Changes in the fair value of the ineffective portion of net investment hedges are recognised in the income statement. Amounts accumulated in equity are transferred to the income statement when the foreign operation is disposed of.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to net profit or loss for the period.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives and recorded on the balance sheet at fair value when their risks and characteristics are not closely related to those of the host contract. Changes in the fair value of those embedded derivatives recognised on the balance sheet are recognised in the income statement as they arise.

c) PFI/PPP concessions
Assets constructed by PFI/PPP concession companies are classified as "available-for-sale financial assets".

Income is recognised by allocating a proportion of total cash projected to be received over the life of the project to service costs, by means of a deemed constant rate of return on those costs. The residual element of projected cash is allocated to the financial asset, using the effective interest method, giving rise to interest income which is recognised in the income statement.

The fair value of the financial asset is measured at each balance sheet date by computing the discounted future value of the cash flows allocated to the financial asset. The movement in the fair value of the financial asset since the previous balance sheet date is taken to equity.

1.20 Trade receivables
Trade receivables are initially recorded at fair value and subsequently measured at amortised cost as reduced by appropriate allowances for estimated irrecoverable amounts.

1.21 Trade payables
Trade payables are not interest-bearing and are stated at their nominal value.

1.22 Bank borrowings
Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are charged to income on an accruals basis using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

1.23 Retirement benefit costs
The Group, through trustees, operates pension schemes the majority of which are of the defined benefit type and are funded. Contributions are determined in accordance with independent actuarial advice.

For defined benefit retirement benefit schemes, the cost of providing benefits recognised in the income statement and the defined benefit obligation are determined at the balance sheet date using the projected unit credit method by independent actuaries. The liability recognised in the balance sheet comprises the present value of the defined benefit pension obligation, determined by discounting the estimated future cash flows using the rate of interest on a high quality corporate bond, less the fair value of the plan assets. Actuarial gains and losses are recognised in full outside the income statement in the period in which they occur in the statement of recognised income and expense.

Contributions to defined contribution pension schemes are charged to the income statement as they fall due.

1 Principal accounting policies continued

1.24 Provisions
Provisions for environmental restoration, legal claims, onerous leases and other onerous commitments are recognised at the best estimate of the expenditure required to settle the Group's liability. Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event; it is probable that an outflow of resources will be required to settle the obligation; and the amount of the obligation can be estimated reliably.

1.25 Financial liabilities and equity instruments
Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

1.26 Share-based payments
Employee services received in exchange for the grant of share options, performance share plan awards and deferred bonus plan awards since 7 November 2002 are charged in the income statement over the vesting period, based on the fair values of the options or awards at the date of grant and the numbers expected to become exercisable. The credits in respect of the amounts charged are included within separate reserves in equity until such time as the options or awards are exercised, when the proceeds received in respect of share options are credited to share capital and share premium or the shares held by the employee trust are transferred to employees in respect of performance share plan awards and deferred bonus plan awards.

1.27 Key sources of estimation uncertainty
The preparation of consolidated financial statements under IFRS requires management to make estimates and assumptions that affect amounts recognised for assets and liabilities at the balance sheet date and the amounts of revenue and the expenses incurred during the reporting period. Actual outcomes may therefore differ from these estimates and assumptions. The estimates and assumptions that have the most significant impact on the carrying value of assets and liabilities of the Group within the next financial year are discussed below.

a) Revenue and margin recognition
The Group's revenue recognition and margin recognition policies, which are set out in notes 1.4 and 1.6 above, are central to the way the Group values the work it has carried out in each financial year. These policies require forecasts to be made of the outcomes of long-term construction and service contracts, which require assessments and judgements to be made on recovery of pre-contract costs, changes in work scopes, contract programmes and maintenance liabilities.

b) Metronet
The Group owns 20% stakes in Metronet Rail BCV Holdings Ltd and Metronet Rail SSL Holdings Ltd ("Metronet") and a 25% stake in Trans4m Ltd ("Trans4m"). Trans4m works exclusively as a sub-contractor for Metronet. Metronet is engaged in modernising two-thirds of the London Underground, under a 30 year project agreement with London Underground Ltd (LUL). In drawing up the Group's accounts to record the level of profitability for the year, and in reviewing the carrying value of investments, assumptions have been made over the current and future performance of both Trans4m and Metronet over the initial 7½ year period and over the life of the 30 year project. These assumptions include estimates of the impact of cost escalation, scope changes, delivery against service metrics, funding and recoveries.

Most construction contracts, and investments in joint ventures and associates, have at least some of the same estimation characteristics noted above. However, in the case of Metronet and Trans4m, the number of estimates involved, the length of the construction contracts and the scale of the projects mean that these estimates are more complex.

c) Impairment of goodwill
Determining whether goodwill is impaired requires an estimation of the value in use of the cash generating units to which the goodwill has been allocated. The value in use calculation requires an estimate to be made of the timing and amount of future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate the present value. The discount rates used are based on the Group's weighted average cost of capital adjusted to reflect the specific economic environment of the relevant cash generating unit. The carrying value of goodwill at 31 December 2006 was £427m after an impairment loss of £16m was recognised in 2006. Details of the impairment loss calculation are provided in Note 12.

d) Available-for-sale financial assets
Assets constructed by the Group's PFI/PPP subsidiary, joint venture and associate companies are classified as "available-for-sale financial assets" and at 31 December 2006 had a value of £1,563m. The fair value of these financial assets is measured at each balance sheet date by discounting the future value of the cash flows allocated to the financial asset. A range of discount rates, varying from 6% to 11%, are used which reflect the prevailing risk-free interest rates and the different risk profiles of the various concessions. A £2m loss was taken to equity in 2006 as a result of movements in the fair value of these financial assets.

e) PFI/PPP derivative financial instruments
The Group's PFI/PPP subsidiary, joint venture and associate companies use derivative financial instruments (principally swaps) to manage the interest rate and inflation rate risks to which the concessions are exposed by their long-term contractual agreements. These derivatives are initially recognised as assets and liabilities at their fair value and subsequently remeasured at each balance sheet date at their fair value. The fair value of derivatives constantly changes in response to prevailing market conditions. At 31 December 2006, a cumulative fair value loss of £56m had arisen on these financial instruments and a gain of £32m was taken to equity in 2006.

f) Retirement benefit obligations
Details of the Group's defined benefit pension schemes are set out in Note 25 and have been valued in accordance with IAS 19 "Employee Benefits". At 31 December 2006, the defined benefit obligation recognised on the Group's balance sheet was £288m (2005: £280m). The benefit obligation is calculated using a number of assumptions including future salary increases, increases in pension benefits, mortality rates, inflation rates and the future investment returns from scheme assets. The present value of the benefit obligation is calculated by discounting the benefit obligation using market rates on relevant AA corporate bonds at the balance sheet date. The schemes' assets are valued at market rates at the balance sheet date. Effects of changes in the actuarial assumptions underlying the benefit obligation, discount rates and the differences between expected and actual returns on the schemes' assets are classified as actuarial gains and losses. During 2006 the Group recognised a net actuarial gain of £36m in equity (2005: £14m loss), including its share of the actuarial gains and losses arising in joint ventures and associates.

g) Taxation
The Group is subject to tax in a number of jurisdictions and judgement is required in determining the worldwide provision for income taxes.

The Group provides for future liabilities in respect of uncertain tax positions where additional tax may become payable in future periods, and such provisions are based upon management's assessment of exposures.

As set out in Note 1.11 above, deferred tax is accounted for on temporary differences using the liability method, with deferred tax liabilities generally being provided for in full and deferred tax assets being recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised. Note 24.2 details the unused tax losses for which deferred tax assets have not been recognised and the undistributed reserves of subsidiaries for which deferred tax liabilities have not been provided, together with the judgements which the Group has made at 31 December 2006 in respect of these matters. These judgements may change in the future and are reviewed at each balance sheet date.

2 Revenue

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Revenue from contracting activities – construction	**3,871**	3,247	**–**	–
– services	**523**	506	**–**	–
Revenue from manufacturing activities	**93**	82	**–**	–
Proceeds on sale of development land	**–**	2	**–**	2
Dividends from subsidiaries	**–**	–	**80**	57
Dividends from joint ventures and associates	**–**	–	**13**	6
	4,487	3,837	**93**	65

3 Segment analysis

3.1 Total Group

	Building, building management and services 2006 £m	Civil and specialist engineering and services 2006 £m	Rail engineering and services 2006 £m	Investments and developments 2006 £m	Corporate costs, assets and liabilities 2006 £m	Total 2006 £m
Performance by activity:						
Results						
Group revenue	**2,030**	**1,677**	**766**	**14**	**–**	**4,487**
Group operating profit	**42**	**47**	**35**	**(19)**	**(24)**	**81**
Share of results of joint ventures and associates	**1**	**8**	**3**	**51**	**–**	**63**
Profit from operations before exceptional items and amortisation	**43**	**55**	**38**	**32**	**(24)**	**144**
Exceptional items	**–**	**(21)**	**2**	**–**	**–**	**(19)**
Amortisation of intangible assets	**–**	**(1)**	**–**	**–**	**–**	**(1)**
Profit from operations	**43**	**33**	**40**	**32**	**(24)**	**124**
Investment income						**26**
Finance costs						**(25)**
Profit before taxation						**125**
Assets and liabilities						
Intangibles assets – goodwill	**78**	**213**	**136**	**–**	**–**	**427**
– other	**1**	**8**	**–**	**–**	**–**	**9**
Investments in joint ventures and associates	**4**	**68**	**2**	**384**	**–**	**458**
Other assets	**395**	**506**	**298**	**44**	**441**	**1,684**
Total assets	**478**	**795**	**436**	**428**	**441**	**2,578**
Total liabilities	**(825)**	**(678)**	**(405)**	**(79)**	**(204)**	**(2,191)**
	(347)	**117**	**31**	**349**	**237**	**387**
Other information						
Capital expenditure	**6**	**36**	**14**	**1**	**–**	**57**
Depreciation	**4**	**23**	**15**	**1**	**–**	**43**
Impairment of goodwill	**–**	**16**	**–**	**–**	**–**	**16**

	Europe 2006 £m	North America 2006 £m	Other* 2006 £m	Total 2006 £m
Performance by geographic origin:				
Group revenue	**3,893**	**572**	**22**	**4,487**
Profit from operations before exceptional items and amortisation	**141**	**(12)**	**15**	**144**
Exceptional items	**(1)**	**(18)**	**–**	**(19)**
Amortisation of intangible assets	**(1)**	**–**	**–**	**(1)**
Profit from operations	**139**	**(30)**	**15**	**124**
Segment assets (net)	**64**	**14**	**52**	**130**
Liability component of preference shares				**(90)**
Net cash				**284**
Tax and dividends				**63**
Net assets				**387**
Capital expenditure	**52**	**5**	**–**	**57**

3 Segment analysis continued

3.1 Total Group continued

	Building, building management and services 2005 £m	Civil and specialist engineering and services 2005 £m	Rail engineering and services 2005 £m	Investments and developments 2005 £m	Corporate costs, assets and liabilities 2005 £m	Total 2005 £m
Performance by activity:						
Results						
Group revenue	1,674	1,366	763	34	–	3,837
Group operating profit	32	39	32	(10)	(21)	72
Share of results of joint ventures and associates	3	10	–	30	–	43
Profit from operations before exceptional items	35	49	32	20	(21)	115
Exceptional items	(8)	–	(12)	36	–	16
Profit from operations	27	49	20	56	(21)	131
Investment income						56
Finance costs						(46)
Profit before taxation						141
Assets and liabilities						
Goodwill	66	85	133	–	–	284
Investments in joint ventures and associates	4	67	–	304	–	375
Other assets	388	376	318	54	445	1,581
Total assets	458	528	451	358	445	2,240
Total liabilities	(671)	(519)	(443)	(70)	(245)	(1,948)
	(213)	9	8	288	200	292
Other information						
Capital expenditure	3	27	27	–	–	57
Depreciation	4	18	17	–	2	41
Impairment of goodwill	–	–	4	–	–	4

	Europe 2005 £m	North America 2005 £m	Other* 2005 £m	Total 2005 £m
Performance by geographic origin:				
Group revenue	3,332	483	22	3,837
Profit from operations before exceptional items	134	(20)	1	115
Exceptional items	28	(12)	–	16
Profit from operations	162	(32)	1	131
Segment assets (net)	(24)	24	52	52
Liability component of preference shares				(98)
Net cash				301
Tax and dividends				37
Net assets				292
Capital expenditure	45	11	1	57

*Other principally comprises the Group's operations in Hong Kong and Dubai.

3 Segment analysis continued

3.2 Investments and developments
The Investments and developments segment includes the Group's PFI/PPP activities (Balfour Beatty Capital) details of which are set out below.

	Group 2006 £m	Share of joint ventures and associates 2006 £m	Total 2006 £m	Group 2005 £m	Share of joint ventures and associates 2005 £m	Total 2005 £m
Revenue						
PFI/PPP						
– joint ventures and associates (Note 15.2)	–	458	458	–	368	368
– subsidiaries (Note 3.3)	14	–	14	32	–	32
Balfour Beatty Capital	14	458	472	32	368	400
Barking Power Ltd (Note 15.2)	–	83	83	–	63	63
Property development and other	–	–	–	2	–	2
	14	541	555	34	431	465

	Group 2006 £m	Share of joint ventures and associates 2006 £m	Total 2006 £m	Group 2005 £m	Share of joint ventures and associates 2005 £m	Total 2005 £m
Profit from operations – before exceptional items and amortisation of intangible assets*						
PFI/PPP						
– joint ventures and associates (Note 15.2)	–	36	36	–	22	22
– bidding costs and overheads	(18)	–	(18)	(10)	–	(10)
Balfour Beatty Capital	(18)	36	18	(10)	22	12
Barking Power Ltd (Note 15.2)	–	15	15	–	8	8
Property development and other	(1)	–	(1)	–	–	–
	(19)	51	32	(10)	30	20

*Profit from operations before exceptional items and amortisation of intangible assets includes the Group's share of profit after taxation of joint ventures and associates (excluding exceptional items and amortisation of intangible assets).

	Group 2006 £m	Share of joint ventures and associates 2006 £m	Total 2006 £m	Group 2005 £m	Share of joint ventures and associates 2005 £m	Total 2005 £m
Net assets						
PFI/PPP						
– joint ventures and associates (Notes 15.2 and 15.3)	–	314	314	–	249	249
– subsidiaries (Note 3.3)	21	–	21	14	–	14
– bidding costs and overheads	(20)	–	(20)	(4)	–	(4)
– loans from joint ventures and associates	(25)	–	(25)	(25)	–	(25)
Balfour Beatty Capital	(24)	314	290	(15)	249	234
Barking Power Ltd (Note 15.2)	–	70	70	–	55	55
Property development and other	(11)	–	(11)	(1)	–	(1)
	(35)	384	349	(16)	304	288

3 Segment analysis continued

3.3 PFI/PPP subsidiaries
As at 31 December 2006, the Group had a 100% interest in two PFI/PPP concessions through its shareholdings in Connect Roads Sunderland Holdings Ltd and Connect Roads South Tyneside Holdings Ltd. The Group also had a 100% interest in three PFI/PPP concessions through its shareholdings in Connect Roads Ltd and Connect M77/GSO Holdings Ltd until 20 December 2005, when the Group disposed of a 15% interest in those concessions and they became joint ventures. The performance of the wholly-owned PFI/PPP concessions (until ceasing to be subsidiaries as appropriate) and their balance sheets are summarised below.

	2006 £m	2005 £m
Income statement		
Group revenue	**14**	32
Profit from operations	**–**	–
Investment income	**1**	36
Finance costs	**(1)**	(19)
Profit before taxation	**–**	17
Taxation	**–**	(5)
Profit for the year	**–**	12
Cash flow		
Profit from operations	**–**	–
Decrease in working capital	**1**	–
Income taxes paid	**–**	(3)
Net cash inflow/(outflow) from operating activities	**1**	(3)
Net cash outflow from investing activities	**(7)**	(20)
Net cash (outflow)/inflow from financing activities	**(1)**	29
Net cash (outflow)/inflow	**(7)**	6
Net borrowings at beginning of year	**(14)**	(244)
Net borrowings at date of disposal	**–**	224
Net borrowings at end of year	**(21)**	(14)
Balance sheet		
PFI/PPP financial assets (Note 17)	**22**	14
Other net current assets	**(1)**	–
Non-recourse term loans	**(21)**	(14)
Net assets	**–**	–

4 Profit from operations

4.1 Profit from operations is stated after charging/(crediting):

	2006 £m	2005 £m
Research and development costs	**4**	4
Depreciation of property, plant and equipment	**43**	41
Impairment of goodwill	**16**	4
Amortisation of other intangible assets	**1**	–
Impairment of trade receivables	**3**	1
Profit on disposal of property, plant and equipment	**(1)**	(2)
Cost of manufacturing inventory recognised as an expense	**58**	48
Auditors' remuneration	**3**	3
Hire charges for plant and equipment	**80**	77
Other operating lease rentals	**43**	42

4.2 Analysis of auditors' remuneration:

	2006 £m	2005 £m
Services as auditors	**0.6**	0.5
Other services – auditing of accounts of subsidiaries	**1.6**	1.5
Group audit fee	**2.2**	2.0
Other services – independent review of interim report	**0.2**	0.1
– tax services – compliance	**0.1**	0.1
– advisory	**0.1**	0.2
– other services – acquisition due diligence	**0.1**	0.6
– IFRS transition	**–**	0.4
	2.7	3.4

5 Employee costs

5.1 Group employee costs during the year amounted to:

	2006 £m	2005 £m
Wages and salaries	**923**	835
Social security costs	**95**	84
Other pension costs (Note 25.1)	**52**	49
Share-based payments (Note 30.1)	**4**	3
	1,074	971

5.2 The average number of Group employees (including executive Directors) was:

	2006 Number	2005 Number
Building, building management and services	**11,457**	10,913
Civil and specialist engineering and services	**11,624**	10,455
Rail engineering and services	**5,512**	5,992
Investments and developments	**167**	136
Corporate	**102**	96
	28,862	27,592

At 31 December 2006, the total number of Group employees was 30,467 (2005: 27,351).

5.3 The average number of employees of Balfour Beatty plc was 87 (2005: 80). Total employee costs of Balfour Beatty plc were £14m (2005: £12m).

6 Investment income

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
PFI/PPP non-recourse				
– interest on financial assets	**1**	36	**–**	–
PFI/PPP subordinated debt interest receivable	**8**	5	**3**	3
Interest receivable from subsidiaries	**–**	–	**11**	10
Other interest receivable and similar income	**17**	15	**7**	8
	26	56	**21**	21

7 Finance costs

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
PFI/PPP non-recourse				
– other interest payable	**1**	19	**–**	–
Interest payable to subsidiaries	**–**	–	**29**	21
Other interest payable				
– bank loans and overdrafts	**3**	1	**3**	3
– other loans	**2**	4	**1**	4
Preference shares				
– finance cost	**12**	13	**12**	13
	18	37	**45**	41
Exceptional items				
– premium on buy-back of preference shares	**7**	3	**7**	3
– net premium on repayment of US Dollar term loan	**–**	6	**–**	6
	25	46	**52**	50

A preference dividend of 5.375p gross (4.8375p net) per cumulative convertible redeemable preference share of 1p was paid in respect of the six months ended 30 June 2006 on 1 July 2006 to holders of these shares on the register on 26 May 2006. A preference dividend of 5.375p gross (4.8375p net) per cumulative convertible redeemable preference share was paid in respect of the six months ended 31 December 2006 on 1 January 2007 to holders of these shares on the register on 24 November 2006.

8 Exceptional items

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
8.1 Credited to/(charged against) profit from operations				
Group operating profit				
– litigation settlements and fines	**2**	(8)	**–**	–
– National Engineering and Contracting Company				
– impairment of goodwill	**(16)**	–	**–**	–
– reorganisation costs	**(2)**	–	**–**	–
	(18)	–	**–**	–
– Birse Group integration costs	**(3)**	–	**–**	–
– profit on sale of interest in Connect Roads	**–**	6	**–**	7
– impairment of investment in Romec Ltd	**–**	(8)	**–**	–
– impairment of goodwill in Balfour Beatty Rail Inc	**–**	(4)	**–**	–
	(19)	(14)	**–**	7
Share of results of joint ventures and associates				
– TXU distributions to Barking Power Ltd	**–**	30	**–**	–
	(19)	16	**–**	7
8.2 Charged to finance costs				
– premium on buy-back of preference shares	**(7)**	(3)	**(7)**	(3)
– net premium on repayment of US Dollar term loan	**–**	(6)	**–**	(6)
(Charged against)/credited to profit before taxation	**(26)**	7	**(7)**	(2)
8.3 Taxation thereon	**1**	(3)	**–**	2
(Charged against)/credited to profit for the year	**(25)**	4	**(7)**	–

8.1 The exceptional item credited to Group operating profit in 2006 arose from the reduction in the fine (less associated costs) imposed on Balfour Beatty Rail Infrastructure Services Ltd in respect of the Hatfield derailment in October 2000. As a result of unsatisfactory performance in the central division of Balfour Beatty Construction Inc, the goodwill arising on the acquisition of National Engineering and Contracting Company has been written off and charged against Group operating profit, together with costs of reorganisation of the division. Costs incurred in the reorganisation and integration of Birse Group acquired in 2006 have been charged against Group operating profit.

8 Exceptional items continued

The exceptional items charged against Group operating profit in 2005 arose from litigation and settlement costs of £8m which include a payment to the US Government by Balfour Beatty Construction Inc, for its share of a settlement payment to resolve allegations arising from investigations into a joint venture contract awarded in 1995 and completed in 2000 and the costs awarded against Balfour Beatty Rail Infrastructure Services Ltd for admitted breaches of the Health and Safety at Work Act following the Hatfield derailment in October 2000, provision for the associated fine having been made in prior years; a profit of £6m on the disposal of a 15% interest in Connect Roads Ltd and Connect M77/GSO Holdings Ltd; an impairment charge of £8m in respect of the Group's investment in Romec Ltd; and a goodwill impairment charge of £4m in respect of Balfour Beatty Rail Inc.

The exceptional item credited to profit from operations in share of results of joint ventures and associates in 2005 arises in Barking Power Ltd in which the Group holds a 25.5% interest. The £30m gain represents the Group's share, after charging taxation of £12m, of the first three distributions received by Barking Power Ltd from the administrator of TXU Europe following the damages agreement reached in December 2004 of £179m.

8.2 The exceptional items charged against finance costs are the premium of £7m (2005: £3m) arising on the repurchase for cancellation of 12.0m (2005: 6.8m) preference shares at a cost of £19m (2005: £11m), and, in 2005, the net premium of £6m arising from the repayment of the US Dollar term loan.

8.3 The exceptional items in 2006 have given rise to a net tax credit of £1m (2005: £3m net charge).

9 Taxation

9.1 Taxation charge

	Group 2006 £m	Group 2005 £m	**Company 2006 £m**	Company 2005 £m
UK current tax				
– corporation tax for the year at 30% (2005: 30%)	**19**	34	**(5)**	(6)
– double tax relief	**(4)**	(6)	**–**	–
– adjustments in respect of previous periods	**–**	(9)	**–**	(6)
	15	19	**(5)**	(12)
Foreign current tax				
– foreign tax on profits for the year	**7**	5	**–**	–
– adjustments in respect of previous periods	**–**	1	**–**	–
	7	6	**–**	–
Total current tax	**22**	25	**(5)**	(12)
Deferred tax				
– UK	**11**	3	**3**	–
– foreign tax	**1**	2	**–**	–
– adjustments in respect of previous periods	**–**	5	**–**	1
Total deferred tax	**12**	10	**3**	1
Total tax charge/(credit)	**34**	35	**(2)**	(11)

The Group tax charge above does not include any amounts for joint ventures and associates, whose results are disclosed in the income statement net of tax (see Note 15.2).

In addition to the Group tax charge above are amounts charged directly to equity for current tax of £8m (2005: £4m credit) and deferred tax of £7m (2005: £10m credit), which with a charge in respect of joint ventures and associates of £11m (2005: £5m) totals £26m (2005: £9m credit).

In addition to the Company tax charge above are amounts credited directly to equity for current tax of £nil (2005: £1m) and deferred tax of £1m (2005: £1m).

The weighted average applicable tax rate is 32% (2005: 35%) based on profit before taxation, exceptional items and amortisation of intangible assets, excluding the results of joint ventures and associates.

9.2 Taxation reconciliation

	Group 2006 £m	Group 2005 £m	**Company 2006 £m**	Company 2005 £m
Profit before taxation	**125**	141	**57**	32
Less: Share of results of joint ventures and associates	**(63)**	(73)		
Group profit before taxation	**62**	68		
Tax on Group/Company profit before taxation at standard UK corporation tax rate of 30% (2005: 30%)	**19**	20	**17**	10
Effects of:				
Expenses not deductible for tax purposes including impairment of goodwill	**5**	6	**2**	–
Dividend income not taxable	**–**	–	**(27)**	(19)
Preference shares finance costs and premium on buy-back not deductible	**6**	5	**6**	5
Movement in deferred tax not recognised	**–**	(3)	**–**	–
Losses not available for offset	**2**	9	**–**	–
Higher/(lower) tax rates on foreign earnings	**2**	3	**–**	–
Disposal of investments and other assets not taxable	**–**	(2)	**–**	(2)
Adjustments in respect of other periods	**–**	(3)	**–**	(5)
Total tax charge/(credit)	**34**	35	**(2)**	(11)

Notes to the accounts (continued)

10 Earnings per ordinary share

	Basic 2006 £m	Diluted 2006 £m	Basic 2005 £m	Diluted 2005 £m
Earnings	**91**	**91**	106	106
Exceptional items	**25**		(4)	
Amortisation of intangible assets	**1**		–	
Adjusted earnings	**117**		102	

	Basic 2006 m	Diluted 2006 m	Basic 2005 m	Diluted 2005 m
Weighted average number of ordinary shares	**427.1**	**431.0**	424.2	428.7

	Basic 2006 Pence	Diluted 2006 Pence	Basic 2005 Pence	Diluted 2005 Pence
Earnings per ordinary share	**21.2**	**21.0**	24.9	24.7
Exceptional items	**5.9**		(0.8)	
Amortisation of intangible assets	**0.2**		–	
Adjusted earnings per ordinary share	**27.3**		24.1	

The calculation of basic earnings is based on profit for the year attributable to equity shareholders. The weighted average number of ordinary shares used to calculate diluted earnings per ordinary share has been adjusted for the conversion of share options. No adjustment has been made in respect of the potential conversion of the cumulative convertible redeemable preference shares, the effect of which would have been antidilutive throughout each year. Adjusted earnings per ordinary share, before exceptional items and amortisation of intangible assets, has been disclosed to give a clearer understanding of the Group's underlying trading performance.

11 Dividends on ordinary shares

	Per share 2006 Pence	Amount 2006 £m	Per share 2005 Pence	Amount 2005 £m
Proposed dividends for the year:				
Interim – current year	**3.9**	**17**	3.5	15
Final – current year	**5.2**	**22**	4.6	20
	9.1	**39**	8.1	35
Recognised dividends for the year:				
Final – prior year		**20**		16
Interim – current year		**17**		15
		37		31

An interim dividend of 3.9p (2005: 3.5p) per ordinary share was paid on 13 December 2006. Subject to approval at the Annual General Meeting on 10 May 2007, the final 2006 dividend will be paid on 2 July 2007 to holders of ordinary shares on the register on 27 April 2007 by direct credit or, where no mandate has been given, by cheque posted on 28 June 2007 payable on 2 July 2007. These shares will be quoted ex-dividend on 25 April 2007.

12 Intangible assets – goodwill

	Cost £m	Accumulated impairment losses £m	Carrying amount £m
At 1 January 2005	292	(18)	274
Exchange adjustments	2	(2)	–
Businesses acquired	14	–	14
Impairment losses for the year	–	(4)	(4)
At 31 December 2005	308	(24)	284
Exchange adjustments	**(11)**	**3**	**(8)**
Businesses acquired (see Note 29)	**167**	**–**	**167**
Impairment losses for the year	**–**	**(16)**	**(16)**
At 31 December 2006	**464**	**(37)**	**427**

The carrying amounts of goodwill by business segment are as follows:

	Europe 2006 £m	**North America 2006 £m**	**Total 2006 £m**	Europe 2005 £m	North America 2005 £m	Total 2005 £m
Building, building management and services	**58**	**20**	**78**	58	8	66
Civil and specialist engineering and services	**213**	**–**	**213**	68	17	85
Rail engineering and services	**128**	**8**	**136**	123	10	133
	399	**28**	**427**	249	35	284

The recoverable amount of goodwill has been based on value in use. Forecast cash flows are based on approved budgets for the next three years. The key assumptions, which have been based on past experience, are revenue growth and forecast operating margin. Subsequent cash flows have been increased in line with projected GDP for each territory. The cash flows have been discounted using a pre-tax discount rate of 14.7% (2005: 12.9%) based on the Group's weighted average cost of capital. The cash flows assume a residual value based on a multiple of earnings before interest and tax.

As a result of unsatisfactory performance in the central division of Balfour Beatty Construction Inc, the goodwill of £16m arising on the acquisition of National Engineering and Contracting Company has been written off in 2006 and charged against Group operating profit. Residual goodwill carried by the business was £nil. During 2005 Balfour Beatty Rail Inc continued to suffer losses on a major contract which was acquired in 2001 as part of the Group's acquisition of ABC NACO. Cash outflows were expected to occur on the contract until its completion in 2007 and as a result, a further goodwill impairment charge of £4m was charged against Group operating profit. Residual goodwill carried by the business was £10m.

13 Intangible assets – other

	Customer contracts £m	**Customer relationships £m**	**Brand names £m**	**Total £m**
Cost				
At 1 January 2006	**–**	**–**	**–**	**–**
Businesses acquired	**3**	**4**	**3**	**10**
At 31 December 2006	**3**	**4**	**3**	**10**
Accumulated amortisation				
At 1 January 2006	**–**	**–**	**–**	**–**
Charge for the year	**(1)**	**–**	**–**	**(1)**
At 31 December 2006	**(1)**	**–**	**–**	**(1)**
Carrying amount				
At 31 December 2006	**2**	**4**	**3**	**9**
At 31 December 2005	–	–	–	–

Intangible assets are amortised on a straight-line basis over their expected useful lives, which are three years for customer contracts and five years for customer relationships and brand names.

Notes to the accounts (continued)

14 Property, plant and equipment

14.1 Movements

	Land and buildings £m	Plant and equipment £m	Assets in course of construction £m	Group Total £m	Company Plant and equipment £m
Cost					
At 1 January 2005	42	335	5	382	2
Exchange adjustments	–	9	–	9	–
Additions	3	51	3	57	–
Disposals	(3)	(52)	–	(55)	–
Businesses acquired	3	3	–	6	–
Transfers	–	5	(5)	–	–
At 31 December 2005	45	351	3	399	2
Exchange adjustments	**–**	**(11)**	**–**	**(11)**	**–**
Additions	**2**	**55**	**–**	**57**	**–**
Disposals	**(2)**	**(32)**	**–**	**(34)**	**(1)**
Businesses acquired	**1**	**12**	**–**	**13**	**–**
Transfers	**–**	**3**	**(3)**	**–**	**–**
At 31 December 2006	**46**	**378**	**–**	**424**	**1**
Accumulated depreciation					
At 1 January 2005	11	222	–	233	1
Exchange adjustments	–	7	–	7	–
Charge for the year	2	39	–	41	1
Disposals	(3)	(46)	–	(49)	–
At 31 December 2005	10	222	–	232	2
Exchange adjustments	**–**	**(8)**	**–**	**(8)**	**–**
Charge for the year	**2**	**41**	**–**	**43**	**–**
Disposals	**–**	**(26)**	**–**	**(26)**	**(1)**
At 31 December 2006	**12**	**229**	**–**	**241**	**1**
Carrying amount					
At 31 December 2006	**34**	**149**	**–**	**183**	**–**
At 31 December 2005	35	129	3	167	–

The carrying amount of the Group's property, plant and equipment held under finance leases was £1m (2005: £1m). The Company has no land and buildings and no property, plant and equipment held under finance leases.

14.2 Analysis of carrying amount of land and buildings

	Group 2006 £m	Group 2005 £m
Freehold	**26**	27
Long leasehold – over 50 years unexpired	**2**	2
Short leasehold	**6**	6
	34	35

15 Investments in joint ventures and associates

15.1 Movements

	Net assets £m	Loans £m	Provisions £m	Total £m
At 1 January 2005	165	63	(25)	203
Income recognised	73	–	–	73
Impairment of investment	(8)	–	–	(8)
Actuarial gains on retirement benefit obligations	7	–	–	7
Fair value revaluation of PFI/PPP cash flow hedges	(20)	–	–	(20)
Fair value revaluation of PFI/PPP financial assets	29	–	–	29
Exchange adjustments	5	–	–	5
Tax on items taken directly to equity	(6)	–	–	(6)
Dividends	(12)	–	–	(12)
Additions	11	–	–	11
Loans granted/repaid	–	1	–	1
Businesses acquired	25	6	–	31
Transfers	40	21	–	61
At 31 December 2005	309	91	(25)	375
Income recognised	**63**	**–**	**–**	**63**
Actuarial gains on retirement benefit obligations	**10**	**–**	**–**	**10**
Fair value revaluation of PFI/PPP cash flow hedges	**32**	**–**	**–**	**32**
Fair value revaluation of PFI/PPP financial assets	**(2)**	**–**	**–**	**(2)**
Exchange adjustments	**(7)**	**–**	**–**	**(7)**
Tax on items taken directly to equity	**(11)**	**–**	**–**	**(11)**
Dividends	**(24)**	**–**	**–**	**(24)**
Additions	**3**	**–**	**–**	**3**
Loans granted/repaid	**–**	**19**	**–**	**19**
At 31 December 2006	**373**	**110**	**(25)**	**458**

Principal joint ventures and associates are shown in Note 36(b). The original cost of the Group's investments in joint ventures and associates was £124m (2005: £121m). The Group's share of borrowings of joint ventures and associates is shown in 15.2 below. The amount of these which was supported by the Group and the Company was £nil (2005: £nil). The borrowings of Barking Power Ltd and the PFI/PPP joint venture and associate companies are repayable over periods extending up to 2040. As disclosed in Note 31, the Company has committed to provide its share of further equity funding of joint ventures and associates in PFI/PPP projects. Further, in respect of a number of these investments the Company has committed not to dispose of its equity interest until the relevant construction has been accepted. As is customary in such projects, dividend payments and other distributions are restricted until certain banking covenants are met.

15 Investments in joint ventures and associates continued

15.2 Share of results and net assets of joint ventures and associates

	Building, building management and services 2006 £m	Civil and specialist engineering and services 2006 £m	Rail engineering and services 2006 £m	Investments and developments PFI/PPP 2006 £m	Investments and developments Barking Power 2006 £m	Investments and developments Total 2006 £m	Total 2006 £m
Revenue	115	705	4	458	83	541	1,365
Operating profit before exceptional items	2	10	3	15	23	38	53
Investment income	–	3	–	122	2	124	127
Finance costs	–	(1)	–	(84)	(4)	(88)	(89)
Profit before taxation and exceptional items	2	12	3	53	21	74	91
Taxation	(1)	(4)	–	(17)	(6)	(23)	(28)
Profit after taxation	1	8	3	36	15	51	63
Non-current assets							
Intangible assets – goodwill	–	22	2	–	–	–	24
– other	–	–	–	2	–	2	2
Property, plant and equipment	2	61	–	29	105	134	197
PFI/PPP financial assets	–	–	–	1,541	–	1,541	1,541
Other non-current assets	–	10	–	121	–	121	131
Current assets							
Cash and cash equivalents	–	109	6	144	52	196	311
Other current assets	18	199	1	150	13	163	381
Total assets	20	401	9	1,987	170	2,157	2,587
Current liabilities							
Borrowings	(2)	(16)	–	(42)	(14)	(56)	(74)
Other current liabilities	(14)	(287)	(7)	(159)	(13)	(172)	(480)
Non-current liabilities							
Borrowings	–	–	–	(1,362)	(47)	(1,409)	(1,409)
Other non-current liabilities	–	(30)	–	(110)	(26)	(136)	(166)
Total liabilities	(16)	(333)	(7)	(1,673)	(100)	(1,773)	(2,129)
Net assets	4	68	2	314	70	384	458

15 Investments in joint ventures and associates continued

15.2 Share of results and net assets of joint ventures and associates continued

	Building, building management and services 2005 £m	Civil and specialist engineering and services 2005 £m	Rail engineering and services 2005 £m	Investments and developments PFI/PPP 2005 £m	Investments and developments Barking Power 2005 £m	Investments and developments Total 2005 £m	Total 2005 £m
Revenue	113	554	3	368	63	431	1,101
Operating profit before exceptional items	4	16	–	15	15	30	50
Investment income	–	1	–	69	–	69	70
Finance costs	–	(1)	–	(52)	(3)	(55)	(56)
Profit before taxation and exceptional items	4	16	–	32	12	44	64
Taxation	(1)	(6)	–	(10)	(4)	(14)	(21)
Exceptional items	–	–	–	–	30	30	30
Profit after taxation	3	10	–	22	38	60	73
Non-current assets							
Intangible assets – goodwill	–	25	2	–	–	–	27
– other	–	–	–	2	–	2	2
Property, plant and equipment	1	66	1	29	109	138	206
PFI/PPP financial assets	–	–	–	1,255	–	1,255	1,255
Other non-current assets	–	15	–	46	–	46	61
Current assets							
Cash and cash equivalents	–	76	6	200	40	240	322
Other current assets	18	165	–	112	22	134	317
Total assets	19	347	9	1,644	171	1,815	2,190
Current liabilities							
Borrowings	(3)	(17)	–	(64)	(12)	(76)	(96)
Other current liabilities	(12)	(220)	(9)	(170)	(16)	(186)	(427)
Non-current liabilities							
Borrowings	–	(4)	–	(1,050)	(60)	(1,110)	(1,114)
Other non-current liabilities	–	(39)	–	(111)	(28)	(139)	(178)
Total liabilities	(15)	(280)	(9)	(1,395)	(116)	(1,511)	(1,815)
Net assets	4	67	–	249	55	304	375

15.3 PFI/PPP investments

The Group's investment in PFI/PPP joint ventures and associates comprises:

	Net investment 2006 £m	**Reserves 2006 £m**	**Total 2006 £m**	Net investment 2005 £m	Reserves 2005 £m	Total 2005 £m
Metronet	**38**	**21**	**59**	27	6	33
Roads	**44**	**62**	**106**	44	60	104
Hospitals	**61**	**59**	**120**	58	46	104
Schools	**10**	**7**	**17**	–	3	3
Other concessions	**3**	**9**	**12**	5	–	5
	156	**158**	**314**	134	115	249

15 Investments in joint ventures and associates continued

15.4 Cash flow from/(to) joint ventures and associates

Net cash flow from/(to) joint ventures and associates comprises:

	PFI/PPP 2006 £m	Other 2006 £m	Total 2006 £m	PFI/PPP 2005 £m	Other 2005 £m	Total 2005 £m
Cash flows from investing activities						
Dividends from joint ventures and associates	15	9	24	3	9	12
Investment in and loans made to joint ventures and associates:						
– Equity	(3)	–	(3)	(11)	–	(11)
– Subordinated debt	(21)	–	(21)	(4)	–	(4)
– Subordinated debt repaid	2	–	2	3	–	3
	(22)	–	(22)	(12)	–	(12)
Cash flows from financing activities						
Subordinated debt interest received	8	–	8	6	–	6
Net cash flow from/(to) joint ventures and associates	1	9	10	(3)	9	6

15.5 Share of joint ventures' and associates' reserves

	Accumulated profit/(loss) £m	Hedging reserves £m	PFI/PPP financial assets £m	Currency translation reserves £m	Total £m
Balance at 1 January 2005	73	(35)	49	(1)	86
Income recognised	73	–	–	–	73
Actuarial gains on retirement benefit obligations	7	–	–	–	7
Fair value revaluation of PFI/PPP cash flow hedges	–	(20)	–	–	(20)
Fair value revaluation of PFI/PPP financial assets	–	–	29	–	29
Exchange adjustments	–	–	–	5	5
Tax on items taken directly to equity	(2)	5	(9)	–	(6)
Dividends paid	(12)	–	–	–	(12)
Transfers	14	(2)	8	–	20
Balance at 31 December 2005	153	(52)	77	4	182
Income recognised	63	–	–	–	63
Actuarial gains on retirement benefit obligations	10	–	–	–	10
Fair value revaluation of PFI/PPP cash flow hedges	–	32	–	–	32
Fair value revaluation of PFI/PPP financial assets	–	–	(2)	–	(2)
Exchange adjustments	–	–	–	(7)	(7)
Tax on items taken directly to equity	(2)	(10)	1	–	(11)
Dividends paid	(24)	–	–	–	(24)
Balance at 31 December 2006	200	(30)	76	(3)	243

The Group has not recognised losses of joint ventures and associates during the year of £nil (2005: £nil) and cumulatively of £nil (2005: £1m).

16 Investments

16.1 Group

Investments of the Group comprise £46m (2005: £38m) held to maturity bonds held by Delphian Insurance Company Ltd, the Group's captive insurance company. These investments comprise fixed rate bonds or Treasury Stock with an average interest rate of 6.44% and weighted average life of 4.99 years. Market value is determined by using the market price of the bonds at the relevant valuation date and is not significantly different to the book value. The maximum exposure to credit risk at 31 December 2006 is the carrying amount.

16.2 Company

	2006 £m	2005 £m
Investment in subsidiaries	**1,035**	1,000
Investment in joint ventures and associates	**16**	16
Provisions	**(147)**	(146)
	904	870

17 PFI/PPP subsidiaries' financial assets

	Roads £m	Street lighting £m	Total £m
Balance at 1 January 2005	333	7	340
Cash expenditure	14	7	21
Cash received	(38)	(3)	(41)
Interest	35	1	36
Fair value adjustment	(21)	2	(19)
Businesses sold	(323)	–	(323)
Balance at 31 December 2005	–	14	14
Cash expenditure	**–**	**12**	**12**
Cash received	**–**	**(5)**	**(5)**
Interest	**–**	**1**	**1**
Balance at 31 December 2006	**–**	**22**	**22**

18 Inventories

	2006 £m	2005 £m
Unbilled work in progress	**37**	24
Development and housing land and work in progress	**6**	14
Manufacturing work in progress	**9**	3
Raw materials and consumables	**20**	17
Finished goods and goods for resale	**3**	3
	75	61

19 Construction contracts

Contracts in progress at balance sheet date:

	2006 £m	2005 £m
Due from customers for contract work	**252**	217
Due to customers for contract work	**(265)**	(274)
	(13)	(57)

The aggregate amount of costs incurred plus recognised profits (less recognised losses) for all contracts in progress at the balance sheet date was £14,050m (2005: £13,368m).

20 Derivative financial instruments

20.1 Group

	Assets 2006 £m	Liabilities 2006 £m	Assets 2005 £m	Liabilities 2005 £m
Current				
Forward foreign exchange contracts – net investment in foreign operations hedges	**3**	**(1)**	–	(4)
	3	**(1)**	–	(4)
Non-current				
Interest-rate swaps – PFI/PPP cash flow hedges	**–**	**–**	2	(2)
Forward foreign exchange contracts – net investment in foreign operations hedges	**2**	**–**	–	–
	2	**–**	2	(2)
	5	**(1)**	2	(6)

Interest-rate swaps:
The notional principal amounts of the outstanding PFI/PPP interest-rate swaps outstanding at 31 December 2006 were £22m (2005: £14m). At 31 December 2006, the fixed interest rates range from 4.565% to 5.055% (2005: 4.565% to 5.055%) and principal floating rates are LIBOR. All other interest-rate swaps, other than in respect of PFI/PPP concessions, were terminated during 2005.

Forward foreign exchange contracts:
The notional principal amounts of forward foreign exchange contracts designated as hedges of net investments in foreign operations at 31 December 2006 was £147m (2005: £151m). The gains and losses in equity on hedges of net investments in foreign operations will be released to the income statement on the disposal of the underlying net investment.

The credit risk on derivative financial instruments is considered to be limited because the counterparties are banks with high credit ratings assigned by international credit agencies.

20.2 Company

	Assets 2006 £m	Liabilities 2006 £m	Assets 2005 £m	Liabilities 2005 £m
Current				
Forward foreign exchange contracts – net investment in foreign operations hedges	**3**	**(3)**	4	(4)
	3	**(3)**	4	(4)
Non-current				
Forward foreign exchange contracts – net investment in foreign operations hedges	**2**	**(2)**	–	–
	2	**(2)**	–	–
	5	**(5)**	4	(4)

21 Trade and other receivables

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Current				
Trade receivables	**491**	507	**6**	15
Less: Provision for impairment of trade receivables	**(13)**	(9)	**–**	–
	478	498	**6**	15
Due from subsidiaries	**–**	–	**409**	371
Due from joint ventures and associates	**35**	16	**–**	–
Due from jointly controlled operations	**6**	6	**–**	–
Contract retentions	**72**	67	**–**	–
Prepayments and accrued income	**35**	24	**1**	1
Advance corporation tax recoverable	**–**	8	**–**	8
	626	619	**416**	395
Non-current				
Trade and other receivables	**12**	7	**–**	2
Due from joint ventures and associates	**–**	–	**32**	33
Contract retentions	**29**	28	**–**	–
Due on acquisitions	**9**	–	**–**	–
	50	35	**32**	35
	676	654	**448**	430

The Group's credit risk is primarily attributable to its trade receivables. Based on prior experience and an assessment of the current economic environment, management believes there is no further credit risk provision required in excess of the normal provision for impairment of trade receivables.

21 Trade and other receivables continued

The Directors consider that the carrying values of current trade and other receivables approximate their fair values. The fair value of non-current and other trade and other receivables amounts to £50m (2005: £32m) and has been determined using yield curves and exchange rates prevailing at the balance sheet date and discounting future cash flows at interest rates prevailing at the balance sheet date.

It is Group policy that forward foreign exchange contracts are entered into as soon as a foreign currency trade receivable is identified.

22 Trade and other payables

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Current				
Trade and other payables	**525**	398	**4**	4
Accruals and deferred income	**653**	536	**9**	8
Advance payments on contracts	**9**	11	**–**	–
VAT, payroll taxes and social security	**77**	64	**13**	10
Due to subsidiaries	**–**	–	**722**	645
Due to joint ventures and associates	**12**	–	**–**	–
Due to jointly controlled operations	**3**	2	**–**	–
Dividends on ordinary shares	**–**	15	**–**	15
Dividends on preference shares	**6**	6	**6**	6
Due on acquisitions	**4**	6	**3**	5
	1,289	1,038	**757**	693
Non-current				
Trade and other payables	**47**	36	**–**	–
Accruals and deferred income	**5**	5	**–**	–
Due to joint ventures and associates	**25**	25	**25**	25
	77	66	**25**	25
	1,366	1,104	**782**	718

The maturity profile of the Group's non-current trade and other payables at 31 December was:

	Trade and other payables 2006 £m	Due to joint ventures and associates 2006 £m	Accruals and deferred income 2006 £m	Total 2006 £m	Trade and other payables 2005 £m	Due to joint ventures and associates 2005 £m	Accruals and deferred income 2005 £m	Total 2005 £m
Due within one to two years	**17**	**–**	**4**	**21**	12	–	5	17
Due within two to five years	**10**	**–**	**1**	**11**	9	–	–	9
Due after more than five years	**20**	**25**	**–**	**45**	15	25	–	40
	47	**25**	**5**	**77**	36	25	5	66
Fair values	**44**	**14**	**4**	**62**	34	14	5	53

The fair value of non-current trade and other payables has been determined by using yield curves and exchange rates prevailing at the balance sheet date and discounting future cash flows at interest rates prevailing at the balance sheet date.

It is Group policy that forward foreign exchange contracts are taken out as soon as a foreign currency trade and other payable is identified. Non-current amounts due to joint ventures and associates are denominated in sterling, and non-current accruals and deferred income are denominated in US dollars.

23 Cash and cash equivalents and borrowings

23.1 Group

	Current 2006 £m	Non-current 2006 £m	Total 2006 £m	Current 2005 £m	Non-current 2005 £m	Total 2005 £m
Unsecured borrowings						
– bank overdrafts	**(15)**	**–**	**(15)**	(29)	–	(29)
– other short-term loans	**(1)**	**–**	**(1)**	–	–	–
Secured borrowings						
– finance leases	**–**	**(1)**	**(1)**	(1)	–	(1)
– other	**(1)**	**–**	**(1)**	–	–	–
	(17)	**(1)**	**(18)**	(30)	–	(30)
Cash and deposits	**142**	**–**	**142**	146	–	146
Term deposits	**181**	**–**	**181**	199	–	199
	306	**(1)**	**305**	315	–	315
PFI/PPP non-recourse term loans						
– sterling floating rate term loan (2008–2027)	**–**	**(17)**	**(17)**	–	(13)	(13)
– sterling floating rate term loan (2011–2030)	**–**	**(4)**	**(4)**	–	(1)	(1)
	–	**(21)**	**(21)**	–	(14)	(14)
Net cash/(borrowings)	**306**	**(22)**	**284**	315	(14)	301

The PFI/PPP project finance sterling debt obligations arise under non-recourse facilities in the concession companies Connect Roads Sunderland Ltd and Connect Roads South Tyneside Ltd. The borrowings are secured by fixed and floating charges over each concession company's right, title and interest in certain assets and/or revenues and over each concession company's shares held by their immediate parent companies, Connect Roads Sunderland Holdings Ltd and Connect Roads South Tyneside Holdings Ltd.

A significant part of the PFI/PPP non-recourse project finance floating rate term loans has been swapped into fixed rate debt by the use of interest rate swaps.

Cash, deposits and term deposits include the Group's share of amounts held by contracting joint arrangements of £94m (2005: £110m).

The interest rate risk profile of the Group's net cash at 31 December 2006 was:

	Fixed rate £m	Floating rate £m	Total £m	Fixed rate: Weighted average interest rate %	Fixed rate: Weighted average period for which rate is fixed Years
Currency					
Cash					
Sterling – excluding PFI/PPP non-recourse project finance	**–**	**247**	**247**	**–**	**–**
US Dollar	**–**	**48**	**48**	**–**	**–**
Other	**–**	**28**	**28**	**–**	**–**
	–	**323**	**323**	**–**	**–**
Borrowings					
Sterling – excluding PFI/PPP non-recourse project finance	**2**	**16**	**18**	**6.0**	**1.3**
Sterling – PFI/PPP non-recourse project finance	**21**	**–**	**21**	**5.0**	**12.4**
	23	**16**	**39**	**5.0**	**11.5**
Net (borrowings)/cash	**(23)**	**307**	**284**		

23 Cash and cash equivalents and borrowings continued

23.1 Group continued

The interest rate risk profile of the Group's net cash at 31 December 2005 was:

	Fixed rate £m	Floating rate £m	Total £m	Fixed rate: Weighted average interest rate %	Fixed rate: Weighted average period for which rate is fixed Years
Currency					
Cash					
Sterling – excluding PFI/PPP non-recourse project finance	–	258	258	–	–
US Dollar	–	46	46	–	–
Other	–	41	41	–	–
	–	345	345	–	–
Borrowings					
Sterling – excluding PFI/PPP non-recourse project finance	1	29	30	5.0	0.7
Sterling – PFI/PPP non-recourse project finance	14	–	14	5.0	11.7
	15	29	44	5.0	10.9
Net (borrowings)/cash	(15)	316	301		

The maturity profile of the Group's borrowings at 31 December was as follows:

	PFI/PPP non-recourse project finance 2006 £m	Other 2006 £m	Total 2006 £m	PFI/PPP non-recourse project finance 2005 £m	Other 2005 £m	Total 2005 £m
Due on demand or within one year	–	17	17	–	30	30
Due within one to two years	3	1	4	–	–	–
Due within two to five years	3	–	3	3	–	3
Due after more than five years	15	–	15	11	–	11
	21	18	39	14	30	44

The Group's undrawn committed borrowing facilities in respect of which all conditions precedent were satisfied at 31 December were:

	PFI/PPP non-recourse project finance 2006 £m	Other 2006 £m	Total 2006 £m	PFI/PPP non-recourse project finance 2005 £m	Other 2005 £m	Total 2005 £m
Expiring in one year or less	–	–	–	–	–	–
Expiring in more than one year but not more than two years	–	–	–	–	–	–
Expiring in more than two years	33	396	429	42	484	526
	33	396	429	42	484	526

The table below compares the book values and the fair values of the Group's borrowings at 31 December:

	Book value 2006 £m	Fair value 2006 £m	Book value 2005 £m	Fair value 2005 £m
Unsecured borrowings				
– bank overdrafts	15	15	29	29
– other short-term loans	1	1	–	–
Secured borrowings				
– finance leases	1	1	1	1
– other	1	1	–	–
	18	18	30	30
PFI/PPP non-recourse term loans				
– sterling floating rate term loan (2008–2027)	17	17	13	13
– sterling floating rate term loan (2011–2030)	4	4	1	1
	21	21	14	14
Borrowings	39	39	44	44

The fair values have been determined by using yield curves and exchange rates prevailing at the balance sheet date and discounting future cash flows at interest rates prevailing at the balance sheet date.

23 Cash and cash equivalents and borrowings continued

23.2 Company

	Current 2006 £m	Non-current 2006 £m	Total 2006 £m	Current 2005 £m	Non-current 2005 £m	Total 2005 £m
Unsecured borrowings						
– bank overdrafts	**(13)**	**–**	**(13)**	(12)	–	(12)
	(13)	**–**	**(13)**	(12)	–	(12)
Term deposits	**167**	**–**	**167**	142	–	142
Net cash	**154**	**–**	**154**	130	–	130

The unsecured borrowings and term deposits are sterling denominated and variable rate instruments. No interest rate risk is attributable to these. The bank overdrafts are repayable on demand and the term deposits have a range of maturities but are no longer than one month.

24 Deferred taxation

24.1 Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities. The net deferred tax position at 31 December was:

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Deferred tax assets	**102**	83	**–**	1
Deferred tax liabilities	**(5)**	(3)	**–**	–
	97	80	**–**	1

The movement for the year in the net deferred tax position was as follows:

	Group £m	Company £m
At 1 January 2005	62	1
Charged to income statement	(10)	(1)
Credited to equity	10	1
Businesses sold	18	–
At 31 December 2005	80	1
Charged to income statement	**(12)**	**(2)**
(Charged)/credited to equity	**(7)**	**1**
Businesses acquired	**36**	**–**
At 31 December 2006	**97**	**–**

24.2 Group
The following are the major deferred tax assets and liabilities recognised and the movements thereon during the year:

Deferred tax assets	Accelerated tax depreciation £m	Retirement benefit obligations £m	Unrelieved trading losses £m	Share-based payments £m	Provisions £m	Total £m
At 1 January 2005	3	70	2	6	12	93
(Charged)/credited to income statement	(3)	2	–	1	(4)	(4)
Credited to equity	–	4	–	–	–	4
Businesses sold	3	–	(2)	–	8	9
At 31 December 2005	3	76	–	7	16	102
(Charged)/credited to income statement	**(2)**	**–**	**–**	**1**	**(10)**	**(11)**
Charged to equity	**–**	**(8)**	**–**	**–**	**–**	**(8)**
Businesses acquired	**1**	**11**	**1**	**–**	**23**	**36**
At 31 December 2006	**2**	**79**	**1**	**8**	**29**	**119**

24 Deferred taxation continued

24.2 Group continued

Deferred tax liabilities	Revaluation of properties £m	Goodwill £m	Fair value adjustments £m	Undistributed earnings of joint ventures and associates £m	Preference shares £m	Total £m
At 1 January 2005	(1)	(2)	(13)	(5)	(10)	(31)
Charged to income statement	–	(4)	(1)	(1)	–	(6)
Credited to equity	–	–	5	–	1	6
Businesses sold	–	–	9	–	–	9
At 31 December 2005	(1)	(6)	–	(6)	(9)	(22)
Charged to income statement	**–**	**(1)**	**–**	**–**	**–**	**(1)**
Credited to equity	**–**	**–**	**–**	**–**	**1**	**1**
At 31 December 2006	**(1)**	**(7)**	**–**	**(6)**	**(8)**	**(22)**

Total net deferred tax asset	**97**

At the balance sheet date, the Group has unused tax losses that arose over a number of years of approximately £250m (2005: £260m) which are available for offset against future profits. No deferred tax has been recognised owing to the unpredictability of future profit streams. Of this total, £140m (2005: £160m) will expire 20 years after the year in which they arose, using losses incurred in earlier years before those incurred in later years, with the first expiry in 2019. The remaining losses may be carried forward indefinitely.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed reserves of subsidiaries for which deferred tax liabilities have not been recognised is £130m (2005: £130m) and for joint ventures and associates is £11m (2005: £nil). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

24.3 Company

The following represents the major deferred tax assets and liabilities recognised by the Company and the movement thereon during the year:

	Deferred tax liability	Deferred tax assets					
	Preference shares £m	Fair value adjustments £m	Share-based payments £m	Retirement benefit obligations £m	Provisions £m	Total £m	Net deferred tax asset £m
At 1 January 2005	(10)	1	6	2	2	11	1
Charged to income statement	–	(1)	1	–	(1)	(1)	(1)
Credited to equity	1	–	–	–	–	–	1
At 31 December 2005	(9)	–	7	2	1	10	1
(Charged)/credited to income statement	**–**	**–**	**(3)**	**1**	**–**	**(2)**	**(2)**
Credited to equity	**1**	**–**	**–**	**–**	**–**	**–**	**1**
At 31 December 2006	**(8)**	**–**	**4**	**3**	**1**	**8**	**–**

Notes to the accounts (continued)

25 Retirement benefit obligations

a) Group

The Group, through trustees, operates a number of pension schemes, the majority of which are of the defined benefit type and are funded. Contributions are determined in accordance with independent actuarial advice. Details of the IAS 19 valuations are set out in 25.1 below. Details of the last actuarial valuations and reviews and the assumptions used by the actuaries are set out in 25.2 below.

25.1 IAS 19 valuations

The latest actuarial funding valuations of the Group's principal defined benefit schemes have been updated by the actuaries to 31 December 2006 on the basis prescribed by IAS 19. In particular, scheme liabilities have been discounted using the rate of return on a high quality corporate bond rather than the expected rate of return on the assets in the scheme used in the funding valuations.

Other than the mortality assumptions set out in 25.2, the principal actuarial assumptions used were as follows:

	Balfour Beatty Pension Fund 2006 %	Railways Pension Scheme 2006 %	Mansell schemes 2006 %	Birse scheme 2006 %	Balfour Beatty Pension Fund 2005 %	Railways Pension Scheme 2005 %	Mansell schemes 2005 %
Inflation rate	**3.10**	**3.10**	**3.10**	**3.10**	2.80	2.80	2.80
Discount rate	**5.15**	**5.15**	**5.15**	**5.15**	4.75	4.75	4.75
Future salary increases	**4.60**	**4.60**	**4.60**	**4.60**	4.30	4.30	4.30
Future pension increases	**3.10**	**3.10**	**3.10**	**3.10**	2.80	2.80	2.80
Expected return on plan assets	**6.35**	**7.30**	**6.79**	**7.36**	5.98	7.00	6.60

The amounts recognised in the balance sheet are determined as follows:

	Balfour Beatty Pension Fund 2006 £m	Railways Pension Scheme 2006 £m	Mansell schemes 2006 £m	Birse scheme 2006 £m	Other schemes 2006 £m	Total 2006 £m	Balfour Beatty Pension Fund 2005 £m	Railways Pension Scheme 2005 £m	Mansell schemes 2005 £m	Other schemes 2005 £m	Total 2005 £m
Present value of funded obligations	**(1,876)**	**(158)**	**(210)**	**(94)**	**(11)**	**(2,349)**	(1,806)	(159)	(212)	(14)	(2,191)
Fair value of plan assets	**1,688**	**150**	**177**	**62**	**10**	**2,087**	1,629	136	160	12	1,937
Deficit	**(188)**	**(8)**	**(33)**	**(32)**	**(1)**	**(262)**	(177)	(23)	(52)	(2)	(254)
Present value of unfunded obligations	**–**	**–**	**–**	**–**	**(26)**	**(26)**	–	–	–	(26)	(26)
Liability in the balance sheet	**(188)**	**(8)**	**(33)**	**(32)**	**(27)**	**(288)**	(177)	(23)	(52)	(28)	(280)

Other schemes comprise funded and unfunded post-retirement defined benefit obligations in Europe and North America, the majority of which arrangements are closed to new entrants.

The amounts recognised in the income statement are as follows:

	Balfour Beatty Pension Fund 2006 £m	Railways Pension Scheme 2006 £m	Mansell schemes 2006 £m	Birse scheme 2006 £m	Other schemes 2006 £m	Total 2006 £m	Balfour Beatty Pension Fund 2005 £m	Railways Pension Scheme 2005 £m	Mansell schemes 2005 £m	Other schemes 2005 £m	Total 2005 £m
Current service cost	**(44)**	**(3)**	**(3)**	**(1)**	**(1)**	**(52)**	(37)	(3)	(3)	(1)	(44)
Interest cost	**(84)**	**(6)**	**(10)**	**(2)**	**(2)**	**(104)**	(85)	(6)	(10)	(2)	(103)
Expected return on plan assets	**96**	**8**	**10**	**2**	**1**	**117**	89	8	9	1	107
	(32)	**(1)**	**(3)**	**(1)**	**(2)**	**(39)**	(33)	(1)	(4)	(2)	(40)
Defined contribution charge	**(7)**	**–**	**–**	**–**	**(6)**	**(13)**	(4)	–	–	(5)	(9)
Total included in employee costs (Note 5)	**(39)**	**(1)**	**(3)**	**(1)**	**(8)**	**(52)**	(37)	(1)	(4)	(7)	(49)

The Balfour Beatty Pension Fund includes a defined contribution section. Employer contributions paid and charged in the income statement have been separately identified in the above table and the defined contribution section assets and liabilities amounting to £25m (2005: £13m) have been excluded from the tables below.

Pension expense, net of expected return on plan assets, is charged to contracts or overheads based on the function of scheme members and is included in cost of sales, net operating expenses and amounts due to or from customers. Actuarial gains and losses have been reported in the statement of recognised income and expense. The actual return on plan assets was £138m (2005: £245m).

25 Retirement benefit obligations continued

25.1 IAS 19 valuations continued

The movement in the present value of obligations is as follows:

	Balfour Beatty Pension Fund 2006 £m	Railways Pension Scheme 2006 £m	Mansell schemes 2006 £m	Birse scheme 2006 £m	Other schemes 2006 £m	Total 2006 £m	Balfour Beatty Pension Fund 2005 £m	Railways Pension Scheme 2005 £m	Mansell schemes 2005 £m	Other schemes 2005 £m	Total 2005 £m
At 1 January	**(1,806)**	**(159)**	**(212)**	**–**	**(40)**	**(2,217)**	(1,633)	(125)	(190)	(36)	(1,984)
Exchange adjustments	**–**	**–**	**–**	**–**	**3**	**3**	–	–	–	–	–
Service cost	**(44)**	**(3)**	**(3)**	**(1)**	**(1)**	**(52)**	(37)	(3)	(3)	(1)	(44)
Interest cost	**(84)**	**(6)**	**(10)**	**(2)**	**(2)**	**(104)**	(85)	(6)	(10)	(2)	(103)
Actuarial gains and losses	**(10)**	**5**	**11**	**(1)**	**–**	**5**	(117)	(25)	(13)	(4)	(159)
Contributions from members	**(10)**	**–**	**(2)**	**(1)**	**–**	**(13)**	(10)	–	(2)	–	(12)
Benefits paid	**78**	**5**	**6**	**1**	**3**	**93**	76	–	6	3	85
Businesses acquired	**–**	**–**	**–**	**(90)**	**–**	**(90)**	–	–	–	–	–
At 31 December	**(1,876)**	**(158)**	**(210)**	**(94)**	**(37)**	**(2,375)**	(1,806)	(159)	(212)	(40)	(2,217)

The movement in the fair value of plan assets is as follows:

	Balfour Beatty Pension Fund 2006 £m	Railways Pension Scheme 2006 £m	Mansell schemes 2006 £m	Birse scheme 2006 £m	Other schemes 2006 £m	Total 2006 £m	Balfour Beatty Pension Fund 2005 £m	Railways Pension Scheme 2005 £m	Mansell schemes 2005 £m	Other schemes 2005 £m	Total 2005 £m
At 1 January	**1,629**	**136**	**160**	**–**	**12**	**1,937**	1,474	111	133	12	1,730
Exchange adjustments	**–**	**–**	**–**	**–**	**(1)**	**(1)**	–	–	–	–	–
Expected return on plan assets	**96**	**8**	**10**	**2**	**1**	**117**	89	8	9	1	107
Actuarial gains and losses	**7**	**9**	**2**	**4**	**(1)**	**21**	107	16	15	–	138
Contributions from employer	**24**	**2**	**9**	**1**	**–**	**36**	25	1	7	–	33
Contributions from members	**10**	**–**	**2**	**1**	**–**	**13**	10	–	2	–	12
Benefits paid	**(78)**	**(5)**	**(6)**	**(1)**	**(1)**	**(91)**	(76)	–	(6)	(1)	(83)
Businesses acquired	**–**	**–**	**–**	**55**	**–**	**55**	–	–	–	–	–
At 31 December	**1,688**	**150**	**177**	**62**	**10**	**2,087**	1,629	136	160	12	1,937

The fair value of and expected rate of return on the assets held by the schemes at 31 December are as follows:

	Balfour Beatty Pension Fund		**Railways Pension Scheme**		**Mansell schemes**		**Birse scheme**		**Other schemes**	
	Expected rate of return 2006 %	**Value 2006 £m**	**Expected rate of return 2006 %**	**Value 2006 £m**	**Expected rate of return 2006 %**	**Value 2006 £m**	**Expected rate of return 2006 %**	**Value 2006 £m**	**Expected rate of return 2006 %**	**Value 2006 £m**
Equities	**8.15**	**717**	**8.15**	**100**	**8.15**	**106**	**8.15**	**45**	**–**	**–**
Bonds	**5.05**	**946**	**5.15**	**35**	**4.80**	**69**	**5.15**	**10**	**4.55**	**10**
Property	**–**	**–**	**6.35**	**15**	**–**	**–**	**6.35**	**3**	**–**	**–**
Cash and other net current assets	**4.10**	**25**	**4.10**	**–**	**4.10**	**2**	**4.10**	**4**	**–**	**–**
Rate of return/total	**6.35**	**1,688**	**7.30**	**150**	**6.79**	**177**	**7.36**	**62**	**4.55**	**10**

	Balfour Beatty Pension Fund		Railways Pension Scheme		Mansell schemes		Other schemes	
	Expected rate of return 2005 %	Value 2005 £m	Expected rate of return 2005 %	Value 2005 £m	Expected rate of return 2005 %	Value 2005 £m	Expected rate of return 2005 %	Value 2005 £m
Equities	8.1	670	8.1	91	8.1	95	–	–
Bonds	4.5	960	4.1	33	4.4	63	5.3	12
Property	–	–	6.1	12	–	–	–	–
Cash and other net current assets	3.8	(1)	–	–	3.8	2	–	–
Rate of return/total	5.98	1,629	7.0	136	6.6	160	5.3	12

25 Retirement benefit obligations continued

25.1 IAS 19 valuations continued

The expected rate of return on scheme assets assumption was determined as the average of the expected returns on the assets held by the scheme on 31 December. The rates of return for each class were determined as follows:

– equities and property: the rate adopted is consistent with the median assumption used in the actuary's asset modelling work as at 31 December.

– bonds: the overall rate has been set to reflect the yields available on the gilts and corporate bond holdings held at 31 December.

– cash and other net current assets: this class is mostly made up of cash holdings and the rate adopted reflects current short-term returns on such deposits.

The estimated amounts of contributions expected to be paid to the defined benefit schemes during 2007 is £41m. Contributions paid in 2006 for the principal schemes were £24m (2005: £25m) for the Balfour Beatty Pension Fund, £2m (2005: £1m) for the Railways Pension Scheme, £9m (2005: £7m) for the Mansell schemes and £1m for the Birse scheme.

The Railways Pension Scheme is a shared cost scheme. Accordingly the deficit shown above assumes that the Group will obtain economic benefit from, or be required to finance, only a proportion of the surplus or deficit in the Balfour Beatty section of the scheme. This proportion has been based on the apportionment of the surplus which has already been agreed together with the relevant provisions of the Trust Deed and Rules and Trustee guidelines regarding future surplus apportionments and deficit financing.

Year end historic information for the Group's post-retirement benefit plans is:

	2006 £m	2005 £m	2004 £m
Defined benefit obligation at end of year	**(2,375)**	(2,217)	(1,984)
Fair value of assets at end of year	**2,087**	1,937	1,730
Funded status at end of year	**(288)**	(280)	(254)
Experience adjustment for liabilities	**(52)**	24	(59)
Experience adjustment for assets	**21**	138	52

25.2 Funding valuations

The last formal valuation of the Balfour Beatty Pension Fund (BBPF) was carried out by the actuary at 31 March 2004 using the projected unit method and disclosed an excess of assets over past service liabilities of 1.7%. Due to the size of the membership of the BBPF (38,062 members at 31 December 2006) the scheme's actuary undertakes regular mortality investigations based on the experience exhibited by pensioners of the BBPF and is able to make statistically credible comparisons of this experience with the mortality rates set out in the various published mortality tables. The actuary is also able to monitor changes in the exhibited mortality over time. As a result of these reviews the Group is able to adopt with a measure of confidence consistent mortality assumptions for its IAS 19 valuations across its various defined benefit schemes.

The mortality tables adopted for these valuations and that of the BBPF's 2004 formal valuation are the 1992 series CMI tables as shown below:

	Mortality table (1992) series	With average life expectancy at 65 years of age
Members in receipt of a pension		
– Male	PMA92c04	+18.4 years
– Female	PFA92c04	+21.3 years
Members not yet in receipt of a pension		
– Male	PMA92c22	+20.0 years
– Female	PFA92c22	+22.9 years

Certain Group employees are members of the Balfour Beatty Shared Cost section of the Railways Pension Scheme ("Railways Pension Scheme"). The last formal valuation of this defined benefit scheme was carried out by independent actuaries at 31 December 2004 using the projected unit method and disclosed that the market value of the scheme's assets represented 92.4% of the benefits of which, being a shared cost scheme, the economic cost to the Group is circa 60% as represented in the scheme's assets and liabilities shown below. This proportion has been based on the apportionment of the surplus which has already been agreed together with the relevant provisions of the Trust Deed and Rules and Trustee guidelines regarding future surplus apportionments.

Mansell plc operates two funded defined benefit schemes, the Mansell plc Pension Scheme and the Hall & Tawse Retirement Benefit Plan ("Mansell schemes"). The most recent actuarial valuation of the Mansell plc Pension Scheme, which was closed to new members from 31 December 2001, was carried out by independent actuaries at 31 July 2005 using the projected unit method. The valuation showed that the market value of the scheme's assets represented 78.0% of the benefits that had accrued to members on an ongoing funding basis. The most recent actuarial valuation of the Hall & Tawse Retirement Benefit Plan, which was closed to new members from 1 July 1998, was carried out by independent actuaries at 31 March 2005 using the projected unit method. The valuation showed that the market value of the scheme's assets represented 79.0% of the benefits that had accrued to members on an ongoing funding basis.

The most recent actuarial valuation of the Birse Group Retirement Benefit Scheme ("Birse scheme") was carried out by independent actuaries at 5 April 2004 using the projected unit method. The valuation showed that the market value of the scheme's assets represented 65.5% of the benefits that had accrued to members on an ongoing funding basis.

25 Retirement benefit obligations continued

25.2 Funding valuations continued

The Group's actuaries have reviewed the funding valuations of the Balfour Beatty Pension Fund, the Railways Pension Scheme, the Mansell schemes and the Birse scheme at 31 December 2006. The results of these reviews along with the assumptions used by the actuaries are set out below together with comparatives at 31 December 2005.

	At the last formal actuarial funding valuation					**At 31 December 2006 valuation review**				At 31 December 2005 valuation review		
			Mansell schemes									
	Balfour Beatty Pension Fund 31/3/2004 %	Railways Pension Scheme 31/12/2004 %	H&T Plan 31/3/2005 %	Mansell plc Scheme 31/7/2005 %	Birse scheme 5/4/2004 %	**Balfour Beatty Pension Fund %**	**Railways Pension Scheme %**	**Mansell schemes %**	**Birse scheme %**	Balfour Beatty Pension Fund %	Railways Pension Scheme %	Mansell schemes %
Principal actuarial valuation assumptions:												
Inflation assumption	2.7	2.8	2.9	2.8	3.0	**3.1**	**3.1**	**3.1**	**3.1**	2.8	2.8	2.8
Rate of increase in salaries	4.2	4.3	4.4	4.3	4.5	**4.6**	**4.6**	**4.6**	**4.6**	4.3	4.3	4.3
Rate of increase in pensions in payment (or such other fixed rate as is guaranteed)	2.7	2.8	2.9	3.0	2.8	**3.1**	**3.1**	**3.1**	**3.1**	2.8	2.8	2.8
Return on existing investments:												
– active and deferred members												
– pre-retirement	8.1	6.8	6.6	6.4	6.5	**7.75**	**7.75**	**7.75**	**7.75**	7.7	7.7	7.7
– post-retirement	5.6	6.8	5.0	4.7	5.25	**5.4**	**5.4**	**5.4**	**5.4**	5.0	5.0	5.0
– pensioners, widows and dependants	5.1	4.8	5.0	4.7	5.25	**4.9**	**4.9**	**4.9**	**4.9**	4.5	4.5	4.5
Number of members:												
Defined benefit												
Active members	8,465	590	225	414	816	**5,178**	**532**	**559**	**685**	5,660	627	604
Deferred pensioners	11,540	1,776	1,001	610	1,061	**12,113**	**1,651**	**1,558**	**1,306**	12,104	1,624	1,607
Pensioners, widows and dependants	16,989	1,018	980	181	54	**16,652**	**1,139**	**1,244**	**95**	17,293	1,091	1,186
Defined contribution	1,196	–	–	–	–	**4,119**	**–**	**–**	**–**	2,776	–	–
Total	38,190	3,384	2,206	1,205	1,931	**38,062**	**3,322**	**3,361**	**2,086**	37,833	3,342	3,397

	£m	£m	£m	£m	£m	**£m**	**£m**	**£m**	**£m**	£m	£m	£m
Scheme surplus/(deficit):												
Market value of assets	1,396	120	90	51	38	**1,689**	**150**	**177**	**63**	1,630	136	160
Present value of scheme liabilities	(1,372)	(130)	(113)	(65)	(58)	**(1,671)**	**(140)**	**(171)**	**(64)**	(1,583)	(137)	(169)
Surplus/(deficit) in scheme	24	(10)	(23)	(14)	(20)	**18**	**10**	**6**	**(1)**	47	(1)	(9)
Funding level	101.7%	92.4%	79.0%	78.0%	65.5%	**101.0%**	**107.1%**	**103.3%**	**98.1%**	103.0%	99.0%	94.7%

b) Company

Certain employees of the Company are members of the Balfour Beatty Pension Fund. Assets, liabilities, income and expenditure relating to this fund are allocated to Group companies participating in the scheme in proportion to pensionable payroll for the year. The Company's share of the net IAS 19 deficit was £8m (2005: £8m).

26 Provisions

	Group				Company
	Employee provisions £m	Contract provisions £m	Other provisions £m	Group total £m	Other provisions £m
At 1 January 2006	**23**	**34**	**52**	**109**	**9**
Exchange adjustments	**–**	**–**	**(1)**	**(1)**	**–**
Charged/(credited) to the income statement					
– additional provisions	**3**	**23**	**9**	**35**	**–**
– unused amounts reversed	**–**	**(13)**	**(10)**	**(23)**	**–**
Used during the year	**(4)**	**(6)**	**(14)**	**(24)**	**–**
Businesses acquired	**2**	**8**	**3**	**13**	**–**
At 31 December 2006	**24**	**46**	**39**	**109**	**9**

Employee provisions comprise obligations to employees other than retirement or post-retirement obligations. Contract provisions relate to provisions on contracts, including fault and warranty provisions, and other provisions principally comprise environmental, lease, legal claims and costs and other onerous commitments. The majority of provisions, other than employee provisions, are expected to be utilised within five years. Provision is made for the Directors' best estimate of known legal claims, investigations and legal actions in progress.

27 Share capital

27.1 Ordinary shares of 50p each

	Authorised		Issued	
	Million	£m	Million	£m
At 1 January 2005	696	348	424	212
Shares issued	–	–	3	2
At 31 December 2005	696	348	427	214
Shares issued	**–**	**–**	**3**	**1**
At 31 December 2006	**696**	**348**	**430**	**215**

All issued ordinary shares are fully paid.

Ordinary shares issued during the year credited as fully paid:

	Ordinary shares 2006 Number	Cash consideration 2006 £m	Ordinary shares 2005 Number	Cash consideration 2005 £m
Savings-related share options exercised	**1,375,582**	**2**	1,814,611	2
Executive share options exercised	**1,999,231**	**4**	1,442,708	4
	3,374,813	**6**	3,257,319	6

27 Share capital continued

27.1 Ordinary shares of 50p each continued

At 31 December, share options outstanding were as follows:

Year of issue	Exercise price Pence	Normally exercisable in periods to	**Ordinary shares 2006 Number**	Ordinary shares 2005 Number
Savings-related				
2000	76.0	January 2006	**–**	51,582
2001	154.0	March 2007	**71,311**	762,994
2002	184.0	December 2007	**638,886**	687,961
2003	133.0	December 2008	**695,251**	1,431,154
2004	210.0	December 2009	**1,535,671**	1,700,912
2005	250.0	December 2010	**1,760,100**	1,914,410
2006	305.0	December 2011	**1,963,095**	–
			6,664,314	6,549,013
Executive				
1996	344.2	April 2006	**–**	459,181
1997	231.0	May 2007	**130,000**	219,000
1998	181.0	May 2008	**69,000**	120,000
1999	110.0	November 2009	**135,618**	192,318
2000	79.0	April 2010	**206,772**	256,772
2001	200.0	June 2011	**292,425**	445,825
2002	238.0	April 2012	**453,000**	762,395
2003	146.0	January 2013	**–**	100,000
2003	173.0	April 2013	**682,866**	1,622,000
2004	261.0	April 2014	**1,659,506**	1,700,506
2004	268.0	September 2014	**55,970**	55,970
			3,685,157	5,933,967

On 3 May 2006, options were granted over 2,001,414 ordinary shares under the Balfour Beatty savings-related share option scheme, at 305p per share, and these are normally exercisable in the periods from July 2009 to December 2009 and from July 2011 to December 2011 depending upon the length of savings contract chosen by the participant.

27 Share capital continued

27.2 Cumulative convertible redeemable preference shares of 1p each

	Authorised		Issued	
	Million	£m	Million	£m
At 1 January 2005	177	2	136	–
Shares repurchased	–	–	(7)	–
At 31 December 2005	177	2	129	–
Shares repurchased	**–**	**–**	**(12)**	**–**
At 31 December 2006	**177**	**2**	**117**	**–**

All issued preference shares are fully paid. During the year, 12,012,640 preference shares (2005: 6,837,500) were repurchased for cancellation by the Company for a total consideration of £18,836,111 (2005: £10,722,218) at an average price of 156.8p (2005: 156.8p).

Holders of preference shares are entitled to a preferential dividend equivalent to a gross payment of 10.75p per preference share per annum, payable half-yearly. Any preference shares still outstanding are redeemable on 1 July 2020 at £1 each, together with any arrears or accruals of dividend, unless the holder exercises any option granted by the Company to extend the redemption date. The maximum redemption value of all of the issued and outstanding preference shares, excluding any arrears or accruals of dividend, was £117m at 31 December 2006 (2005: £129m).

At the option of the holder, preference shares are convertible on the first day of the next calendar month following receipt of the conversion notice into new Balfour Beatty plc ordinary shares effectively on the basis of 21.05263 ordinary shares for every 100 preference shares, subject to adjustment in certain circumstances. The Company is entitled to convert all outstanding preference shares into ordinary shares if there are fewer than 44,281,239 preference shares in issue or if the average of the closing mid-market price for a Balfour Beatty plc ordinary share during a 30 day period exceeds 950p, subject to adjustment in certain circumstances.

The preference shares carry no voting rights at a general meeting of the Company, except where the dividend is six months or more in arrears, or where the business of the meeting includes a resolution which directly affects the rights and privileges attached to the preference shares or a resolution for the winding-up of the Company. On a winding-up of the Company, holders are entitled to receive the sum of £1 per preference share, together with any arrears or accruals of dividend, in priority to any payment on any other class of shares.

The preference shares are regarded as a compound instrument, consisting of an equity and a liability component. The fair value of the liability component at the date of issue, included under non-current liabilities, was estimated using the prevailing market interest rate of 13.5% for a similar non-convertible instrument. The difference between the proceeds of issue of the preference shares and the fair value assigned to the liability component, representing the value of the equity conversion component, is included in shareholders' equity, net of deferred tax.

The liability component recognised on the balance sheet is calculated as follows:

	2006 £m	2005 £m
Redemption value of shares in issue at 1 January	**129**	136
Equity component	**(18)**	(19)
Deferred tax and interest element	**(13)**	(14)
Liability component at 1 January	**98**	103
Buy-back of preference shares	**(8)**	(5)
Liability component at 31 December	**90**	98

The fair value of the liability component of the preference shares at 31 December 2006 amounted to £90m (2005: £98m). The fair value is calculated using the cash flows discounted at a rate based on the borrowings rate of 13.5%. Interest expense on the shares is calculated using the effective interest method.

28 Movements in equity

28.1 Group

	Called-up share capital £m	Share premium account £m	Equity component of preference shares £m	Special reserve £m	Share of joint ventures' and associates' reserves £m	Other reserves: Hedging reserves £m	Other reserves: PFI/PPP financial assets £m	Other reserves: Currency translation reserves £m	Other reserves: Other £m	Accumulated losses £m	Total £m
At 1 January 2005	212	15	19	181	86	(6)	26	–	9	(315)	227
Net profit for the year	–	–	–	–	73	–	–	–	–	33	106
Actuarial gains/(losses) on retirement benefit obligations	–	–	–	–	7	–	–	–	–	(21)	(14)
PFI/PPP cash flow hedges:											
– net fair value (losses)/gains	–	–	–	–	(20)	3	–	–	–	–	(17)
– reclassified and reported in net profit	–	–	–	–	–	1	–	–	–	–	1
PFI/PPP financial assets:											
– fair value revaluation	–	–	–	–	29	–	(19)	–	–	–	10
– reclassified and reported in net profit	–	–	–	–	–	–	(4)	–	–	–	(4)
Changes in fair value of net investment hedges	–	–	–	–	–	–	–	(6)	–	–	(6)
Currency translation differences	–	–	–	–	5	–	–	3	–	–	8
Tax on items taken directly to equity	–	–	1	–	(6)	–	5	1	–	8	9
Total recognised income for the year	–	–	1	–	88	4	(18)	(2)	–	20	93
Ordinary dividends	–	–	–	–	–	–	–	–	–	(31)	(31)
Joint ventures' and associates' dividends	–	–	–	–	(12)	–	–	–	–	12	–
Issue of ordinary shares	2	4	–	–	–	–	–	–	–	–	6
Buy-back of preference shares	–	7	(2)	–	–	–	–	–	–	(8)	(3)
Movements relating to share-based payments	–	–	–	–	–	–	–	–	(2)	2	–
Transfers	–	–	–	(6)	20	2	(8)	–	–	(8)	–
At 31 December 2005	214	26	18	175	182	–	–	(2)	7	(328)	292
Net profit for the year	**–**	**–**	**–**	**–**	**63**	**–**	**–**	**–**	**–**	**28**	**91**
Actuarial gains on retirement benefit obligations	**–**	**–**	**–**	**–**	**10**	**–**	**–**	**–**	**–**	**26**	**36**
PFI/PPP cash flow hedges:											
– net fair value gains	**–**	**–**	**–**	**–**	**32**	**–**	**–**	**–**	**–**	**–**	**32**
PFI/PPP financial assets:											
– fair value revaluation	**–**	**–**	**–**	**–**	**(2)**	**–**	**–**	**–**	**–**	**–**	**(2)**
Changes in fair value of net investment hedges	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**14**	**–**	**–**	**14**
Currency translation differences	**–**	**–**	**–**	**–**	**(7)**	**–**	**–**	**(10)**	**–**	**–**	**(17)**
Tax on items taken directly to equity	**–**	**–**	**1**	**–**	**(11)**	**–**	**–**	**(8)**	**–**	**(8)**	**(26)**
Total recognised income for the year	**–**	**–**	**1**	**–**	**85**	**–**	**–**	**(4)**	**–**	**46**	**128**
Ordinary dividends	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(37)**	**(37)**
Joint ventures' and associates' dividends	**–**	**–**	**–**	**–**	**(24)**	**–**	**–**	**–**	**–**	**24**	**–**
Issue of ordinary shares	**1**	**5**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**6**
Buy-back of preference shares	**–**	**12**	**(3)**	**–**	**–**	**–**	**–**	**–**	**–**	**(12)**	**(3)**
Movements relating to share-based payments	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2**	**(1)**	**1**
Transfers	**–**	**–**	**–**	**(6)**	**–**	**–**	**–**	**–**	**2**	**4**	**–**
At 31 December 2006	**215**	**43**	**16**	**169**	**243**	**–**	**–**	**(6)**	**11**	**(304)**	**387**

Our accounts

28 Movements in equity continued

28.2 Company

	Called-up share capital £m	Share premium account £m	Equity component of preference shares £m	Special reserve £m	Other reserves £m	Accumulated profits £m	Total £m
At 1 January 2005	212	15	19	181	50	101	578
Net profit for the year	–	–	–	–	–	43	43
Actuarial losses on retirement benefit obligations	–	–	–	–	–	(1)	(1)
Ordinary dividends	–	–	–	–	–	(31)	(31)
Issue of ordinary shares	2	4	–	–	–	–	6
Buy-back of preference shares	–	7	(2)	–	–	(8)	(3)
Movements relating to share-based payments	–	–	–	–	(1)	1	–
Tax on items taken directly to equity	–	–	1	–	–	–	1
Transfers	–	–	–	(6)	–	6	–
At 31 December 2005	214	26	18	175	49	111	593
Net profit for the year	**–**	**–**	**–**	**–**	**–**	**59**	**59**
Actuarial gain on retirement benefit obligations	**–**	**–**	**–**	**–**	**–**	**1**	**1**
Ordinary dividends	**–**	**–**	**–**	**–**	**–**	**(37)**	**(37)**
Issue of ordinary shares	**1**	**5**	**–**	**–**	**–**	**–**	**6**
Buy-back of preference shares	**–**	**12**	**(3)**	**–**	**–**	**(12)**	**(3)**
Movements relating to share-based payments	**–**	**–**	**–**	**–**	**(3)**	**(2)**	**(5)**
Tax on items taken directly to equity	**–**	**–**	**1**	**–**	**–**	**–**	**1**
Transfers	**–**	**–**	**–**	**(6)**	**–**	**6**	**–**
At 31 December 2006	**215**	**43**	**16**	**169**	**46**	**126**	**615**

The accumulated profits of Balfour Beatty plc are wholly distributable.

By special resolution on 13 May 2004, confirmed by the court on 16 June 2004, the share premium account was reduced by £181m and the £4m capital reserve was cancelled, effective on 25 June 2004, and a special reserve of £185m was created. This reserve becomes distributable to the extent of future increases in share capital and share premium account, of which £6m occurred in 2006 (2005: £6m).

28.3 The accumulated losses in the Group and the accumulated profit of the Company are stated net of investments in Balfour Beatty plc ordinary shares of 50p each acquired by the Group's employee discretionary trust, the Balfour Beatty Employee Share Ownership Trust, to satisfy awards under the Balfour Beatty performance share plan and the Balfour Beatty deferred bonus plan. In 2006, 1.1m (2005: 1.1m) shares were purchased at a cost of £3.9m (2005: £3.5m). The market value of the 1.6m (2005: 1.5m) shares held by the Trust at 31 December 2006 was £7.1m (2005: £5.4m). Following confirmation of the performance criteria at the end of the performance period in the case of the performance share plan and at the end of the vesting period in the case of the deferred bonus plan, the appropriate number of shares will be unconditionally transferred to participants. In 2006, 1.0m shares were transferred to participants in relation to the April 2003 awards under the performance share plan (2005: 0.8m shares for the April 2002 awards). The trustees have waived the rights to dividends on shares held by the Trust. Other reserves in the Group include £3.2m relating to unvested performance share plan awards (2005: £2.8m), £4.8m relating to unvested share options (2005: £3.9m), and £0.3m (2005: £nil) relating to unvested deferred bonus plan awards.

29 Acquisitions

On 30 March 2006, the Group acquired 100% of the issued share capital of Edgar Allen Ltd, the UK rail track products manufacturer, for an initial consideration of £21.0m, before adjustment to reflect the value of the net assets acquired estimated at £7.3m, and costs of £0.7m. The provisional fair value of net assets acquired was £7.5m and goodwill arising was £6.9m, pending finalisation of the post-acquisition review of the fair value of the net assets. The goodwill recognised is attributable to the acquisition strengthening the Group's position in the design, manufacture and supply of track products.

On 31 March 2006, the Group acquired 100% of the issued share capital of Charter Builders Ltd, the US construction management company, for a consideration of £17.3m and costs of £0.8m. The provisional fair value of net assets acquired was £3.8m and goodwill arising was £14.3m, pending finalisation of the post-acquisition review of the fair value of the net assets. The goodwill recognised is attributable to the acquisition complementing the Group's US project and programme management business, with a particular strength in the education sector.

On 21 July 2006, the Group acquired 100% of the issued share capital of Birse Group plc, the UK regional civil engineering company, for a consideration of £32.1m and costs of £2.2m. The provisional fair value of net liabilities acquired was £110.9m (including intangible assets recognised of £9.2m) and provisional goodwill arising was £145.2m, pending finalisation of the post-acquisition review of the fair value of the net liabilities. The goodwill recognised is attributable to the acquisition strengthening the Group's regional presence in the UK civil engineering sector.

The provisional fair value of the net assets acquired, consideration paid and provisional goodwill arising on these transactions were:

	Birse Group plc			Others			Total		
	Book value of assets acquired £m	Fair value adjustments £m	Fair value of assets acquired £m	Book value of assets acquired £m	Fair value adjustments £m	Fair value of assets acquired £m	Book value of assets acquired £m	Fair value adjustments £m	Fair value of assets acquired £m
Net assets acquired:									
Intangible assets – other	–	9	9	–	1	1	–	10	10
Property, plant and equipment	11	–	11	2	–	2	13	–	13
Working capital	(11)	(87)	(98)	(6)	–	(6)	(17)	(87)	(104)
Retirement benefit obligations	2	(37)	(35)	–	–	–	2	(37)	(35)
Provisions	(1)	(7)	(8)	–	(5)	(5)	(1)	(12)	(13)
Current tax liabilities	–	–	–	(1)	–	(1)	(1)	–	(1)
Deferred taxation	3	33	36	–	–	–	3	33	36
Cash and cash equivalents	(24)	–	(24)	20	–	20	(4)	–	(4)
Borrowings	(2)	–	(2)	–	–	–	(2)	–	(2)
	(22)	(89)	(111)	15	(4)	11	(7)	(93)	(100)
Goodwill			145			22			167
			34			33			67
Satisfied by:									
Cash consideration			32			38			70
Costs incurred			2			2			4
			34			40			74
Deferred consideration			–			(7)			(7)
			34			33			67

In 2006, £2m deferred consideration was paid in respect of acquisitions completed in earlier years.

Birse Group plc earned revenues of £154m and a loss from continuing operations of £3m (after charging exceptional items of £3m and amortisation of intangible assets of £1m) in the period since acquisition. Other acquired businesses earned revenues of £97m and profits from continuing operations of £4m in the periods since acquisition.

The following summary presents the Group as if all of the businesses acquired during the year ended 31 December 2006 had been acquired on 1 January 2006. The amounts include the results of the acquired companies, depreciation and amortisation of the acquired fixed assets and intangible assets recognised on acquisition. The amounts do not include any possible synergies from the acquisition. The results of the acquired companies for the period before acquisition have not been adjusted to reflect Balfour Beatty accounting policies nor to reflect the fair value adjustments made on acquisition. The information is provided for comparative purposes only and does not necessarily reflect the actual results that would have occurred, nor is it necessarily indicative of future results of operations of the combined companies.

	£m
Group revenue	4,749
Profit from continuing operations for the year	91
Loss from discontinued operations for the year	(18)
Profit for the year attributable to equity shareholders	73

Loss from discontinued operations for the year arose in the accounts of Birse Group plc in relation to those divisions of its building business that were closed prior to acquisition by Balfour Beatty plc.

30 Share-based payments

30.1 The Company operates four equity-settled share-based payment arrangements, namely the savings-related share option scheme, the executive share option scheme, the performance share plan and the deferred bonus plan. The Group recognised total expenses related to equity-settled share-based payment transactions since 7 November 2002 of £4.4m in 2006 (2005: £3.3m).

30.2 Savings-related share options:
The Company operates an Inland Revenue approved savings-related share option scheme ("SAYE") under which employees are granted an option to purchase ordinary shares in the Company in either three or five years time, dependent upon their entering into a contract to make monthly contributions to a savings account over the relevant period. These savings are used to fund the option exercise. This scheme is open to all employees based in the UK and performance conditions are not applied to the exercise of SAYE options. Employees normally have a period of six months after completion of the savings contributions during which to exercise the SAYE options, failing which they lapse. Details of SAYE options granted during the year are shown in Note 27.1. The information in relation to SAYE options granted since 7 November 2002 was:

	SAYE options 2006 Number	Weighted average exercise price 2006 Pence	SAYE options 2005 Number	Weighted average exercise price 2005 Pence
Outstanding at 1 January	**5,046,476**	**203.3**	3,504,625	175.0
Granted during the year	**2,001,414**	**305.0**	1,983,110	250.0
Forfeited during the year	**(420,401)**	**215.5**	(413,624)	189.9
Exercised during the year	**(673,372)**	**137.0**	(27,635)	157.4
Expired during the year	**–**	**–**	–	–
Outstanding at 31 December	**5,954,117**	**244.2**	5,046,476	203.3
Exercisable at 31 December	**24,418**	**133.0**	–	

The weighted average share price at the date of exercise for those SAYE options exercised during the year was 354.1p (2005: 330.4p). Those SAYE options outstanding at 31 December 2006 had a weighted average remaining contractual life of 2.9 years (2005: 3.1 years).

The principal assumptions used by the consultants in the stochastic model for the SAYE options granted in 2006, including expected volatility determined from the historic weekly share price movements over the three year period immediately preceding the invitation date, were:

Invitation date	Exercise price Pence	Closing share price before invitation date Pence	Expected dividend yield %	Expected volatility of shares %	Expected term of options Years	Risk-free interest rate %	Calculated fair value of an option Pence
6 April 2006	**305.0**	**386.75**	**2.09**	**23.1**	**3.25**	**4.45**	**112.2**
6 April 2006	**305.0**	**386.75**	**2.09**	**23.1**	**5.25**	**4.45**	**125.7**

30 Share-based payments continued

30.3 Executive share options:
The Company has not granted any executive share options in 2006, but has previously operated the scheme under which employees are granted an option to purchase ordinary shares in the Company, which is exercisable between three and 10 years after the date of grant provided that any performance condition has been met. For the executive options granted since 7 November 2002, earnings per share before goodwill amortisation and exceptional items ("eps") for the last year of the minimum three year performance period must have grown from their respective fixed base eps by a total of at least 3% per annum plus the increase in RPI over the relevant period. The performance condition allows for re-testing from the fixed base eps after a four or five year performance period. The information in relation to executive options granted since 7 November 2002 was:

	Executive options 2006 Number	**Weighted average exercise price 2006 Pence**	Executive options 2005 Number	Weighted average exercise price 2005 Pence
Outstanding at 1 January	**3,478,476**	**216.8**	3,753,470	216.7
Granted during the year	**–**	**–**	–	–
Forfeited during the year	**(53,000)**	**227.8**	(263,500)	214.1
Exercised during the year	**(1,027,134)**	**171.1**	(11,494)	261.0
Expired during the year	**–**	**–**	–	–
Outstanding at 31 December	**2,398,342**	**236.1**	3,478,476	216.8
Exercisable at 31 December	**682,866**	**173.0**	–	

The weighted average share price at the date of exercise for those executive options exercised during the year was 386.5p (2005: 315.9p). Those executive options outstanding at 31 December 2006 had a weighted average remaining contractual life of 7.0 years (2005: 7.8 years).

30.4 Performance share plan awards:
The Company operates a performance share plan under which executive Directors and key senior employees are granted conditional awards of ordinary shares in the Company, which are exercisable within three months of the third anniversary of the date of award. These awards will only vest to the extent that performance targets are met over a three year performance period. On 13 June 2006 a maximum of 1,879,339 conditional shares were awarded which are normally exercisable in the period between June 2009 and September 2009. 50% of the 2006 award is based on an eps growth target: the maximum award of shares is made only where the Company's eps increases by at least RPI +45% in the relevant performance period; 25% of this element of the award is made where the Company's eps increases by RPI +15% over the period; if growth in eps is between RPI +15% and RPI +45%, the number of shares will be awarded pro rata to the growth in eps; and no shares from this element of the award can be awarded if growth in eps is less than RPI +15% over the period.

The other 50% of that 2006 award is based on total shareholder return (TSR) performance measured against a group of UK listed companies operating in comparable markets to the Company: the maximum award of shares is made only where the Company's TSR is in the upper quartile; 25% of this element of the award is made where the Company's TSR is at the median; if the Company's TSR is between the median and the upper quartile, the number of shares will be awarded pro rata; and no shares can be awarded if the Company's TSR is below median.

The information in relation to performance share awards granted since 7 November 2002 was:

	Conditional awards 2006 Number	Conditional awards 2005 Number
Outstanding at 1 January	**4,809,251**	3,766,120
Granted during the year	**1,879,339**	1,708,394
Forfeited during the year	**(129,572)**	(665,263)
Exercised during the year	**(972,450)**	–
Expired during the year	**(1,009,334)**	–
Outstanding at 31 December	**4,577,234**	4,809,251
Exercisable at 31 December	**–**	–

The weighted average share price at the date of exercise for those performance share awards exercised during the year was 365.0p (2005: n/a). Those performance share awards outstanding at 31 December 2006 had a weighted average remaining contractual life of 1.7 years (2005: 1.4 years).

The awards are satisfied by the transfer of shares for no consideration. For the 50% of the 2006 award which is subject to a performance test based on eps, the fair value of the award is the closing share price before the award date (307.75p). For the 50% of that 2006 award which is subject to a market condition based on TSR, the consultants have used a stochastic model, including expected volatility determined from the historic weekly share price movements over the three year period preceding the award date, with the following assumptions used:

Award date	**Closing share price before award date Pence**	**Expected volatility of shares %**	**Expected term of awards Years**	**Risk-free interest rate %**	**Calculated fair value of an award Pence**
6 April 2006	**307.75**	**23.7**	**3.0**	**4.66**	**103.1**

Our accounts

30 Share-based payments continued

30.5 Deferred bonus plan awards:
The Company introduced a deferred bonus plan in 2005 under which one-third of the annual bonus of executive Directors and key senior employees will be deferred in the form of ordinary shares in the Company, which will be released after three years, providing the individual is still in the Group's employment at that time. On 31 March 2006 a maximum of 352,831 conditional shares were awarded which will normally be released on 31 March 2009. On 3 July 2006 a further 4,650 conditional shares were awarded in lieu of entitlements to the final 2005 dividend and on 13 December 2006 a further 3,146 conditional shares were awarded in lieu of entitlements to the interim 2006 dividend. The information in relation to deferred bonus plan awards granted since 7 November 2002 was:

	Conditional awards 2006 Number	Conditional awards 2005 Number
Outstanding at 1 January	–	–
Awards granted during the year	352,831	–
Awards granted in lieu of dividends	7,796	–
Forfeited during the year	(2,501)	–
Exercised during the year	–	–
Expired during the year	–	–
Outstanding at 31 December	358,126	–
Exercisable at 31 December	–	–

Those deferred bonus plan awards outstanding at 31 December 2006 had a weighted average remaining contractual life of 2.75 years (2005: n/a).

As the awards are satisfied by the transfer of shares for no consideration, the fair values of those awards are the closing share price before award date, which was 375.0p, 343.5p and 432.25p for the awards made on 31 March 2006, 3 July 2006 and 13 December 2006 respectively.

31 Commitments

Capital expenditure authorised and contracted for which has not been provided for in the accounts amounted to £6m (2005: £5m) in the Group and at nil (2005: nil) in the Company.

The Company has committed to provide its share of further equity funding and subordinated debt of joint ventures and associates in PFI/PPP projects amounting to £75m (2005: £75m) and £5m (2005: £5m) in respect of PFI/PPP subsidiaries.

Details of acquisitions which were in progress at the year end and completed prior to the signing of the accounts are shown in Note 34.

The Group leases land and buildings, equipment and other various assets under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights. The lease expenditure charged to the income statement is disclosed under Note 4.1.

Future operating lease expense commitments comprise:

	Land and buildings 2006 £m	Other 2006 £m	Land and buildings 2005 £m	Other 2005 £m
Group				
Due within one year	23	25	23	24
Due between one and five years	67	43	63	43
Due after more than five years	45	–	44	–
	135	68	130	67
Company				
Due within one year	3	–	3	–
Due between one and five years	14	–	13	–
Due after more than five years	10	–	14	–
	27	–	30	–

Future operating lease income commitments comprise:

	Land and buildings 2006 £m	Plant 2006 £m	Land and buildings 2005 £m	Plant 2005 £m
Group				
Due within one year	4	2	3	3
Due between one and five years	2	1	5	1
	6	3	8	4
Company				
Due within one year	3	–	3	–
Due between one and five years	4	–	6	–
Due after more than five years	–	–	1	–
	7	–	10	–

32 Contingent liabilities

The Company and certain subsidiary undertakings have, in the normal course of business, given guarantees and entered into counter-indemnities in respect of bonds relating to the Group's own contracts and given guarantees in respect of the Group's share of certain contractual obligations of joint ventures and associates. Where the Company enters into such arrangements, it considers these to be insurance arrangements, and accounts for them as such. In this respect, guarantees are treated as contingent liabilities until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

Each shareholder of Trans4m Ltd has committed, under the shareholders agreement relevant to Trans4m Ltd, to ensure that Trans4m Ltd continues to be funded in order that it can meet its contractual obligations to Metronet Rail BCV Ltd and Metronet Rail SSL Ltd. The obligations of Balfour Beatty Group Ltd, which owns the Group's investment in Trans4m Ltd, are guaranteed by Balfour Beatty plc.

The Company has given limited indemnities up to a maximum of £11m to Halliburton Company and Brown & Root Ltd in respect of the performance of Devonport Management Ltd on certain construction contracts and a further limited guarantee in respect of operational contracts undertaken for the Ministry of Defence.

32 Contingent liabilities continued

Prior to 1999, the Group owned large cable manufacturing businesses, predominantly in Europe and North America. These businesses have subsequently been sold through a number of sale and purchase agreements. In common with many such agreements, the Group gave certain indemnities in respect of environmental and other matters which extend until 2007. The Group maintains provisions against all identified issues based on current available information and carries some insurance cover against further liabilities that may arise.

As stated in Note 26, provision has been made for the Directors' best estimate of the known legal claims and legal actions in progress. The Group takes legal advice as to the likelihood of success of claims and actions and no provision is made where the Directors consider, based on that advice, that the action is unlikely to succeed or a sufficiently reliable estimate of the potential obligation cannot be made.

33 Related party transactions

Joint ventures and associates:
The Group has contracted with, provided services to, and received management fees from, certain joint ventures and associates amounting to £733m (2005: £431m). These transactions occurred in the normal course of business at market rates and terms. In addition, the Group procured equipment and labour on behalf of certain joint ventures and associates which were recharged at cost with no mark-up. The amounts due to or from joint ventures and associates at 31 December are disclosed within trade and other receivables and trade and other payables in Notes 21 and 22 respectively.

Pension schemes:
The Group recharged the Balfour Beatty Pension Fund with the costs of administration and advisers' fees borne by the Group amounting to £3.1m in 2006 (2005: £3.0m).

Key personnel:
The remuneration of key personnel of Balfour Beatty plc was:

	2006 £m	2005 £m
Short-term benefits	**4.324**	3.771
Post employment benefits	**0.640**	1.553
Termination benefits	**0.453**	–
Share-based payments	**1.111**	0.678
	6.528	6.002

Key personnel comprise the Board and five Group managing directors (2005: three) who are directly responsible for the Group's operating companies. The remuneration included above is that paid in respect of the period of the year during which the individuals were Directors and Group managing directors. Further details of Directors' emoluments, pension benefits and interests are set out in the Remuneration report on pages 54 to 60.

34 Post balance sheet events

On 5 January 2007, the Group acquired Exeter and Devon Airport Ltd for a cash consideration of £60m.

On 1 February 2007, the Group agreed to acquire Centex Construction, a leading US building company, from Centex Corporation for a cash consideration of approximately US$362m.

35 Notes to the cash flow statement

35.1 Cash generated from operations comprises:

	Group 2006 £m	Group 2005 £m	**Company 2006 £m**	Company 2005 £m
Profit from operations	**124**	131	**88**	61
Share of results of joint ventures and associates	**(63)**	(73)	**–**	–
Dividends received	**–**	–	**(93)**	(63)
Depreciation of property, plant and equipment	**43**	41	**–**	–
Amortisation of other intangible assets	**1**	–	**–**	–
Impairment charges	**16**	12	**–**	–
Movements relating to share-based payments	**4**	3	**(2)**	3
Profit on disposal of property, plant and equipment	**(1)**	(2)	**–**	–
Profit on disposal of businesses	**–**	(6)	**–**	–
Profit on disposal of investment	**–**	–	**–**	(7)
Operating cash flows before movements in working capital	**124**	106	**(7)**	(6)
Decrease in working capital	**93**	61	**17**	3
Cash generated from operations	**217**	167	**10**	(3)

35.2 Cash and cash equivalents comprise:

	Group 2006 £m	Group 2005 £m	**Company 2006 £m**	Company 2005 £m
Cash and deposits	**142**	146	**–**	–
Term deposits	**181**	199	**167**	142
Bank overdrafts	**(15)**	(29)	**(13)**	(12)
	308	316	**154**	130

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of less than three months and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities within the balance sheet.

35.3 Analysis of movement in net cash:

	Group 2006 £m	Group 2005 £m	**Company 2006 £m**	Company 2005 £m
Opening net cash	**301**	67	**130**	193
Net (decrease)/increase in cash and cash equivalents	**(2)**	(93)	**24**	(129)
Acquisitions – borrowings at date of acquisition	**(2)**	(1)	**–**	–
Businesses sold – borrowings at date of disposal	**–**	253	**–**	–
New loans	**(35)**	(6)	**(27)**	–
Repayment of loans	**27**	80	**27**	66
Finance lease principal repayments	**1**	2	**–**	–
Exchange adjustments	**(6)**	(1)	**–**	–
Closing net cash	**284**	301	**154**	130

35 Notes to the cash flow statement continued

35.4 Acquisitions of businesses:

	Group 2006 £m	Group 2005 £m
Net assets acquired:		
Intangible assets – goodwill	167	14
– other	10	–
Property, plant and equipment	13	6
Investments in joint ventures and associates	–	31
Working capital	(104)	4
Retirement benefit obligations	(35)	–
Provisions	(13)	–
Current tax liability	(1)	–
Deferred tax assets	36	–
Term loans	(2)	(1)
	71	54
Due on acquisitions	9	2
	80	56
Satisfied by:		
Cash consideration	76	56
Cash, deposits and overdrafts acquired	4	–
Cash outflow	80	56

35.5 Disposals of businesses:

	Group 2006 £m	Group 2005 £m
Net assets disposed of:		
PFI/PPP financial assets	–	323
Working capital	–	(8)
Current tax liabilities	–	(1)
Deferred tax liabilities	–	(18)
PFI/PPP non-recourse term loans	–	(253)
	–	43
Profit on sale	–	6
Fair value movements	–	(3)
	–	46
Satisfied by:		
Cash consideration	–	14
Cash, deposits and overdrafts sold	–	(29)
	–	(15)
Interest in joint venture retained	–	61
	–	46

35.6 Non-cash transactions:
On 29 December 2006, the Group exercised its pre-emption rights under the Connect M1-A1 Holdings Ltd shareholders' agreement and purchased for £44m, and immediately sold at the same value, its co-shareholder's 50% interest in Connect M1-A1 Holdings Ltd. Funding for the transaction was provided by the ultimate purchaser.

36 Principal subsidiaries, joint ventures and associates

	Country of incorporation or registration
a) Principal subsidiaries	
Building, civil and rail engineering	
Balfour Beatty Civil Engineering Ltd	
Balfour Beatty Construction Inc	USA
Balfour Beatty Construction Northern Ltd	
Balfour Beatty Construction Scottish and Southern Ltd	Scotland
Balfour Beatty Group Ltd	
Balfour Beatty Infrastructure Services Ltd	
Balfour Beatty Management Ltd	
Balfour Beatty Power Networks (Distribution Services) Ltd	
Balfour Beatty Power Networks Ltd	
Balfour Beatty Rail AB	Sweden
Balfour Beatty Rail GmbH	Germany
Balfour Beatty Rail Infrastructure Services Ltd	
Balfour Beatty Rail Ltd	
Balfour Beatty Rail Projects Ltd	
Balfour Beatty Rail Services Inc	USA
Balfour Beatty Rail Signal GmbH	Germany
Balfour Beatty Rail SpA	Italy
Balfour Beatty Rail Track Systems Ltd	
Balfour Beatty Refurbishment Ltd	
Balfour Beatty Utilities Ltd	
Balfour Kilpatrick Ltd	Scotland
Balvac Ltd	
Birse Build Ltd	
Birse Civils Ltd	
Birse Construction Ltd	
Birse Group plc*	
Charter Builders Ltd	USA
Cruickshanks Ltd*	Scotland
Edgar Allen Ltd	
Haden Building Management Ltd	
Haden Building Services Ltd	
Haden Young Ltd	
Heery International Inc	USA
Heery International Ltd	
Lounsdale Electric Ltd	Scotland
Mansell Construction Services Ltd	
Mansell plc	
Marta Track Constructors Inc	USA
Metroplex Corporation	USA
National Engineering and Contracting Company	USA
Painter Brothers Ltd	
Pennine Projects Ltd	
Raynesway Construction Ltd	
Stent Foundations Ltd	

36 Principal subsidiaries, joint ventures and associates continued

	Country of incorporation or registration
a) Principal subsidiaries continued	
Investments and developments	
PFI/PPP:	
Balfour Beatty Capital Ltd	
Balfour Beatty Infrastructure Investments Ltd*	
Connect Roads South Tyneside Holdings Ltd	
Connect Roads Sunderland Holdings Ltd	
Property:	
Balfour Beatty Property Ltd*	
Others:	
Balfour Beatty Inc	USA
Balfour Beatty Investment Holdings Ltd*	
BICC Finance BV	Holland
BICC Overseas Investments Ltd	
Bruton Investments Ltd	
Delphian Insurance Company Ltd*	Isle of Man
Fielden & Ashworth Ltd	
Guinea Investments Ltd	
Mayfair Place Investments Ltd	

	Country of incorporation or registration	Ownership interest %
b) Principal joint ventures and associates		
Building, civil and rail engineering		
Balfour Beatty Abu Dhabi LLC	Abu Dhabi	49.0
BK Gulf LLC	Dubai	49.0
Devonport Management Ltd*		24.5
Dutco Balfour Beatty LLC	Dubai	49.0
Dutco Construction Co LLC	Dubai	49.0
Gammon China Ltd	Hong Kong	50.0
Kerjaya Balfour Beatty Cementation Sdn Bhd	Malaysia	35.0
Monteray Ltd		24.5
PT Balfour Beatty Sakti Indonesia	Indonesia	49.0
Romec Ltd		49.0
Trans4m Ltd		25.0

	Country of incorporation or registration	Ownership interest %
Investments and developments		
PFI/PPP:		
Aberdeen Environmental Services (Holdings) Ltd	Scotland	45.0
Connect M1-A1 Holdings Ltd*		50.0
Connect M77/GSO Holdings Ltd (Note v)		85.0
Connect Roads Ltd* (Note v)		85.0
Consort Healthcare (Birmingham) Holdings Ltd		40.0
Consort Healthcare (Blackburn) Holdings Ltd		50.0
Consort Healthcare (Durham) Holdings Ltd*		50.0
Consort Healthcare (Edinburgh Royal Infirmary) Holdings Ltd* (Note v)	Scotland	73.9
EDF Energy Powerlink Ltd (Note vi)		10.0
Health Management (UCLH) Holdings Ltd		33.3
Metronet Rail BCV Holdings Ltd		20.0
Metronet Rail SSL Holdings Ltd		20.0
Power Asset Development Company Ltd		25.0
Transform Schools (Bassetlaw) Holdings Ltd		50.0
Transform Schools (Birmingham) Holdings Ltd		50.0
Transform Schools (North Lanarkshire) Holdings Ltd		50.0
Transform Schools (Rotherham) Holdings Ltd		50.0
Transform Schools (Stoke) Holdings Ltd		50.0
Other:		
Thames Power Ltd* (Note iv)		50.0

c) Principal jointly controlled operations

The Group carries out a number of its larger construction contracts in joint arrangement with other contractors so as to share resources and risk. The principal construction projects in progress are given below:

East London Line		50.0
Greenbush Railroad Rehabilitation Project	USA	50.0
I-5/I-15 Highway Projects	USA	30.0
La Mesa Light Rail	USA	40.0
M1 Widening Job 6a-10		50.0
Scotland Transerv	Scotland	70.0
SH130 Highway	USA	35.0
South West England Roads		73.0
South East England Roads		60.0
University College London Hospital		50.0
Westminster Transerv		80.0

Notes:

(i) Subsidiaries, joint ventures and associates whose results did not, in the opinion of the Directors, materially affect the results or net assets of the Group are not shown.

(ii) *Indicates held directly by Balfour Beatty plc, except Consort Healthcare (Edinburgh Royal Infirmary) Holdings Ltd, 42.5% held directly by Balfour Beatty plc.

(iii) Unless otherwise stated, 100% of the equity capital is owned and companies are registered in England. The principal operations of each company are conducted in its country of incorporation.

(iv) Thames Power Ltd owns 51% of the equity capital in Barking Power Ltd.

(v) Due to the Connect Roads Ltd, Connect M77/GSO Holdings Ltd and Consort Healthcare (Edinburgh Royal Infirmary) Holdings Ltd shareholder agreements between Balfour Beatty and the other shareholders requiring unanimity of agreement in respect of significant matters related to the financial and operating policies of those companies, the Directors are of the opinion that the Group did not control those companies and they have been accounted for as joint ventures.

(vi) The Group exercises significant influence through its participation in the management of EDF Energy Powerlink Ltd and therefore accounts for its interest as an associate.

36 Principal subsidiaries, joint ventures and associates continued

d) PFI/PPP concessions

Metronet

Summary: Balfour Beatty is a promoter, developer and 20% investor in Metronet Rail BCV Ltd and Metronet Rail SSL Ltd, which are modernising two-thirds of the London Underground.

Project description: Metronet is upgrading, replacing and maintaining infrastructure and procuring the associated financing on the Bakerloo, Central, Victoria and Waterloo & City lines (Metronet Rail BCV Ltd) and the Metropolitan, District, Circle, Hammersmith and City and East London lines (Metronet Rail SSL Ltd).

Contractual arrangements: For each concession the principal contract is a 30 year project agreement with London Underground Ltd (LUL) with a review interval every 7½ years under which the concession company will maintain and upgrade the rolling stock, civil engineering infrastructure and stations on the underground lines for an inflation indexed periodic fee subject to performance related deductions and incentives. Operation of the trains and stations, ticketing and collection of fares remain the responsibility of LUL. The majority of the track renewal work has been subcontracted to Balfour Beatty Rail Projects Ltd. The majority of the civil engineering work and the refurbishment and modernisation of the stations has been subcontracted to Trans4m, a company owned 25% by Balfour Beatty. Replacement of the rolling stock has been subcontracted to another shareholder. All assets transfer to the client LUL at the end of the concession.

							Equity and subordinated debt	
Concession company	Project	Total debt and equity funding	Shareholding	Financial close	Duration years	Construction completion	**Invested to 31 December 2006**	**Committed post 31 December 2006**
Metronet Rail BCV Ltd	London Underground modernisation	£1,783m	20%	April 2003	30	2033	**£20m**	**£15m**
Metronet Rail SSL Ltd	London Underground modernisation	£2,108m	20%	April 2003	30	2033	**£18m**	**£17m**
		£3,891m					**£38m**	**£32m**

Roads

Summary: Balfour Beatty is a promoter, developer and investor in roads projects under Balfour Beatty's Connect Roads brand, to construct new roads and upgrade and maintain existing roads and to replace and maintain street lighting.

Project descriptions: The roads projects comprise the design, construction, operation, maintenance and associated financing of the following roads: the M1-A1 link road, A30 Honiton to Exeter, A35 Tolpuddle to Puddletown bypass, A50 Stoke-Derby, the M77 from Fenwick to Malletsheugh and the Glasgow Southern Orbital. The roads concessions typically run for 30 years and reached financial close at various dates between March 1996 and May 2003. The street lighting projects are for the replacement and maintenance and associated financing over a 25 year period of the street lighting and highway signs in Sunderland and South Tyneside. All construction is new build rather than refurbishment.

Contractual arrangements: The principal contract in the roads concessions is the project agreement with the governmental highway authority setting out the obligations for the construction, operation and maintenance of the roads including life cycle replacement by Connect for the life of the concession to specified standards. In the case of M1-A1, A30/A35 and A50, the inflation indexed payment is related to traffic volumes. In the case of M77/GSO the inflation indexed payment is partly based on availability and partly on traffic volumes and subject to any performance related deductions. Construction of the roads was subcontracted to construction joint ventures in which Balfour Beatty had a 50% interest or, in the case of the M77/GSO, to Balfour Beatty Civil Engineering Ltd. On the street lighting projects payment is by a periodic inflation indexed availability payment subject to performance deductions and the replacement and maintenance obligations have been subcontracted to Balfour Beatty Power Networks Ltd. There are no provisions to reprice the contracts and all assets transfer to the client at the end of the concession.

							Equity and subordinated debt	
Concession	Project	Total debt and equity funding	Shareholding	Financial close	Duration years	Construction completion	**Invested to 31 December 2006**	**Committed post 31 December 2006**
Connect M1-A1 Ltd	M1-A1 30km road	£290m	50%	March 1996	30	1999	**£14m**	–
Connect A50 Ltd	A50 57km road	£42m	85%	May 1996	30	1998	**£6m**	–
Connect A30/A35 Ltd	A30/A35 102km road	£127m	85%	July 1996	30	2000	**£21m**	–
Connect M77/GSO plc	M77/GSO 25km road	£167m	85%	May 2003	32	2005	**£15m**	–
Connect Roads Sunderland Ltd	Street lighting apparatus in Sunderland	£27m	100%	August 2003	25	2008	–	**£3m**
Connect Roads South Tyneside Ltd	Street lighting apparatus in South Tyneside	£28m	100%	December 2005	25	2010	–	**£2m**
		£681m					**£56m**	**£5m**

36 Principal subsidiaries, joint ventures and associates continued

Hospitals

Summary: Balfour Beatty is a promoter, developer and investor in five hospitals, four of which are under Balfour Beatty's Consort Healthcare brand, comprising the building or refurbishment of hospitals and associated financing and the provision of certain non-medical facilities management services over the remainder of the concession period.

Project descriptions: The projects comprise University Hospital of North Durham, Edinburgh Royal Infirmary, Royal Blackburn Hospital, University College London Hospital and Queen Elizabeth Hospital Birmingham. Construction is principally new build rather than refurbishment.

Contractual arrangements: The principal contract is the project agreement between the concession company and the NHS Trust. An inflation indexed payment is primarily based upon availability of the hospital subject to any performance related deductions. Construction of the hospitals has been subcontracted to construction joint ventures in which Balfour Beatty subsidiaries participated 100% (University Hospital of North Durham, Royal Blackburn Hospital and Queen Elizabeth Hospital Birmingham), 85% (Edinburgh Royal Infirmary), and 50% (University College London Hospital). In the case of Edinburgh Royal Infirmary, University Hospital of North Durham, Royal Blackburn Hospital and Queen Elizabeth Hospital Birmingham, facilities management has been subcontracted to a Balfour Beatty subsidiary, Haden Building Management Ltd. The payments for the facilities management services are repriced every five years. All assets transfer to the client at the end of the concession, with the exception of Edinburgh Royal Infirmary, where the client has the option to terminate the arrangement for the provision of the hospital and services in 2028.

							Equity and subordinated debt	
Concession company	Project	Total debt and equity funding	Shareholding	Financial close	Duration years	Construction completion	Invested to 31 December 2006	Committed post 31 December 2006
Consort Healthcare (Durham) Ltd	District general hospital	£90m	50%	March 1998	30	2001	**£7m**	–
Consort Healthcare (Edinburgh Royal Infirmary) Ltd	Teaching hospital and medical school	£220m	73.9%	August 1998	30	2003	**£40m**	–
Consort Healthcare (Blackburn) Ltd	District general hospital	£116m	50%	July 2003	38	2006	**£6m**	–
Health Management (UCLH) Ltd	University College London teaching hospital	£282m	33.3%	July 2000	40	2008	**£9m**	–
Consort Healthcare (Birmingham) Ltd	Teaching hospital and mental health hospital	£553m	40%	June 2006	40	2011	–	**£23m**
		£1,261m					**£62m**	**£23m**

Schools

Summary: Balfour Beatty is a promoter, developer and investor in five grouped schools projects under Balfour Beatty's Transform Schools brand to design, build or refurbish schools and to provide certain non-educational services over the concession period.

Project descriptions: The projects comprise 98 schools in the city of Stoke-on-Trent, 15 schools in Rotherham, 21 schools in North Lanarkshire and six new schools, two post-16 learning centres and two leisure centres in Bassetlaw, Nottinghamshire and 12 schools in Birmingham. Construction in Bassetlaw and North Lanarkshire is all new build. On Stoke, construction comprises £16m of new build and £63m of refurbishment, on Rotherham, £78m of new build and £21m of refurbishment and on Birmingham, £69m of new build and £5m of refurbishment.

Contractual arrangements: The principal contract is the project agreement between the concession company and the local authority that provides for an inflation indexed availability based payment subject to any performance related deductions. Construction is subcontracted to a construction joint venture of Balfour Beatty subsidiaries and the facilities management services are subcontracted to a Balfour Beatty subsidiary, Haden Building Management Ltd. The payments for the facilities management services are repriced every five years. All assets transfer to the client at the end of the concession.

							Equity and subordinated debt	
Concession company	Project	Total debt and equity funding	Shareholding	Financial close	Duration years	Construction completion	Invested to 31 December 2006	Committed post 31 December 2006
Transform Schools (Stoke) Ltd	Grouped schools project in Stoke-on-Trent	£84m	50%	October 2000	25	2005	**£5m**	–
Transform Schools (Rotherham) Ltd	Grouped schools project in Rotherham	£113m	50%	June 2003	31	2006	**£5m**	–
Transform Schools (North Lanarkshire) Ltd	Grouped schools project in North Lanarkshire	£140m	50%	June 2005	32	2008	–	**£8m**
Transform Schools (Bassetlaw) Ltd	Grouped schools project in Bassetlaw, Notts	£127m	50%	July 2005	27	2007	–	**£7m**
Transform Schools (Birmingham) Ltd	Grouped schools project in Birmingham	£89m	50%	March 2006	33	2009	–	**£4m**
		£553m					**£10m**	**£19m**

36 Principal subsidiaries, joint ventures and associates continued

Other concessions

Summary: Balfour Beatty is a promoter, developer and investor in a number of other infrastructure concessions.

Project descriptions: Aberdeen Environmental Services Limited (AES) has a contract to design, build and finance wastewater treatment facilities in North Eastern Scotland and operate them for the remainder of a 30 year period. The construction is principally new build. The Powerlink project comprises two companies: EDF Energy Powerlink Ltd (EDFEPL), which operates the London Underground high voltage power system under a 30 year contract and is responsible for procuring various new power assets, and Power Asset Development Company Ltd (PADCO), which is constructing the new build power assets and leasing them to EDFEPL.

Contractual arrangements: For AES the principal agreement is the project agreement with Scottish Water under which AES receives inflation indexed payments on the basis of flows and loads of influent to the treatment works less any performance related deductions. AES subcontracted construction to a construction joint venture in which Balfour Beatty Civil Engineering Ltd had a 50% interest and subcontracted operations and maintenance to a subsidiary of one of the other shareholders. For the Powerlink project the principal project agreement is the power services contract between EDFEPL and LUL that provides for an inflation indexed availability payment subject to any performance deductions. EDFEPL operates and maintains the power network using its own staff and is leasing the new power assets from PADCO, which has subcontracted construction to a construction joint venture in which a Balfour Beatty subsidiary, Balfour Kilpatrick Ltd, has a 40% interest. There are no provisions to reprice contracts and all assets transfer to the client at the end of the concession.

							Equity and subordinated debt	
Concession company	Project	Total debt and equity funding	Shareholding	Financial close	Duration years	Construction completion	**Invested to 31 December 2006**	**Committed post 31 December 2006**
Aberdeen Environmental Services Ltd	Wastewater treatment in North East Scotland	£92m	45%	May 2000	30	2002	**£3m**	–
EDF Energy Powerlink Ltd/Power Asset Development Company Ltd	London Underground power system	£184m	10%/25%	August 1998	30	2006	**£4m**	**£1m**
		£276m					**£7m**	**£1m**
							£173m	**£80m**

Group five-year summary

IFRS	2006 £m	2005 £m	2004 pro forma £m	2004 £m
Income				
Revenue (including share of joint ventures and associates)	**5,852**	4,938	4,239	4,239
Profit from continuing operations before exceptional items and amortisation of intangible assets	**144**	115	94	94
Exceptional items	**(19)**	16	5	(2)
Amortisation of intangible assets	**(1)**	–	–	–
Profit from continuing operations	**124**	131	99	92
Net investment income	**1**	10	7	28
Profit from continuing operations before taxation	**125**	141	106	120
Profit from discontinued operations before taxation	**–**	–	180	180
	125	141	286	300
Capital employed				
Equity/shareholders' funds	**387**	292	227	302
Liability component of preference shares	**90**	98	103	–
Net cash	**(284)**	(301)	(67)	(67)
	193	89	263	235
Statistics				
Adjusted earnings per ordinary share*	**27.3p**	24.1p	22.1p	22.5p
Basic earnings per ordinary share	**21.2p**	24.9p	58.7p	57.4p
Diluted earnings per ordinary share	**21.0p**	24.7p	58.1p	56.9p
Proposed dividends per ordinary share	**9.1p**	8.1p	6.6p	6.6p
Profit from continuing operations before exceptional items and amortisation : revenue	**2.5%**	2.3%	2.2%	2.2%

Notes
Figures for the three years ended 31 December 2006 shown above were prepared under International Financial Reporting Standards (IFRS) with pro forma figures shown for the year ended 31 December 2004 which include the impact of IAS 32 and IAS 39 as if the Group had adopted them for that year.

*Adjusted earnings per ordinary share before exceptional items, amortisation of intangible assets and appropriations arising on the buy-back of preference shares and including the results of discontinued operations have been disclosed to give a clearer understanding of the Group's underlying trading performance.

UK GAAP	2004 £m	2003 as restated £m	2002 as restated £m
Profits			
Turnover (including share of joint ventures and associates)	4,171	3,678	3,441
Operating profit – before goodwill amortisation and exceptional items	173	161	149
Goodwill amortisation and impairment	(35)	(17)	(21)
Exceptional items	142	5	(9)
Profit on ordinary activities before interest	280	149	119
Net interest payable	(23)	(31)	(31)
Profit before taxation	257	118	88
Capital employed			
Shareholders' funds	413	231	192
Net cash	(67)	(124)	(67)
	346	107	125
Statistics			
Adjusted earnings per ordinary share**	23.4p	20.6p	16.1p
Basic earnings per ordinary share	43.8p	16.9p	8.5p
Diluted earnings per ordinary share	43.4p	16.7p	8.4p
Proposed dividends per ordinary share	6.6p	6.0p	5.4p
Operating profit before goodwill amortisation and exceptional items : turnover	4.2%	4.4%	4.3%

Notes
Figures for the three years ended 31 December 2004 shown above were prepared under UK generally accepted accounting principles (UK GAAP) as applied in the Company's annual report and accounts 2004. An explanation of the transition from UK GAAP to IFRS and reconciliations showing the effects of changes in presentation and accounting policies arising from the adoption of IFRS are set out in Note 37 of the Company's annual report and accounts 2005.

**Adjusted earnings per ordinary share before goodwill amortisation and impairment, exceptional items and appropriations arising on the buy-back of preference shares have been disclosed to give a clearer understanding of the Group's underlying trading performance.

Shareholder information

Financial calendar

	2007
25 April	Ex-dividend date for final 2006 ordinary dividend
27 April	Final 2006 ordinary dividend record date
10 May	Annual General Meeting
30 May	Ex-dividend date for July 2007 preference dividend
1 June	July 2007 preference dividend record date
11 June	Final date for receipt of DRIP mandate forms (see below)
1 July	Preference dividend payable
2 July*	Final 2006 ordinary dividend payable
15 August*	Announcement of 2007 half-year results
12 December*	Interim 2007 ordinary dividend payable

	2008
1 January	Preference dividend payable

*Provisional dates.

Registrar and transfer office

All administrative enquiries relating to shareholdings should, in the first instance, be directed to the Company's Registrars and clearly state the shareholder's registered name and address and, if available, the full shareholder reference number. Please write to:

The Balfour Beatty plc Registrar
Computershare Investor Services PLC
PO Box 82, The Pavilions, Bridgwater Road, Bristol BS99 7NH
Telephone 0870 702 0122 or by email to: web.queries@computershare.co.uk
or visit www.computershare.com

They can help you to:
- check your shareholding;
- register a change of address or name;
- obtain a replacement dividend cheque or tax voucher;
- record the death of a shareholder;
- amalgamate multiple accounts;
- resolve any other question about your shareholding.

Computershare's Investor Centre also allows you to view your shareholding and update your address and payment instructions online. You can register at www.computershare.com/investor/uk. In order to register, you need your shareholder reference number, which you can find on your share certificate or tax voucher.

Dividend mandates

If you wish dividends to be paid directly into your bank or building society account, you should contact the Registrars for a dividend mandate form.

Dividends paid in this way will be paid through the Bankers Automated Clearing System (BACS).

Information about Balfour Beatty's Dividend Reinvestment Plan ("DRIP") can also be obtained from the Registrars.

Subject to shareholder approval, the final dividend for 2006 will be paid on 2 July 2007. If you have already elected to join the DRIP, then you need take no further action. If you wish to join the DRIP, then you should apply online at www.computershare.com/Investor/UK or, alternatively, you can complete a mandate form and return it to the Registrars. If you do not have a DRIP mandate form, please contact the Registrars. The Registrars must receive your completed mandate by no later than 11 June 2007 in order to participate in the DRIP for this dividend. Applications received by the Registrars after that date will be effective for the following dividend.

If you hold your shares in uncertificated form in the CREST system, you may elect to participate in the DRIP by means of the CREST procedures that require the use of the Dividend Election Input Message in accordance with the CREST Manual.

Shareholder information on the internet and electronic communications

The Balfour Beatty website at www.balfourbeatty.com offers shareholders and prospective investors a wealth of information about the Company, its people and businesses and its policies on corporate governance and corporate responsibility. It should be regarded as your first point of reference for information on any of these matters.

Computershare Investor Services PLC have introduced a facility enabling Balfour Beatty shareholders to access details of their shareholding over the internet subject to complying with an identity check. You can access this service via the shareholder information section of the Balfour Beatty website at www.balfourbeatty.com. You can also obtain information on recent trends in Balfour Beatty's share price.

Balfour Beatty actively supports eTree, a programme designed to promote shareholder communication through electronic means rather than paper, by rewarding every shareholder who switches with a sapling to be planted on behalf of the Woodland Trust's Tree for All campaign. To register, or to find out more, please visit www.etreeuk.com/balfourbeatty. This service enables you to save paper, contribute to a better environment and give a child the chance to plant a tree.

In order to receive shareholder communications such as notices of shareholder meetings and the annual report and accounts electronically rather than by post, you need to register your details at www.etree.uk.com/balfourbeatty.

Unsolicited mail or telephone calls

Balfour Beatty is obliged by law to make its share register available on request to other organisations who may then use it as a mailing list. This may result in you receiving unsolicited mail. If you wish to limit the receipt of unsolicited mail, you may do so by writing to the Mailing Preference Service, an independent organisation whose services are free to you. Once your name and address have been added to its records, it will advise the companies and other bodies that support the service that you no longer wish to receive unsolicited mail. If you would like more details, please write to:

Mailing Preference Service
Freepost 29 LON20771, London W1E 0ZT
or visit the Mailing Preference Service website at www.mpsonline.org.uk.

In addition, it has come to our attention that in the past, some of our shareholders have received unsolicited telephone calls or correspondence concerning investment matters from organisations or persons claiming or implying that they have some connection with the Company. These are typically from overseas based "brokers" who target UK shareholders offering to sell them what often turn out to be worthless or high risk shares in US or UK investments. Shareholders are advised to be very wary of any unsolicited advice, offers to buy shares at a discount or offers of free reports into the Company.

If you receive any unsolicited investment advice:

- make sure that you obtain the correct name and address of the person and the organisation;
- check that they are properly authorised by the Financial Services Authority ("the FSA") before getting involved. You can check at www.fsa.gov.uk/register;

- the FSA also maintains on its website a list of unauthorised overseas firms who are targeting, or have targeted UK investors, and any approach from such organisations should be reported direct to the FSA Consumer Helpline (Telephone: 0845 606 1234) so that this list can be kept up to date and any other appropriate action can be considered. Alternatively, you can report such approaches online via the FSA's website at www.fsa.gov.uk/Pages/Doing/Regulated/Law/Alerts/form.shtml. If you deal with an unauthorised firm, you will not be eligible to receive payment under the Financial Services Compensation Scheme. More detailed information on this or similar activity can be found on the FSA website at www.moneymadeclear.fsa.gov.uk. You should also report any approach to Operation Archway, an initiative by the City of London Police which combines the resources of the FSA, the Serious Fraud Office, the Serious Organised Crime Agency and every police force in the UK: email operationarchway@city-of-london.pnn.police.uk.

Identity theft

Identity theft has become a growing concern within financial services and poses an increasing threat to investors, including individual shareholders who are at particular risk from this type of fraud. Criminals may steal your personal information, putting your shareholding at risk. You may therefore wish to take the following precautions:

- ensure that all of your share certificates are kept securely in a safe place or hold your shares electronically in CREST via a nominee;
- keep all correspondence from the Registrars which shows your shareholder reference number securely in a safe place, or destroy correspondence by shredding. You should only divulge your shareholder reference number if requested to do so by the Registrars or an appropriate professional adviser eg your stockbroker or solicitor;
- if you use the Registrars' services via their website, you should ensure that your username and password are kept confidential at all times. Never respond to an email asking you to disclose your online password information;
- if you change address, please inform the Registrars. If you receive a letter from the Registrars regarding a change of address and have not recently moved, please contact them immediately. You may be a victim of identity theft;
- make sure that you know when the Company pays its dividends and consider having them paid directly into your bank or building society account through BACS, if you have not already done so. This will reduce the risk of your cheque being intercepted or lost in the post. If you change your bank or building society account, please inform the Registrars of the details of your new account. If, for example, a dividend payment or share certificate is late, please telephone the Registrars immediately and check the address to which it has been sent. Please respond to any letters that the Registrars send you about any of these issues;
- if you are buying or selling shares, only deal with brokers registered in your country of residence or the UK.

Gifting shares to your family or to charity

To transfer shares to another member of your family as a gift, please ask the Registrars for a Balfour Beatty gift transfer form. Alternatively, if you only have a small number of shares whose value makes it uneconomic to sell them, you may wish to consider donating them to the share donation charity ShareGift (registered charity no. 1052686), whose work Balfour Beatty supports. Any shares that you donate to ShareGift will be aggregated, sold when possible, and the proceeds will be donated to a wide range of other UK charities. Since ShareGift was launched, over £10m has been given to more than 1,200 charities. The relevant share transfer form may be obtained from the Registrars; further information about the scheme is available from the ShareGift Internet site www.ShareGift.org.

Share dealing services

The Company has established an execution-only postal share dealing service, through JPMorgan Cazenove Limited, for private investors who wish to buy or sell Balfour Beatty plc's shares. Further details can be obtained from:

The Balfour Beatty Share Dealing Service
JPMorgan Cazenove Limited
20 Moorgate, London EC2R 6DA
Telephone: 020 7155 5155

Alternatively, Hoare Govett Limited also offers a low-cost, execution-only, postal share dealing service for UK resident individuals. Further details can be obtained from:

Hoare Govett Limited (LCSD)
250 Bishopsgate, London EC2M 4AA
Telephone: 020 7678 8300

Both JPMorgan Cazenove Limited and Hoare Govett Limited are authorised and regulated by the Financial Services Authority.

Share price

The Balfour Beatty share price can be found at the Balfour Beatty website at www.balfourbeatty.com and in the appropriate sections of national newspapers under the classification "Construction and Building Materials". It is also available on Ceefax and Teletext and a number of personal finance websites on the Internet. Historic share prices are available from the library at Hoare Govett. Telephone: 020 7678 5926.

The London Stock Exchange Daily Official List (SEDOL) codes are:
Ordinary shares: 0096162
Preference shares: 0097820

The London Stock Exchange "ticker" codes are:
Ordinary shares: BBY
Preference shares: BBYB

Capital gains tax

For capital gains tax purposes the market value on 31 March 1982 of Balfour Beatty plc's ordinary shares of 50p each was 307.3p per share. This has been adjusted for the 1-for-5 rights issue in June 1992 and the 2-for-11 rights issue in September 1996.

Enquiries

Enquiries relating to Balfour Beatty's results, business and financial position should be made in writing to the Corporate Communications Department at the Company's Registered Office address or by e-mail to info@balfourbeatty.com.

Balfour Beatty plc
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Registered in England Number 395826

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