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**Our business** – Introduction

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We operate in a world where quality, exceptional service, a strong safety record, technical expertise and a trusted brand are real differentiators.

Balfour Beatty is focused on **Engineering and Construction, Professional and Support Services** and **Investments**.

A key strength is the breadth of capability we bring to major infrastructure projects that often require an integrated approach.

We continually assess what our customers want, and deliver it.

**Balfour Beatty produced another excellent financial performance in 2008**, together with further progress in the Group's strategic development. We are strong both operationally and financially. Our scale and the resilience of our business model will serve us well in this difficult economic environment. The majority of our work is in partnership with public sector and regulated customers, who are long-term investors in infrastructure.



**Ian Tyler** Chief Executive

## Group performance

## Our performance demonstrates the resilience of our business model

Strong growth in profits\* and earnings\*

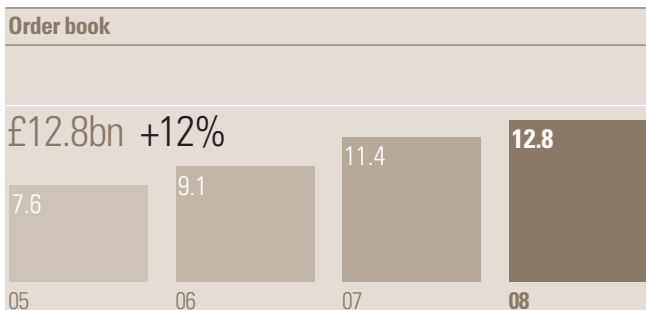
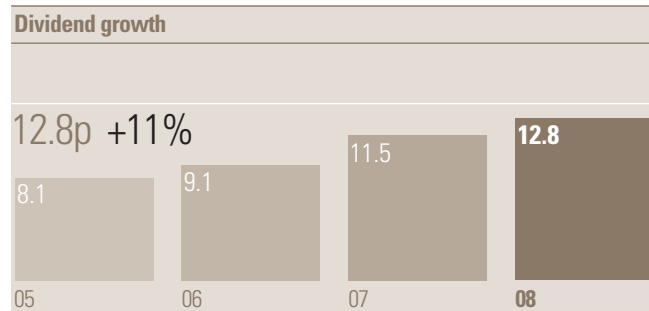
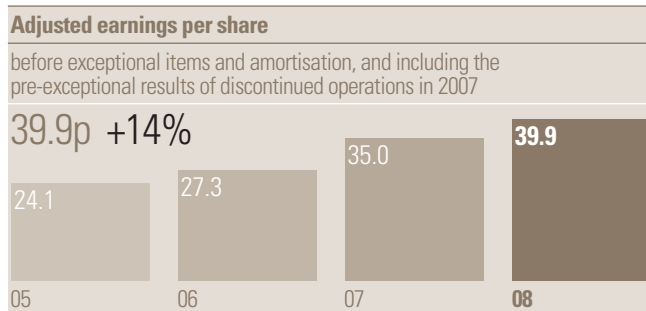
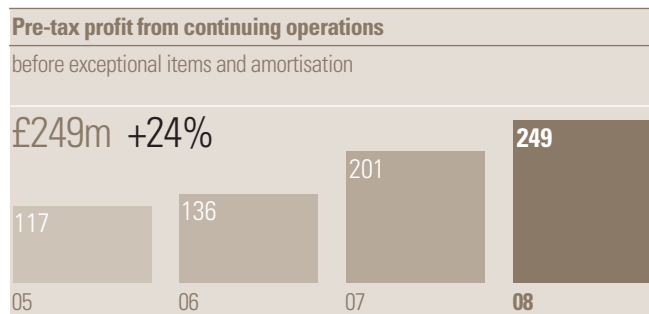
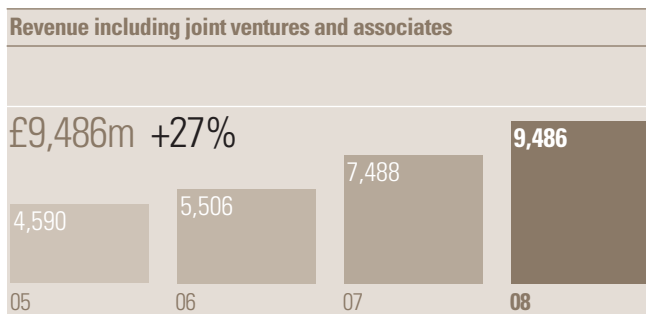
Average net cash in the year of £239m

Order book of £12.8bn at year-end

Recent acquisitions performing well

Dividend increase of 11%

\*Before exceptional items and amortisation, and including the pre-exceptional results of discontinued operations in adjusted earnings per share in 2007.



## Financial review

**The Financial review covers the topics shown below. Additional information can be found elsewhere in the Annual review 2008 as indicated.**

Topic	Additional information
Group trading performance	See Annual review 2008 pages 26 to 43 for more detailed comments on performance by segment.
Group cash flow performance	More detailed analysis on the movements in net cash are shown in Note 36.
Group balance sheet and capital structure	A key part of the Group's balance sheet is the investment in PPP concessions, which is dealt with in detail on pages 6 to 8.

The accounting policies used by the Group are outlined in Note 1 to the financial statements, and there have been no changes to these policies in the year. The presentation of pension costs has changed in the year, and this is explained below.

Treasury risk management	The Financial review largely focuses on treasury related risk matters. A broader description of the Group's principal risks and risk management is included on pages 9 to 10.
Going concern	To appreciate the prospects for the Group as a whole, the complete Annual report and accounts 2008 needs to be read, with particular reference to Notes 21 and 24.

### Group trading performance

#### Results for the year

	2008	2007	Percentage increase
<b>Revenue including joint ventures and associates*</b>	<b>£9,486m</b>	£7,488m	<b>+27%</b>
<b>Group revenue*</b>	<b>£8,261m</b>	£6,466m	<b>+28%</b>
<b>Pre-tax profit from continuing operations</b>			
– before exceptional items and amortisation	<b>£249m</b>	£201m	<b>+24%</b>
– after exceptional items and amortisation	<b>£270m</b>	£157m	<b>+72%</b>
<b>Earnings per share</b>			
– adjusted**	<b>39.9p</b>	35.0p	<b>+14%</b>
– basic	<b>42.9p</b>	35.1p	<b>+22%</b>

\* Continuing operations.

\*\* Before exceptional items and amortisation of intangible assets, and including the pre-exceptional results of discontinued operations in 2007.

2008 has been an extraordinary year for the world economy. In the early part of the year, there were concerns over the level of inflation driven in part by the price of oil and commodities. The risk of inflation receded to be replaced by concerns over the stability of the banking sector, and the year ended with concerns over deflation and recession.

Through this period we have demonstrated the resilience of the Group's business model and in particular the conservative management of its balance sheet. The lack of debt has seen the Group end the year in a very strong position.

2008 was a year of very good progress across the Group. Revenue in 2008 from continuing operations, including the Group's share of the revenue of joint ventures and associates, was £9,486m (2007: £7,488m), an increase of 27%, of which half was attributable to acquisitions. Profit from operations before exceptional items and amortisation of intangible assets increased from £178m to £230m (29%).

Pension charges of £73m (2007: £71m) have been made to the income statement in accordance with IAS 19, including a service charge of £38m (2007: £47m) for the defined benefit section of the Balfour Beatty Pension Fund. In 2008, to help show true underlying trading performance movements, the net of the expected return on pension assets and the interest cost of £5m (2007: £13m) is now shown within investment income, leaving only the service charge within profit from operations. The figures for 2007 have been re-presented on the same basis.

Investment income, net of finance costs, reduced from £23m in 2007 to £19m in 2008, before exceptional items. An increase in interest income from net investment hedging of £6m was more than offset by a reduction of £8m in the net return on pension scheme assets and liabilities.

The Directors expect a further reduction in net investment income in 2009, as a result of a reduced pension return, a reduction in our hedging programme and lower interest rates.

Pre-tax profit before exceptional items and amortisation increased from £201m to £249m (24%).

### Exceptional items

The Group has recorded a net exceptional gain after tax of £33m (2007: £7m). The single biggest component of this was a £60m gain from a reduction in past service pension liabilities in certain sections of the Balfour Beatty Pension Fund. This resulted from measures to limit future increases in salary used for defined benefit pension purposes. This change is part of the work being performed to manage the impact on the Group of the liabilities that arise from the pension schemes.

During the year £6m of reorganisation costs were incurred, largely resulting from the acquisition and integration of businesses.

The tax impact of these items is a net charge of £15m, in addition to which there was a one-off write-off of deferred tax balances of £6m in the year, as a result of changes in tax legislation from the 2008 Finance Act relating to the phased withdrawal of industrial building allowances.

### Taxation

The Group's effective tax rate in 2008 was 38% (2007: 39%) 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% (2007: 36%). The benefit of lower UK tax rates has been offset by an increase in the proportion of profits from higher tax countries, notably the US.

### Earnings per share

Adjusted earnings per ordinary share increased by 14% to 39.9p (2007: 35.0p). The percentage increase in EPS was less than the increase in profit before tax due principally to the impact of the shares issued in May 2008.

### Cash flow performance

Cash flow performance in the year was again strong with cash generated from operations of £297m (2007: £277m) exceeding profit from operations of £251m (2007: £136m).

In the year, we used some of the Group's cash resources to continue to grow the business, and in particular continued to acquire businesses which had a good fit with our strategic objectives.

Strategic objective	Segment	Acquisition	Consideration £m
UK regional contracting	Building & Civils	Dean & Dyball	46
Non-PPP and overseas	Investments	Blackpool Airport	3
PPP investments		GMH Military Housing	180
Professional services and Domestic expansion outside UK	Building	Barnhart	63
Domestic expansion outside UK	Rail	Schreck-Mieves	25
	Various	Other	16
		<b>Total</b>	<b>333</b>

## Financial review

The acquisition of Balfour Beatty Communities (formerly GMH Military Housing) in April 2008 for £180m resulted in the Group's net cash balance reducing substantially, following which we raised £182m of equity in May 2008.

The Company has agreed with the trustees of the Balfour Beatty Pension Fund to make deficit payments of £17m per year until April 2013. As the agreement was back dated to the date of the last valuation, being 31 March 2007, the total deficit payments in 2008 were £29m. Deficit payments for other funds during 2008 were £9m (2007: £10m in total).

Average cash in the second half of the year was £254m, although the Group's net cash at 31 December 2008 was significantly in excess of that at £440m (2007: £374m), before taking into account the consolidation of £143m (2007: £61m) of non-recourse net debt held in wholly-owned PPP project companies.

The year-end position benefited from favourable movements in exchange rates from holding significant cash balances in the US in US dollars, although as the US dollar cash position is broadly hedged, this will be offset, assuming exchange rates stay at the year-end level, by a £70m outflow in September 2009 when the hedges mature.

### Balance sheet and capital structure

#### Goodwill and intangibles

As noted above, total consideration on acquisitions in the year amounted to £333m. Goodwill arising on these acquisitions amounted to £144m, and a further £137m of intangible assets were recognised in respect of brand names and customer contracts and relationships. As a result, and after exchange adjustments, the goodwill on the Group's balance sheet at 31 December 2008 increased to £975m (2007: £694m) and other intangible assets to £223m (2007: £59m).

Impairment reviews have been carried out, and none of the goodwill has been impaired. Details of the calculations and assumptions are shown in Note 13.

Charges for the amortisation of intangible assets have increased to £27m (2007: £9m) due to the impact of acquisitions, with a related tax credit of £7m (2007: £3m).

#### Public Private Partnerships (PPP)

During 2008, the Group invested £12m in a combination of equity in and shareholder loans to Balfour Beatty Capital's PPP project companies. At 31 December 2008, the Group had invested a total of £156m in equity and subordinated loans to its 26 continuing PPP project companies and had committed to provide a further £89m over the period 2009 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 £98m funding.

At 31 December 2008, the Group's share of non-recourse net debt within Balfour Beatty Capital's continuing PPP project companies amounted to £1,511m (2007: £1,418m), comprising £1,368m (2007: £1,357m) in relation to joint ventures and associates as disclosed in Note 16.2 and £143m (2007: £61m) on the Group balance sheet in relation to wholly-owned project companies as disclosed in Note 24.1.

The Group's share of the results of the military housing PPP concessions of Balfour Beatty Communities is contractually limited to a maximum pre-agreed level of return on funds invested, which is shown under the equity method of accounting within joint ventures and associates. The Group's investment in those concessions is recorded on the balance sheet at the initial equity investment plus the value of the Group's accrued preferred return. The fee income which is the bulk of the return earned by the Group from these concessions is included within Group operating profit.

The Directors have carried out a valuation of the Group's PPP concessions, including the military housing PPP concessions of Balfour Beatty Communities, and this is set out on pages 6 to 8.

#### Infrastructure investments

In 2008, the Group added to its existing non-PPP infrastructure investment portfolio, comprising the Group's 25.5% interest in Barking Power and 60% stake in Exeter International Airport, by purchasing a 95% stake in Blackpool

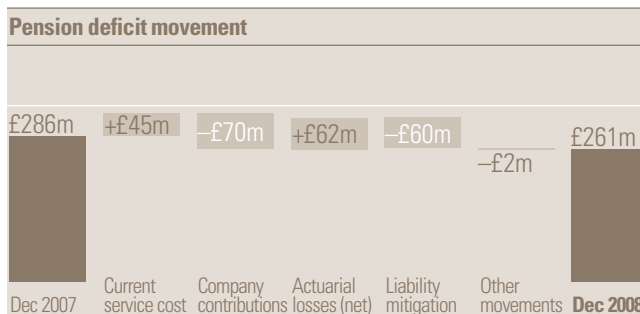
International Airport. At 31 December 2008, the Group's share of non-recourse net debt in relation to these investments amounted to £20m (2007: £24m), as disclosed in Note 16.2.

#### Pensions

The Group's balance sheet includes aggregate deficits of £261m (2007: £286m) for the Group's pension funds based on the assumptions set out in Note 26.1. The Group recorded net actuarial losses for 2008 on those funds totalling £62m (2007: £1m loss), with the effects of the higher discount rates applied to the funds' liabilities countered by worse than expected returns on the assets held by the funds.

The last formal actuarial valuation of the Balfour Beatty Pension Fund was carried out at 31 March 2007 and showed a funding position of 96%. 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.

Note 26 includes a sensitivity analysis which identifies the impact on the profit and loss account and the balance sheet from changes in the assumptions.



#### Equity raising

In May 2008, the Company successfully placed 43.3m shares at a price of 430p, raising £182m of cash. This equated to just under 10% of the Company's issued ordinary share capital. This resulted in the total number of ordinary shares in issue at the end of the year being 478m (2007: 433m) and the average number of shares in the year being up 6% at 458m (2007: 430m).

#### Dividend policy

Balfour Beatty aims to grow the dividend broadly in line with the growth in earnings, taking into account the investment needs of the business. The Board has recommended a final dividend of 7.7p in respect of 2008, giving a full-year dividend of 12.8p (2007: 11.5p), up 11% on last year. Underlying dividend cover for 2008 is 3.1, similar to the cover of 3.0 last year.

#### Treasury risk management

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

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.

Balfour Beatty's cash and liquid investments comprise cash, term deposits and the use of money market liquidity funds.

Additionally, the Group has a series of bilateral facilities which total £404m, 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.



### Treasury counterparty risk

Treasury counterparty risk is monitored regularly and mitigated by limiting deposits in value and duration to reflect the credit rating of the counterparty.

### 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 2008, contract bonds in issue by financial institutions covered £3.7bn (2007: £2.1bn) of contract commitments of the Group.

### Currency risk

The following exchange rates were applied in the preparation of the accounts:

#### Average rates

£ 1 buys	2008	2007	Change
USD	<b>1.86</b>	2.00	(7)%
EUR	<b>1.26</b>	1.46	(14)%

#### Closing rates

£ 1 buys	2008	2007	Change
USD	<b>1.46</b>	1.99	(27)%
EUR	<b>1.05</b>	1.36	(23)%

### 2008 foreign exchange rates



The Group's businesses manage their known foreign currency transactional exposures by taking out forward foreign exchange contracts through Group Treasury. The Group has decided not to adopt hedge accounting for its foreign currency transactional exposures except where the exposure is in excess of pre-set materiality limits in which case a decision is made as to whether to hedge account or not. As a result, there was a charge to profit of £3m which would otherwise have been charged directly to equity.

The Group also faces currency exposures on the translation into sterling of the profits 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.

In addition the Group is exposed to currency exposures from translation of the net assets of overseas subsidiaries and associates. Balance sheet translation exposure can be managed by matching net assets denominated in currencies other than sterling by way of forward foreign exchange contracts. The hedging policy is reviewed periodically to consider the potential cash effect of the hedging programme against the potential effect that the movement in currencies can have on the Group's net assets, and the level of hedging is adjusted accordingly. Given the growth in the Group's net assets and the additional focus on cash due to the economic climate the level of hedging in 2008 was reduced. As at 31 December 2008 approximately 45% of the US dollar denominated net assets were hedged (2007: 81%), and none of the Euro denominated assets (2007: 81%). The level of US dollar hedging broadly equated to the level of US dollar cash balances that were held.

### Interest rate risk

The Group has no significant borrowings (excluding PPP non-recourse term loans). Group policy is for PPP concessions to use interest rate swaps to swap floating rate borrowings to fixed rates to mitigate the risk of changing interest rates on the project cash flows. The Group's deposits (excluding PPP guaranteed investment contracts) earn interest at variable rates and are short-term in nature.

### Going concern

In reviewing the future prospects of the Group the following factors are relevant:

- the Group has a strong order backlog, and good forward visibility;
- growth in the business is expected to continue to generate additional cash through cash backed profit; and
- the Group had in excess of £400m net cash at 31 December 2008, in addition to which it had undrawn committed facilities in excess of £400m, of which £279m last through until the fourth quarter of 2012.

Based on the above, and having made appropriate enquiries and reviewed medium-term cash forecasts, the Directors 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.

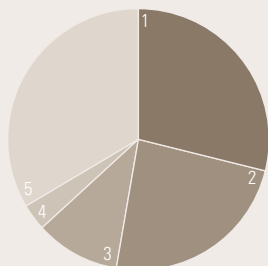
**Duncan Magrath** Finance Director

## Directors' valuation of PPP concessions

### Our portfolio

Equity committed by sector

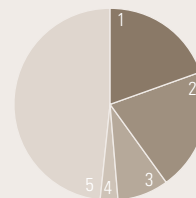
	2008	2007
1 Connect: 9 projects	<b>£149m</b>	£68m
2 Consort: 9 projects	<b>£123m</b>	£123m
3 Transform: 8 projects	<b>£54m</b>	£48m
4 Other: 4 projects	<b>£17m</b>	£12m
5 BB Communities: 17 projects	<b>£173m</b>	–
	<b>£516m</b>	£251m



### Our portfolio

Cash invested by December 2008

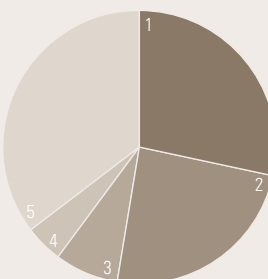
	2008	2007
1 Connect: 9 projects	<b>£59m</b>	£56m
2 Consort: 9 projects	<b>£62m</b>	£62m
3 Transform: 8 projects	<b>£26m</b>	£18m
4 Other: 4 projects	<b>£9m</b>	£8m
5 BB Communities: 17 projects	<b>£146m</b>	–
	<b>£302m</b>	£144m



### Portfolio valuation: December 2008

Value by sector

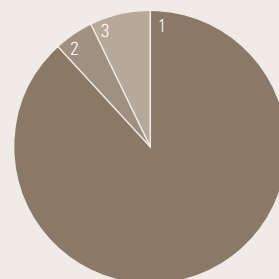
	2008	2007 (Restated)
1 Connect	<b>£158m</b>	£135m
2 Consort	<b>£135m</b>	£125m
3 Transform	<b>£42m</b>	£23m
4 Other	<b>£25m</b>	£23m
5 BB Communities	<b>£196m</b>	–
	<b>£556m</b>	£306m



### Portfolio valuation: December 2008

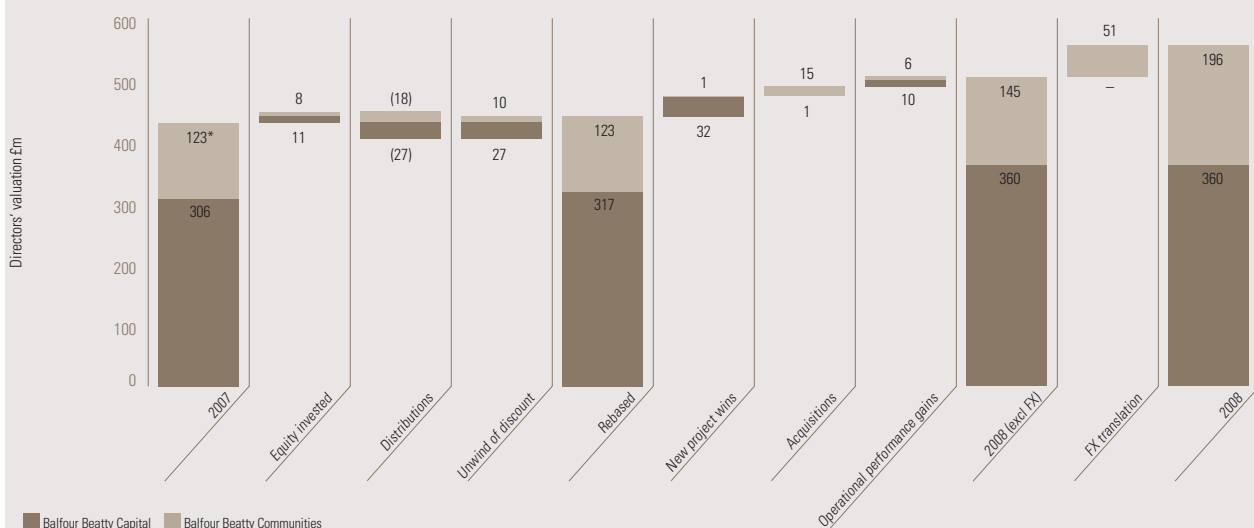
Value by phase

	2008	2007 (Restated)
1 Operations	<b>£490m</b>	£273m
2 Construction	<b>£26m</b>	£27m
3 Preferred bidder	<b>£40m</b>	£6m
	<b>£556m</b>	£306m



### Movement in value 2007/2008 (£m)

	2007	Equity invested	Distributions	Unwind of discount	Rebased	New project wins	Acquisitions	Operational performance gains	2008 (excl FX)	FX translation	2008	Growth (excl FX)
<b>Balfour Beatty Capital</b>	<b>306</b>	11	(27)	27	<b>317</b>	32	1	10	<b>360</b>	–	<b>360</b>	13.6%
<b>Balfour Beatty Communities</b>	<b>123*</b>	8	(18)	10	<b>123</b>	1	15	6	<b>145</b>	51	<b>196</b>	17.9%
<b>Total</b>	<b>429</b>	<b>19</b>	<b>(45)</b>	<b>37</b>	<b>440</b>	<b>33</b>	<b>16</b>	<b>16</b>	<b>505</b>	<b>51</b>	<b>556</b>	14.8%



\* Value of closed and preferred bidder projects acquired on 30 April 2008

### Balfour Beatty Capital restated 2007 Directors' valuation

	2007 Directors' valuation	Unwind PB discount	2007 Directors' valuation no PB discount	Move to 8.0% discount rate	Restated 2007 Directors' valuation	Move to 8.0% discount rate	2007 Alternative valuation post tax	Move to post shareholder tax	2007 Alternative valuation
<b>Balfour Beatty Capital</b>	<b>299</b>	3	<b>302</b>	4	<b>306</b>	(93)	399	(67)	<b>466</b>

## Introduction

Balfour Beatty's PPP concession portfolio has grown both organically and through acquisition to become a very significant part of the Group's business and a major driver of shareholder value. At 31 December 2008, Balfour Beatty had total committed equity and subordinated debt of £516m across 47 projects (29 UK, 17 US and 1 Singapore), four of which were at preferred bidder stage. At that date, £302m had already been invested and £214m is due over the next six years. The accounting book value of PPP investments at 31 December 2008 was £295m (2007: £209m).

In order to provide an indicator of value, Balfour Beatty publishes its own valuation benchmark for the Group's PPP investments, based on discounting expected future cash flows ("DCF valuation") but without taking into account potential refinancing gains. The valuations do not include Balfour Beatty's non-PPP infrastructure investments in Barking Power, Exeter International Airport and Blackpool International Airport.

## Directors' valuation

At 31 December 2008, the Directors' valuation of Balfour Beatty's PPP concession portfolio stood at £556m, at a post-tax nominal discount rate of 8.0% (2007: £306m). The movement in value arises principally through the acquisition on 30 April 2008 of Balfour Beatty Communities (formerly GMH Military Housing). In addition, shareholder cash inflows and outflows during the year, acquisitions, project wins, operational performance gains and underlying growth in the portfolio arising from the unwinding of the discount from year to year also had an effect.

The Directors' valuation incorporates all future distributions to equity and repayment thereof, interest and principal payments on shareholder subordinated debt and fees payable to shareholders from projects that have either reached financial close or are at the preferred bidder stage. The DCF valuation does not take into account profits made by other Balfour Beatty Group companies that perform the construction, maintenance or facilities management services associated with the projects.

## Acquisition of Balfour Beatty Communities

Balfour Beatty acquired Balfour Beatty Communities on 30 April 2008 for consideration of £177m (\$350m). This comprised working capital £7m (\$13m), the existing portfolio and preferred bidder projects £123m (\$244m) (including related tax benefit of £26m (\$51m)), and £47m (\$93m) for the ability of the management team to win future projects (the "Pipeline"). The Directors' valuation of the Balfour Beatty Communities portfolio at 31 December 2008 of £196m (\$286m) represents only the closed and preferred bidder projects acquired, plus post acquisition movements. All projects involve the simultaneous transfer of responsibility for existing housing stock and commencement of construction activity at financial close and are therefore classified as operations.

Balfour Beatty Communities holds a market leading position in the US military housing sector for married personnel ("MPH") and derives its income both from fees associated with managing construction and operations and from returns on equity and debt capital. The value at acquisition attributed to the future Pipeline projects, but not included in the Directors' valuation, reflects the company's ability to secure further projects in the MPH sector as well as leveraging its market leading position to secure projects in the developing unaccompanied personnel military housing sector ("UPH") and into the US PPP market generally.

## 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 43 concessions that have reached financial close and a further four at preferred bidder stage.

## DCF

The method used to value the PPP concession 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. DCF has been used on all the 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.

## Discount rate

In order to simplify the valuation methodology, and to align the valuation more readily with market benchmarks, the Directors have adopted a single discount rate of 8.0% nominal post shareholder tax to value the portfolio of closed and preferred bidder projects. The Directors' valuation of Balfour Beatty Capital's portfolio at 31 December 2007 of £299m restated for this approach consequently increases to £306m as at that date. The Directors' valuation of Balfour Beatty's PPP concession portfolio is sensitive to the discount rate adopted. The valuations for a range of discount rates are shown on page 8.

## Shareholder tax

Balfour Beatty receives a number of cash flow streams from its investments. Most, but not all, of these cash flows are subject to tax upon receipt by the Balfour Beatty Group. The Directors' valuation takes into account these cash flows after the imposition of taxation upon the Group and thus uses a post tax discount rate. The post tax discount rate of 8.0% used in the Directors' valuation equates to a discount rate of 10.3% (9.4% for Balfour Beatty Capital and 12.5% for Balfour Beatty Communities) were the value of the cash flows to be reported before the imposition of Group taxation, a methodology also currently used in the marketplace.

## Operational performance gains

In 2008, operational performance gains arise principally from operational improvements identified leading to a revision of the future cost and/or revenue forecasts.

## Translation gain

The USD exchange rate on 30 April 2008, the acquisition date of Balfour Beatty Communities, was 1.98. At 31 December 2008 the exchange rate was 1.46, generating an unrealised gain on translation relating to the Balfour Beatty Communities portfolio valuation of £51m. Of the Balfour Beatty Capital portfolio of 30 projects, one project, ITE West in Singapore, has non GBP denominated cash flows. The unrealised translation gain on the value of ITE West is immaterial and does not register in the movement analysis. The values of Balfour Beatty Communities and the ITE West project are included in the Directors' valuation as at 31 December 2008 at the exchange rates prevailing on that date.

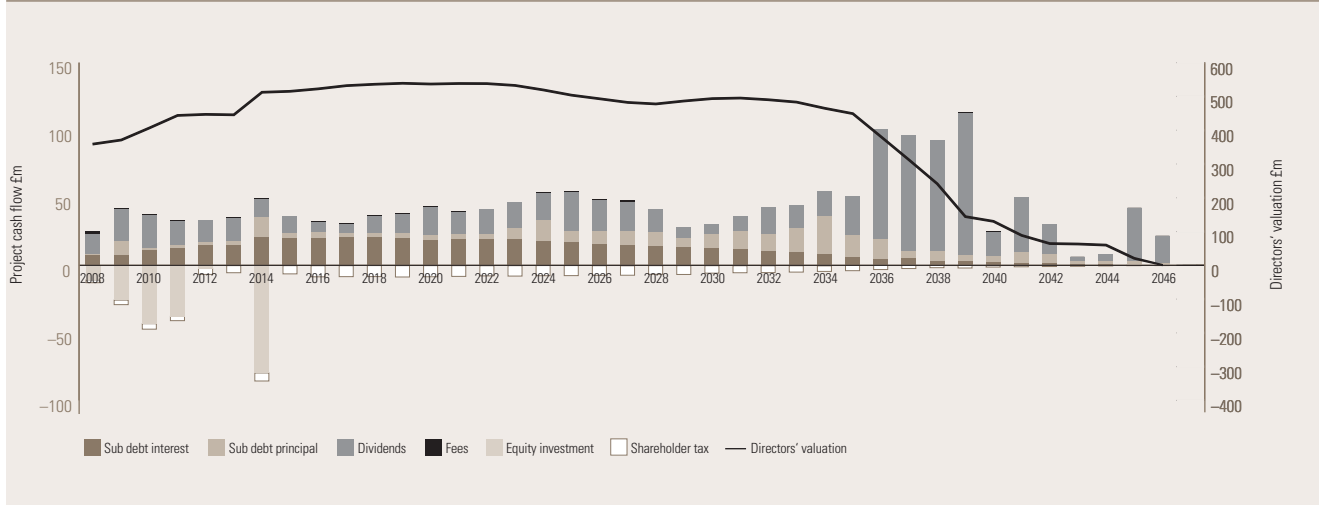
The values shown as at 31 December 2008 for equity committed of £516m and equity invested of £302m include the acquired Balfour Beatty Communities portfolio of £123m (\$244m) together with equity contributed during the year at the exchange rate applicable at the acquisition date of 1.98. A further £27m (\$39m) of future equity commitments for Balfour Beatty Communities have been translated into sterling at the 31 December 2008 exchange rate of 1.46. In addition, the movement in value analysis for Balfour Beatty Communities between years has been translated at an exchange rate of 1.98; the movement between that rate and the year-end exchange rate is shown separately as FX translation.

## Assurance

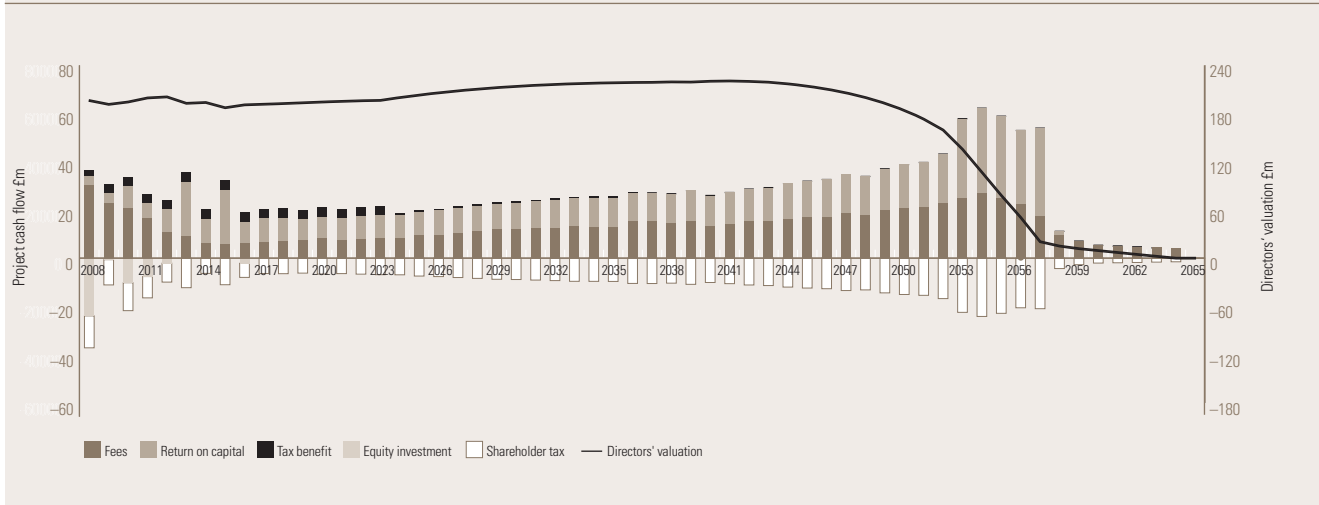
The calculations underpinning the valuation have been independently checked to ensure that the valuation has been accurately carried out in accordance with the specified methodology. However, the detailed financial models have not been audited.

# Directors' valuation of PPP concessions

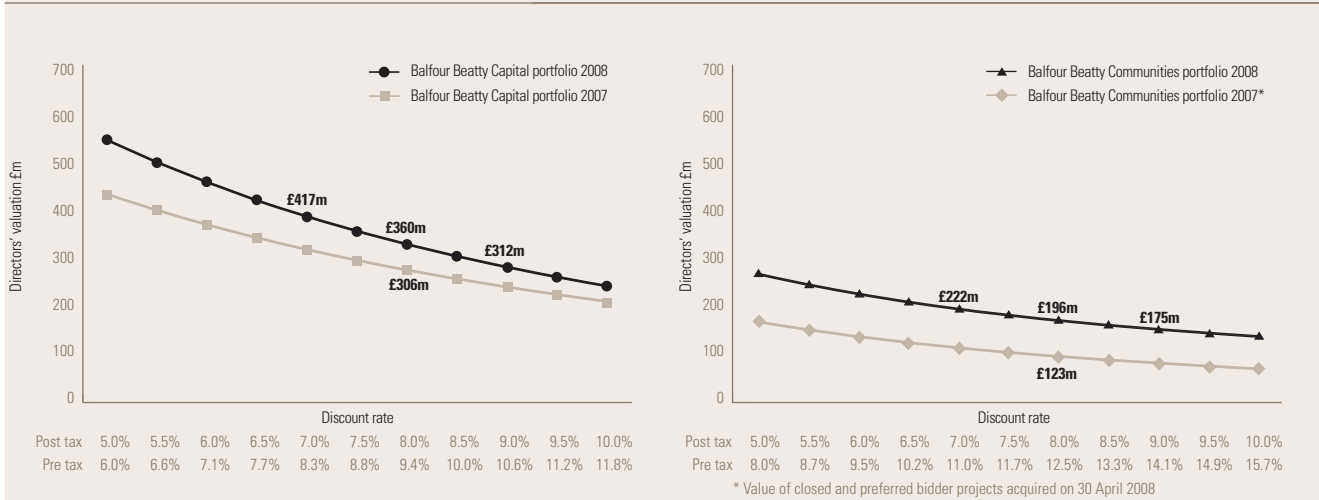
## Balfour Beatty Capital – Annual forecast cash flows and DCF valuation over time



## Balfour Beatty Communities – Annual forecast cash flows and DCF valuation over time



## Balfour Beatty PPP concessions' valuation range



## Principal risks and risk management

The identification, assessment, pursuit and management of opportunities and the associated risks is an integral and inseparable part of management skills and processes. These are a core element of activity throughout the Group and, as such, are especially important for stakeholders.

As referred to in the Directors' report, under the heading "Risk management" on page 15, a Group-wide risk management system underpins and assists in the delivery of this principle.

The system is founded upon a process that drives perceived opportunities and risks progressively, against formal impact and likelihood rating criteria, up through the management chain for review and challenge.

In addition to a discrete review of each individual opportunity and risk, various exercises are carried out at Group level, three times a year, to identify key issues facing the Group as a whole, the changing risk profile facing the Group and emerging issues that may affect the Group, as well

as to assess if the aggregation effect of lower-level risks is material. Such reviews identify the extent to which further initiatives are required, for example, to develop specific additional risk management capability and mitigation measures. The output from these reviews is contained in reports to the Board and Audit Committee.

Furthermore, senior management at operating company and Group level review regularly the opportunity and risk management system and its application with a view to identifying potential improvements to the system and/or its application. The output from these reviews is captured in development plans, which are reviewed at Group level. Progress against the plans is reported upon three times a year to Group senior management and the Board and Audit Committee. Occasionally, independent third parties are engaged to assist the Group with the identification and implementation of potential improvements.

### Risk management process



### Principal risks and risk management

The following table shows the key business risks, which are then addressed below.

Risk group	Type of risk
External	<ul style="list-style-type: none"> <li>• Economic environment</li> <li>• Increased customer expectations</li> <li>• Commercial counterparty solvency</li> <li>• Legal and regulatory</li> </ul>
Strategic	<ul style="list-style-type: none"> <li>• Bidding</li> <li>• Joint venture</li> <li>• Acquisition</li> <li>• Investment</li> </ul>
Organisation and management	<ul style="list-style-type: none"> <li>• Growth</li> <li>• People</li> <li>• Business conduct</li> <li>• Information technology</li> <li>• Information security</li> </ul>
Financial and treasury	<ul style="list-style-type: none"> <li>• Treasury risk management</li> <li>• Finance and liquidity</li> <li>• Treasury counterparty</li> <li>• Contract bonds</li> <li>• Currency</li> <li>• Interest rate</li> <li>• Pension</li> </ul>
Delivery and operational	<ul style="list-style-type: none"> <li>• Performance</li> <li>• Supply chain</li> <li>• Health, safety and environmental</li> </ul>

#### External risks

The Group addresses continually the impact of the external business environment, updating as appropriate its strategy and medium-term planning, both at Group and operating company level. Areas of focus include the following:

##### Economic environment

The Group has a broad exposure to infrastructure markets across its various operating companies. A significant proportion of the Group's revenue flows from contracts founded upon government policy and/or public funding. The current economic environment may cause some customers to delay or postpone their capital investment and asset maintenance plans which would then impact the Group's order book. The breadth of the Group's

exposure to infrastructure markets mitigates the risk of changes in government/regulated entities' expenditure policy in any one market.

The difficult economic environment has also seen increased competition in tenders for work in some private markets and has also resulted in challenges in completing project financing.

##### Increased customer expectations

Customers are increasingly demanding the provision of an integrated approach to the delivery of infrastructure projects. The Group has specialist operating companies which support cross-Group activities and provide customers with management of the delivery of those services.

##### Commercial counterparty solvency

The Group's financial exposure to any of its major customers, subcontractors and suppliers is mitigated by rigorous checks on their financial strength prior to the signing of contracts. To the extent possible, the Group seeks to ensure that it is not over-reliant on any one counterparty.

##### Legal and regulatory

The Group operates in a diverse number of territories and its businesses are therefore subject to a number of complex, demanding and evolving legal and regulatory requirements. In addition to ensuring rigorous compliance with existing regulations, the Group continually monitors and responds to legal and regulatory developments.

##### Strategic risks

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

##### Bidding

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.

##### Joint venture

Joint ventures are formed for contracts where to do so will strengthen the quality of the bid and prospects of delivering a contract successfully.

## Principal risks and risk management

Procedures are in place to ensure that joint venture partners bring skills, experience and resources that complement and add to those provided from within the Group.

### Acquisition

The Group seeks to identify, in alignment with its strategy, a small number of acquisitions in defined sectors. Group management project manages the due diligence, with operating companies drawing on their 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. As the Group grows, it recognises that acquisitions may bring new approaches to opportunity and risk management from which the Group can learn and these are considered as part of regular improvement reviews.

### Investment

The Group promotes and invests in a number of privately-funded infrastructure assets, in selected sectors, both in the UK and internationally. The Group's approach to such opportunities is on a limited recourse finance basis in those business 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.

### Organisation and management risks

As the Group grows, it responds to the challenges this brings to its organisational and management structures, in particular:

#### Growth

The recent and sustained pace of growth of the Group has acted as a catalyst for a number of targeted reviews of the Group's organisation and management structure. Where the results of such reviews indicate a need for changes, these are made promptly, with the allocation of suitably experienced and qualified staff.

#### People

The retention and recruitment of staff is a key challenge for a business which is growing both organically and by acquisition. Defined recruitment and remuneration processes exist at a local level and are centrally co-ordinated to ensure that the Group is competitive and continues to attract the best candidates.

As part of its overall talent management process the Group has well developed succession planning procedures which have ensured that high calibre management is developed and successfully retained within the Group to fill key roles as they arise. In addition, where appropriate, the Group seeks to complement and supplement its existing talent pool with selected strategic hires from outside the Group.

#### Business conduct

The Group expects the highest standards of integrity and conduct from all its employees in their dealings with customers, suppliers and other stakeholders. The Group's "Business Conduct Guidelines" and "Stakeholder Codes of Practice" clearly set out a framework of behaviour expected by the Group of its employees and operating companies. The Group is carrying out a review of its existing codes of practice to ensure they are consistent with best practice. More details are given in the Corporate responsibility statement on page 45 of the Annual review 2008.

### Information technology

The Group is conscious of the reliance placed on IT systems as a platform for efficient delivery of day-to-day operational activities and for knowledge gathering and sharing. Following an internal review, supported by an independent third-party review team, the Group has positioned itself to respond more rapidly to increasing demands in this area, by augmenting its central IT team, to work with operating companies and Group functions to develop and deliver further improvements in line with the Group's IT and disaster recovery strategies.

### Information security

In common with most large organisations, the Group is exposed to potential information security threats and consequently takes active steps to protect both its customers', and partners' as well as its own information and systems from loss or compromise. The Group currently has an initiative in progress to upgrade further its capabilities in this area, following an independent third-party review to identify areas where already effective protection may be strengthened.

### Financial and treasury risks

The Financial review from page 3, together with Note 21 to the accounts, addresses the Group's financial and treasury risks.

### Pension

The Group's pension deficit in respect of its defined benefit schemes is subject to changes in market conditions and increasing longevity assumptions. The assets of the schemes are managed in the light of updated liability assumptions. In addition, specific steps have been taken during the year to restrict certain future increases in the principal defined benefit scheme's liabilities and these are detailed on page 3 of the Financial review and in Note 26 to the accounts.

### Delivery and operational risks

The Group is engaged on a wide range of contracts e.g. asset creation, long-term maintenance, facilities management and asset management, with the successful discharge of all contracts being controlled and managed through the Group's operating structure. In delivering these contracts, rigorous processes are in place for managing the potential risk exposure:

#### Performance

The Group's procedures embrace regular and frequent reviews with an agenda centred on health, safety and environmental performance, issues affecting delivery and the impact on costs to completion and forecast revenue. Where the Group provides services or manages the delivery of such services on behalf of clients or manages assets, such reviews also concentrate on key operational and performance measures. This approach is underpinned by a continuing focus on assurance as to the effectiveness of the relevant controls. Emphasis is also placed on ensuring that the assurance mechanism responds to the challenges posed by the Group's growth.

#### Supply chain

The execution of a large number of the Group's contracts is dependent on the availability of appropriately skilled subcontractors. An increasing proportion of the Group's supply base is retained in long-term relationships based on their alignment with the aims and objectives of the Group, in particular, in respect of adherence to health and safety, ethical standards and financial stability, as well as product quality and price.

#### Health, safety and environmental

The Group has further enhanced the attention it gives to HS&E, along with the continuing objective of improving its performance, as embraced in the safety commitment, Zero Harm, as reported on in more detail in the Chief Executive's review on page 12 and Corporate responsibility statement from page 44 of the Annual review 2008.