

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).



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

