Financial review

Pre-tax profit before exceptional items and amortisation increased from £136m to £201m (48%).

Results

Revenue in 2007 from continuing operations, including the Group's share of the revenue of joint ventures and associates, was £7,488m (2006: £5,506m), an increase of 36%, of which 22% was attributable to acquisitions.

Profit from continuing operations before exceptional items and amortisation of intangible assets increased from £128m to £191m (49%). In the building and building services sector, there was a first contribution from Balfour Beatty Construction US and good performances from the UK businesses. Performance in the civil and specialist engineering sector improved substantially, with improved contributions from the Group's joint ventures in Hong Kong and Dubai, the elimination of losses in Balfour Beatty Infrastructure Inc in the US and positive contributions in the UK businesses. In the rail sector, there was good progress on major UK projects, and steady performances in the international rail electrification business and the US business. In the investments sector, five concessions reached financial close during 2007, Edinburgh Royal Infirmary was refinanced and preferred bidder status was achieved on four projects, including the Institute of Technical Education in Singapore, the Group's first overseas PPP project.

A more detailed analysis of performance in our operating businesses is contained in the Annual review and summary financial statement.

Acquisitions and goodwill

During 2007, the Group acquired Centex Construction (now Balfour Beatty Construction US) for £212m (including £20m deferred consideration), Cowlin for £53m, Covion for £33m, and a number of smaller businesses for a further £25m. Goodwill arising on these acquisitions amounted to £263m, and a further £59m intangible assets were recognised in respect of brand names and customer contracts and relationships. As a result, the goodwill on the Group's balance sheet at 31 December 2007 increased to £694m (2006: £427m) and other intangible assets to £59m (2006: £9m).

Exceptional items

The Group has recorded a net exceptional gain of £7m (2006: £25m charge). This reflects a post-tax charge of £95m in respect of the write-off of the Group's 20% investment in Metronet and an estimate of other consequential write-offs, which was offset by credits arising from the sale of the Group's 24.5% interest in Devonport Management (£57m) and the crystallisation of tax benefits in the US following the acquisition of Balfour Beatty Construction US (£51m). There were also £3m integration costs following the acquisition of Balfour Beatty Construction US, £3m further reorganisation costs for Balfour Beatty Rail Inc and Balfour Beatty Infrastructure Inc (formerly Balfour Beatty Construction Inc) and £2m premium on the purchase of preference shares, less a further £2m tax credit.

Taxation

The Group's effective tax rate in 2007 was 39% (2006: 40%) of profit from continuing operations 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 36% (2006: 35%).

Pre-tax profits and earnings

Profits from continuing operations before taxation, exceptional items and amortisation of intangible assets amounted to £201m (2006: £136m), an increase of 48%, and adjusted earnings per share were 35.0p (2006: 27.3p), an increase of 28%.

Cash

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

	2007 £m	2006 £m
Group operating profit	**78**	60
Trading (loss)/profit from discontinued operations	**(1)**	1
Depreciation	**50**	43
Amortisation and impairment	**9**	17
Other items	**4**	3
Working capital decrease	**141**	93
Cash generated from operations	**281**	217

Cash flow from operations and the sale of the Group's interest in Devonport Management for £84m (after costs) provided further capacity to grow the Group's core activities through acquisitions (£198m outflow). The level of the Group's net cash at 31 December 2007 increased to £374m (2006: £305m), before taking into account the consolidation of £61m (2006: £21m) 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 of 102%. A valuation as at 31 March 2007 is in preparation by the actuaries to that fund and is due to be completed by 30 June 2008. A formal actuarial valuation of the Railways Pension Scheme was carried out at 31 December 2004 and showed a funding position of 92%. 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 Birse scheme was merged into the Balfour Beatty Pension Fund on 5 April 2007.

The position of each of the funds has been updated by the actuaries at 31 December 2007 to review ongoing funding levels and details are included in Note 26.2. The funding position of the Balfour Beatty Pension Fund has reduced to 90% as a result of strengthening in the mortality assumptions. The Group contributed £31m to the defined benefit section of the Balfour Beatty Pension Fund for the year ended 31 December 2007 (2006: £24m).

Charges

Pension charges of £58m (2006: £52m) have been made to the income statement in accordance with IAS 19, including £36m (2006: £32m) for the defined benefit section of the Balfour Beatty Pension Fund.

Balance sheet impact

The Group's balance sheet includes the deficits of £286m (2006: £288m) for the Group's funds as required by IAS 19 on the assumptions set out in Note 26.1. The Group recorded net actuarial losses for 2007 on those funds totalling £1m (2006: £26m gains), with the effects of the higher discount rates applied to the funds' liabilities countered by changes to mortality assumptions as a result of continuing improvements in life expectancy, and worse than expected returns on the assets held by the funds. The deficits recorded at 31 December 2007 have increased by £126m from the position at 30 June 2007 as a result of the strengthening of mortality assumptions.

Public Private Partnerships (PPP)

During 2007, the Group invested £40m in a combination of equity in and shareholder loans to its PPP project companies, including £32m in Metronet. Following Metronet's request to the Arbiter for an Extraordinary Review of the incurred and forecast costs on the BCV concession, his subsequent interim award, and the consequent appointment of a PPP Administrator, the Group has written off its investment in the Metronet holding companies and classified the Metronet activities as discontinued operations. At 31 December 2007, the Group had invested a total of £144m in equity in and subordinated loans to its 23 continuing PPP project companies and had committed to provide a further £88m over the period 2008 to 2012. The Group has also been appointed preferred bidder for a further four PPP projects to which it is expected at financial close to commit to provide approximately £19m funding.

At 31 December 2007, the Group's share of non-recourse net debt within its continuing PPP project companies amounted to £1,418m (2006: £1,281m), comprising £1,357m (2006: £1,260m) in relation to joint ventures and associates as disclosed in Note 16.2 and £61m (2006: £21m) on the Group balance sheet in relation to wholly-owned project companies as disclosed in Note 24.1.

The Directors have carried out a valuation of the Group's PPP concessions and this is set out on pages 6 to 7.

Infrastructure investments

In the early part of 2007, the Group invested £18m for a 60% interest in Exeter International Airport. This now forms part of Balfour Beatty Capital's non-PPP infrastructure investment portfolio, along with the Group's 25.5% interest in Barking Power. At 31 December 2007, the Group's share of non-recourse net debt in relation to these investments amounted to £24m (2006: £9m), as disclosed in Note 16.2.

Treasury

The Group's policy remains to carry no significant net debt, other than the non-recourse borrowings of companies engaged in PPP projects and infrastructure investments.

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.

Details of the Group's financial risk factors and financial instruments are shown in Note 21.

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 £395m, the majority of which mature in 2012. 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.

Contract 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 2007, contract bonds in issue by financial institutions covered £2.1bn (2006: £1.2bn) of contract commitments of the Group.

Currency risk

The Group's businesses manage 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 directly 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 forward foreign exchange contracts.

Interest rate risk

The Group has no significant fixed rate borrowings (excluding 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

Anthony Rabin Finance Director