

# Directors' report

For the year ended 31 December 2005

The Directors present their annual report on the affairs of the Group, together with the accounts and auditors' report, for the year ended 31 December 2005. Details in relation to health, safety and the environment, business ethics and employment practice and employee consultation are included in the Corporate Responsibility Statement on pages 26 to 29.

## Principal activity

Ultra Electronics is a group of businesses engaged in the design, development and manufacture of electronic systems for the international defence and aerospace markets.

## Results and dividends

The Operating and Financial Review is contained on pages 4 to 25. Group results and dividends are as follows:

	2005 £'000
Balance on retained earnings, beginning of year	34,640
Total recognised income and expense	27,432
Dividends: 2004 final paid of 9.2p per share	(6,078)
2005 interim paid of 5.2p per share	(3,489)
Equity settled employee share schemes	1,142
<b>Balance on retained earnings, end of year</b>	<b>53,647</b>

The final 2005 dividend is proposed to be paid on 5 May 2006 to shareholders on the register at 18 April 2006. The interim dividend was paid on 27 September 2005, making a total of 14.4p (2004: 12.8p) per share paid for the year.

## Future developments

A review of the activities and future developments of the Group is contained in the Operating and Financial Review on pages 4 to 25.

## Research and development

The Directors are committed to maintaining a significant level of research and development expenditure in order to expand the Group's range of proprietary products. During the year a total of £77.9 million (2004: £70.4 million) was spent on engineering development of which £60.6 million (2004: £54.9 million) was funded by customers and £17.3 million (2004: £15.5 million) by the Group.

## Post balance sheet date events

On 12 January 2006, Ultra announced the acquisition of Polyflex Aerospace Ltd., a company based in Cheltenham, UK, for a cash consideration, subject to net asset adjustment on completion, of £4.0 million.

## Directors and their interests

The Directors who served throughout the year and their interests in the shares of the Company are listed on page 44.

## Substantial shareholdings

At 27 February 2006, the Company had been notified in accordance with Sections 198-208 of the Companies Act 1985 that the following were registered as having an interest in 3% or more of the Company's ordinary share capital:

	Percentage of ordinary share capital	Number of 5p ordinary shares
Barclays plc	10.2	6,840,590
The Aegon UK plc Group of Companies	4.1	2,739,212
Legal and General	3.9	2,678,026
Morley Fund Management	3.1	2,106,456
Sun Life Assurance	3.1	2,064,069
Lloyds TSB Group plc	3.0	2,015,937

## Charitable and political contributions

The Group contributed £23,000 (2004: £19,000) to charities and made no contributions for political purposes in either year.

### Supplier payment policy

Operating divisions are responsible for agreeing the terms and conditions under which they conduct business transactions with their suppliers. It is Group policy that payments to suppliers are made in accordance with those terms, provided that the supplier is also complying with all relevant terms and conditions.

Trade payable days of the Group for the year ended 31 December 2005 were 51 days (2004: 51 days), based on the ratio of Group trade payables at the end of the year to the amounts invoiced during the year by suppliers. The Company had no trade payables at either year end.

### Annual General Meeting

Explanation of special business resolutions is given below:

#### **Resolution 8**

This resolution authorises the Directors to allot shares in the Company up to a maximum nominal amount of £1,120,351 (one third of the allotted and fully paid up share capital of the Company).

#### **Resolution 9**

That, the definition of "adjusted capital and reserves" in article 103 (C)(i) of the Company's Articles of Association be amended by the addition of the following article 103 (C)(i)(f):

(f) excluding the effect on the reserves of any retirement benefits scheme deficit or surplus (net of associated deferred tax) which would otherwise be included in accordance with applicable accounting standards.

The Board of the Company is required to restrict the borrowings of the Group such that they do not exceed twice the Company's share capital and consolidated reserves. The implementation and application of IAS 19 and the International Financial Reporting Standards impacts upon accounting for retirement benefits scheme deficits and surpluses when calculating reserves. A retirement benefits scheme deficit would, as a result, reduce the Company's borrowing limit. The proposed resolution would exclude the retirement benefits scheme deficit or surplus in the calculation of consolidated reserves.

#### **Resolution 10**

This resolution authorises the Directors to allot shares for cash, without first having offered to allot such shares to existing shareholders in proportion to their existing holdings, in respect of 5% of the total issued share capital of the Company. Resolutions 8 and 10 comply with the Association of British Insurers' guidelines and renew similar authorities given previously. The authorities expire on the earlier of the conclusion of the next Annual General Meeting of the Company or 15 months after the date of passing these resolutions. The Directors have no current intention to exercise the authorities sought by these resolutions except for employee share option schemes.

#### **Resolution 11**

This resolution authorises the Directors to purchase up to a total of 3,361,054 of the Company's shares (representing 5% of the issued share capital of the Company). This authority expires on the earlier of 12 months from the date of passing this resolution or the conclusion of the next Annual General Meeting of the Company.

The Directors will use the share purchase authority with discretion. In reaching a decision to purchase shares of the Company the Directors would take account of the Company's business and any impact on earnings per share and net tangible assets per share. The Directors have no current intention to exercise the authority sought by this resolution.

#### **Resolution 12**

To amend the Company's Memorandum and Articles of Association to allow the Company to provide appropriate indemnities to its Directors against any liability incurred by them in relation to alleged Company-related negligence, default, breach of duty or breach of trust and to fund Director's defence costs against such allegations.

The Board believes that the provision of appropriate indemnities and the funding of Director's defence costs are important to ensure that the Company continues to attract and retain the highest calibre of Directors. The full wording of this resolution is included in the Notice of Annual General Meeting.

**By order of the Board,**

**D. Jeffcoat**  
*Company Secretary*  
27 February 2006

Registered Office: 417 Bridport Road, Greenford, Middlesex UB6 8UA Registered Number: 2830397

### Combined code compliance

This section describes how the Group has applied the principles set out in Section 1 of the Combined Code on Corporate Governance, published in July 2003 ("the Code"). A summary of the Group's compliance position throughout the year follows with details of any exceptions.

### Main Board

The Board deals with the important aspects of the Group's affairs including setting and monitoring strategy, reviewing performance, ensuring that the Group has adequate financial resources and reporting to shareholders.

The Board has established Audit, Nominations and Remuneration Committees, to which certain key responsibilities are delegated. These responsibilities, which are in line with the recommendations of the Combined Code, are set out below.

At the end of 2005 the main Board comprised the Chairman, three independent non-executive Directors and four executive Directors. The former Chairman, Peter Macfarlane, retired after the 2005 Annual General Meeting. Julian Blogh, who had previously been Chief Executive, was appointed Chairman. This appointment followed consultations with major shareholders who supported this step. Dr Blogh was replaced as Chief Executive by Douglas Caster, an existing executive Director and previously Chief Operating Officer of the Group. As senior independent non-executive Director, Andrew Walker has particular responsibility, on behalf of the Board, for safeguarding the provisions of the Combined Code on Corporate Governance, and is available to shareholders if they have concerns that contact through the normal channels of Chairman, Chief Executive or Finance Director has failed to resolve, or for which such contact is inappropriate.

Christopher Bailey replaced Mr Macfarlane as an independent non-executive Director. Ian Griffiths continues in his role as an independent non-executive Director. Although the Code calls for the majority of the Board to be independent non-executive Directors, it is the view of the Directors that the current structure of the Board is appropriate for Ultra given the relative complexity of the business and the desire of the Board to maintain a flexible, rapid and informed decision-making process. Any further increase in the number of non-executive Directors at this time would result in reduced focus, slower decisions and a higher cost base.

David Jeffcoat, who was appointed to the Board in 2000, is both Finance Director and Company Secretary, reporting to the Chief Executive. Although this does not follow best governance practice, which calls for the roles to be separated and for the Company Secretary to report directly to the Chairman, Ultra's lean management structure does not permit extra costs to be incurred by appointing an independent Company Secretary. The Board believes that Mr Jeffcoat is able to effectively maintain sufficient separation of his two roles to avoid any significant conflicts of interest.

The Board met ten times during the year. Details of the numbers of meetings of the main Board and its sub-committees that were attended by the individual Directors are set out in the table on page 36.

Key decisions that are delegated to the Chief Executive include the approval of budgeted capital investments below £500,000 in value, major contract bids below £100.0 million, the appointment and dismissal of business unit Managing Directors and setting their individual levels of remuneration, and charitable donations with the advice of an internal charities committee.

### Audit Committee

The Board has overall responsibility for reviewing the effectiveness of internal control procedures throughout the Group, although the Audit Committee monitors the internal financial control procedures that are operated by the Group and their effectiveness.

During 2005 the Audit Committee initially comprised Andrew Walker, Committee Chairman and senior independent non-executive Director, Ian Griffiths and Peter Macfarlane. Christopher Bailey joined the committee in January 2005, whilst Mr Macfarlane left the Committee when he retired in April 2005. Mr Bailey was Group Finance Director of Aggregate Industries plc for seven years until his retirement in 2004. His recent financial experience is of great benefit to the Board.

The Committee met five times during the year. The main topics considered during the meetings were:

- agreeing the strategy and scope of planned internal and external audit activities;
- reviewing the outcome of internal and external audits carried out and agreeing upon the necessary actions;
- reviewing the financial results of the Group and the formal external announcements relating to them;
- monitoring the independence and effectiveness of the internal and external audit functions, both of which are carried out by professional accounting firms on behalf of the Group;
- assessing the risk that the Group's financial statements are materially mis-stated as a result of fraud, and
- re-appointment of Deloitte & Touche LLP as external auditors.

### Audit Committee (continued)

It is the policy of the Group that non-audit services provided by Deloitte & Touche LLP, Ultra's external auditors, are restricted to regulatory reporting, training and consultancy services connected with responding to new reporting requirements, due diligence assignments of larger potential acquisition targets and other attestation work. In connection with due diligence assessments, the Board believes that the auditors' familiarity with the accounting techniques that are involved in the Group's long-term contracting activities serves them well in carrying out effective due diligence reviews of other similar companies. Appropriate controls are in place to ensure that the objectivity and independence of Deloitte & Touche LLP is safeguarded.

### Nominations Committee

The Nominations Committee comprises the non-executive Directors and the Chief Executive. The Committee was chaired by Peter Macfarlane and met once during 2005. Following the retirement of Mr Macfarlane, Julian Blogh has taken over as Chairman. Douglas Caster was appointed to the Nominations Committee with effect from April 2005. The key responsibility of the Committee is to review all main Board and sub-committee appointments. The main action taken by the Committee during the year was to recommend the appointment of Christopher Bailey as a non-executive Director and as a member of the Audit, Remuneration and Nominations Committees with effect from January 2005.

### Remuneration Committee

The Board Remuneration Committee consists of Andrew Walker, Chairman, Christopher Bailey and Ian Griffiths. Peter Macfarlane was also a member of the Committee until April 2005. It met six times during the year. The Committee is responsible for evaluating the performance of the executive Directors, including the Chief Executive, and for setting their levels of remuneration. A Directors' remuneration report is included on page 39, together with details of the Directors' pension entitlements, long term incentive share awards and shareholdings.

### Evaluation of Board and Committee effectiveness

Following the recommendations of the Code, the Board has introduced an evaluation process in which the effectiveness of the Board, its sub-committees and each individual Director are assessed over a two year rolling period. In 2004 the main Board and its sub-committees were reviewed with the assistance of external consultants. This review was based upon a questionnaire that was completed independently by all members of the Board. The scope of the review covered the Board structure, processes and administration, together with the distribution of information. Its results were communicated to the Directors in a written report, considered at a separate meeting and a number of actions were agreed as a result. Subsequently during 2005 the contribution of each individual Director was assessed by the rest of the Board. This stage was based upon a self-assessment questionnaire that was completed by each individual Director and also by each of the remaining Board members. The results of this survey were summarised and fed back separately to each individual and in total to the Chairman. Again this process was designed and coordinated by external consultants. The intention is to repeat this review cycle every two years in the future.

### Directors' re-election

Douglas Caster and Andrew Hamment are retiring by rotation in accordance with the Articles of Association and standing for re-election. Andrew Walker has served as an independent non-executive Director for more than nine years and is therefore required to stand for re-election annually. The complexity of the Group's activities, his previous experience as an executive Director of several major groups and his extensive knowledge of Ultra mean that he is well qualified for his current position on Ultra's Board. The Directors are convinced that Mr Walker remains highly effective in his role as senior non-executive and that it is in the best interests of the shareholders for him to continue.

### Meeting attendance

	Main Board	Audit Committee	Nominations Committee	Remuneration Committee
Number of meetings	10	5	1	6
C. Bailey	10	5	-	6
J. Blogh	10	-	1	-
D. Caster	10	-	-	-
I. Griffiths	9	5	1	5
A. Hamment	10	-	-	-
F. Hope	10	-	-	-
D. Jeffcoat <sup>1</sup>	9	5	1	1
P. Macfarlane	4	2	1	3
A. Walker	9	5	1	5

<sup>1</sup> Mr Jeffcoat is secretary to the Board and all three sub-committees. He attends all Committee meetings in that capacity.

### Internal controls

The Combined Code states that Directors should review the effectiveness of the Group's entire system of internal controls, covering business risks associated with strategic, operational, financial and information technology matters. Ultra's internal controls are designed to meet the Group's particular needs and the risks to which it is exposed. In this context the controls can provide only reasonable, not absolute, assurance against material errors, losses or fraud. The key features of the internal control system that operated during the year and that remain in existence are described below.

### Control environment

Ultra's organisational structure has clearly defined lines of responsibility and delegated authorities, which have been reviewed by the Board during the year to ensure that they are still relevant given the current size and structure of the Group. Ethical values and control consciousness are communicated to managers and staff via performance appraisal and development and training programmes.

All businesses are required to maintain written financial procedure manuals that are consistent with the control principles and policies that are set out in the Ultra Group Finance Manual. Acquisitions, major capital investments and bids above a defined value require Board approval, with smaller investment decisions delegated to the Chief Executive.

### Risk management

Management has a responsibility for identifying the risks facing Ultra's businesses and for putting in place procedures to monitor and mitigate such risks. Strategic risks are formally assessed by the Board during the annual strategic planning process and steps are taken following this process to ensure that all such risks are minimised throughout the year.

Operational risks are monitored as part of the Group's monthly business performance review process. Business units are required to report on all key areas of risk, indicating situations that are not compliant with normal controls.

Remedial actions must be proposed and such situations are then monitored until a satisfactory conclusion is reached. All significant deviations are reported to the Board by the responsible Director twice annually.

The Board has established an Internal Audit process, carried out by Ernst & Young LLP, to review financial and information systems control procedures throughout the Group. All business units are audited at least once every two years and those judged to represent a higher risk are reviewed more often. In addition all significant newly acquired businesses are audited within six months of the acquisition date. Internal Audit reports to the Chairman of the Audit Committee and presents its findings to the Audit Committee. Follow-up actions to deal with any control weaknesses are reported to the Committee every six months and Internal Audit confirms that satisfactory progress has been made during its next visit to the business concerned.

In addition the executive Directors take an active role in identifying and assessing potential risks in all areas of the business. This is achieved both through the normal monthly business review programme and also through day-to-day management contact.

### Financial reporting systems

The Group has a comprehensive system of financial reporting covering key performance indicators such as sales, profits and cash flow. The annual budget and five year strategic plan for each business are approved by the executive Directors and the Board approves the Group's budget and plan. The actual results for each business and variances against budget are reported monthly to the Board, normally during the third week of the following month. Revised forecasts for the half-year and full-year are prepared monthly for each business unit, and for the Group as a whole, and also presented to the Board.

### Shareholder communication

The Group encourages two-way communications with both institutional and private investors and endeavours to respond promptly to queries received. Ultra's website provides detailed financial and business information about the Group. Meetings between Directors, institutional shareholders and other market professionals are held regularly as a part of Ultra's investor relations programme. Shareholders are invited to attend the Annual General Meeting, to ask questions during the meeting and to meet individual Directors after the formal proceedings have ended. Documentation relevant to Ultra's governance framework will be available for inspection before the Meeting, including the terms of reference of the Board and its sub-committees and the Directors' contracts of employment. The terms of reference can also be found on the Group website at [www.ultra-electronics.com](http://www.ultra-electronics.com).

### Effectiveness of controls

The Board accepts overall responsibility for reviewing the operation and effectiveness of the Group's internal control framework on a regular basis; internal procedures are reviewed and updated where necessary. The Board has performed a specific assessment for the purpose of this annual report. This assessment considered all significant aspects of internal control arising during the period covered by the report, including the work of Internal Audit. The Audit Committee assists the Board in discharging its review responsibilities.

### Going concern

After making enquiries the Directors have established that the Group's forward order book provides satisfactory cover for trading in the year to come and have a reasonable expectation that the Company and Group have adequate financial resources to continue in operational existence for the foreseeable future. The Group's banking facilities were renewed in November 2005 evidencing the Group's strong credit standing. For these reasons, the Board continues to adopt a going concern basis in preparing the accounts.

### Statement of responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements. The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRS) and have chosen to prepare the Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP).

In the case of UK GAAP company financial statements, the Directors are required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In the case of IFRS financial statements, International Accounting Standard 1 requires that financial statements present fairly for each financial year the Group's financial position, financial performance and cash flows. 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 International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards. Directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in International Financial Reporting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- prepare the accounts on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or have no realistic alternative but to do so.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' report and Directors' remuneration report which comply with the requirements of the Companies Act 1985.

The Directors are responsible for the maintenance and integrity of the Company website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

### UNAUDITED INFORMATION

#### Composition and role of the Remuneration Committee ('the Committee')

The Company complies with the relevant conditions of the Combined Code on Corporate Governance relating to Directors' remuneration as published by the London Stock Exchange and the Directors' Remuneration Report Regulations 2002.

Andrew Walker is the Chairman of the Committee and the other members are Christopher Bailey and Ian Griffiths. All three members are non-executive Directors. Julian Blogh and Douglas Caster also normally attend Remuneration Committee meetings, although they are not formally members of the Remuneration Committee.

The task of the Committee is to make recommendations to the Board on the framework of executive remuneration and to determine annually the individual salaries, annual bonuses payable (if any) and other terms and conditions of employment of the executive Directors and other senior executives. The Committee also approves the terms of any discretionary share schemes in which executive Directors and senior executives may be invited to participate, and the terms of the Company's Savings Related Share Option Scheme and All-Employee Share Ownership Plan.

The Committee consulted Douglas Caster, Chief Executive, with regard to the remuneration and benefits packages offered to executive Directors and senior executives during the year, except in relation to his own remuneration and benefits package which is determined by the Committee in his absence.

In addition, wholly independent advice on executive remuneration and share schemes was received from New Bridge Street Consultants who were appointed by the Company and who provided no other services to the Company during the year, save for ongoing advice in connection with the operation of the Company's share schemes.

#### Remuneration policy

The policy of the Committee is to reward senior management competitively, enabling the Company to recruit, motivate and retain executives of high calibre, whilst avoiding paying excessive remuneration. Further details of the remuneration policy followed by the Committee are set out below. The remuneration practices adopted by a group of like companies that, in the opinion of the Committee, face similar remuneration issues to the Company, are considered with guidance from the remuneration consultants who advise the Committee. The size and nature of each key element of the remuneration package of the executive Directors has been determined following this analysis.

It is the aim of the Committee to encourage and reward high performance. It is the opinion of the Committee that shareholders' interests are best served by setting a moderate level of fixed pay, while providing competitive potential levels of total remuneration through short and longer term incentive arrangements which require the satisfaction of challenging performance conditions. Therefore, a significant proportion of the executive Directors' remuneration is performance-linked.

#### Salaries

Salaries of executive Directors are reviewed by the Committee annually. In addition to an analysis presented by New Bridge Street Consultants, the Committee uses published salary surveys and information available in the annual reports of similar companies as sources of market information. The Committee takes account of pay and employment conditions elsewhere in the Group when determining annual salary increases.

Specific factors taken into account by the Committee when determining each executive Director's base salary are:

- the median level of base salary for a similar position within a like group of companies;
- the individual Director's performance; and
- the responsibilities of the respective Director.

The Chairman's remuneration is set by the Committee, which meets without him for this purpose. The remaining non-executive Directors' fees are set by a Committee comprising the executive Directors. In all cases the remuneration awards are based upon published salary surveys, taking account of individual responsibilities. Andrew Walker is Chairman of the Audit and Remuneration Committees and receives additional remuneration as a result.

#### Annual bonus scheme

Bonus payments are based upon the achievement of operating profit and cash flow targets. The maximum bonus for 2005 was 50% of base salary, of which 10% related to the achievement of a £45,900,000 profit before tax and loss on fair value movements on derivatives and amortisation of intangibles arising on acquisition and 40% to achieving an operating cash flow of £34,000,000 after capital expenditure and purchase of long-term incentive plan shares. The actual results for the year led to a bonus pay-out of 44.9%. The pay-out was below the maximum despite the above target full year results because of higher working capital levels during the year. The performance measures for bonus payments are reviewed annually by the Committee to ensure that they are appropriate to the current market conditions and position of the Group and, therefore, that they continue to remain challenging. It is the opinion of the Committee that the use of operating profit and cash flow targets remains appropriate for the 2006 bonus scheme.

### Long-Term Incentive Plan

In April 2002, shareholders approved the establishment of the Ultra Electronics Long-Term Incentive Plan 2002-2007 (the 'New LTIP') to replace the previous Ultra Electronics Long-Term Incentive Plan (the 'Old LTIP') that had expired. The Committee's current policy is for the New LTIP to be the sole vehicle through which long-term incentives are provided to executive Directors and that executive Directors who participate in the New LTIP will not be granted options under either the Company Share Option Plan or the Executive Share Option Scheme (which are share schemes operated by the Company for the benefit of less senior executives and certain key employees).

Under the New LTIP, a participant may be granted an award over ordinary shares worth up to 100% of gross base salary each year. The vesting of awards is dependent on the extent to which genuinely stretching earnings per share ('EPS') based performance conditions are met over the three-year period following grant. The Committee believes that the most appropriate approach to determine the extent to which these performance targets are achieved is for the relevant calculations to be undertaken by an independent third party. For the purposes of the performance targets for 2005 onwards, the Company's EPS will be calculated before amortisation of intangible assets arising on acquisition and gain or loss on derivative financial instruments. For earlier periods the Company's EPS has been calculated before goodwill amortisation but after exceptional items.

More particularly, the Committee's current policy is for vesting of awards to be dependent upon the Company's EPS growth over this three-year period relative to the EPS growth of a group of comparative companies. For the 2005 vesting these companies were:

<b>Alba plc</b>	<b>Henlys Group plc</b>
<b>Alvis plc</b>	<b>Meggitt plc</b>
<b>AIM Group plc</b>	<b>Rolls-Royce plc</b>
<b>Amstrad plc</b>	<b>Rotork plc</b>
<b>BAE Systems plc</b>	<b>Senior plc</b>
<b>Charter plc</b>	<b>Smiths Group plc</b>
<b>Chemring Group plc</b>	<b>Spirax-Sarco Engineering plc</b>
<b>Chloride Group plc</b>	<b>Telemetrix plc</b>
<b>Cobham plc</b>	<b>TT Electronics plc</b>
<b>Delta plc</b>	<b>Vitec Group plc</b>
<b>Domino Printing Sciences plc</b>	<b>Volex Group plc</b>
<b>Halma plc</b>	<b>VT Group plc</b>
<b>Hampson Industries plc</b>	<b>Whatman plc</b>

Vesting commences at 20% for median performance, rising on a straight-line basis so that the award vests in full for upper-quartile performance. To the extent that the targets are not met at the end of the three-year period, the award lapses. Ultra achieved third quartile EPS growth performance during the period 2003-2005 and therefore the 2002 award vested at 84%.

The Committee believes that the appropriate performance measure for New LTIP awards is comparative EPS, because this measure ensures that the Company's earnings growth must be at the upper-quartile of a group of similar companies before awards vest in full. Such earnings growth performance, sustained over the medium to long-term, should ensure above average share price growth, and hence out-performance against market benchmarks in creating shareholder value.

The executive Directors are also eligible to participate in the Company's Inland Revenue approved All-Employee Share Ownership Plan ('AESOP').

Under the AESOP, employees in the UK are offered the opportunity to buy shares up to the value of £1,500 per year from pre-tax salary. Shares are then held in trust on behalf of employees until the maturity date or until they leave the Company.

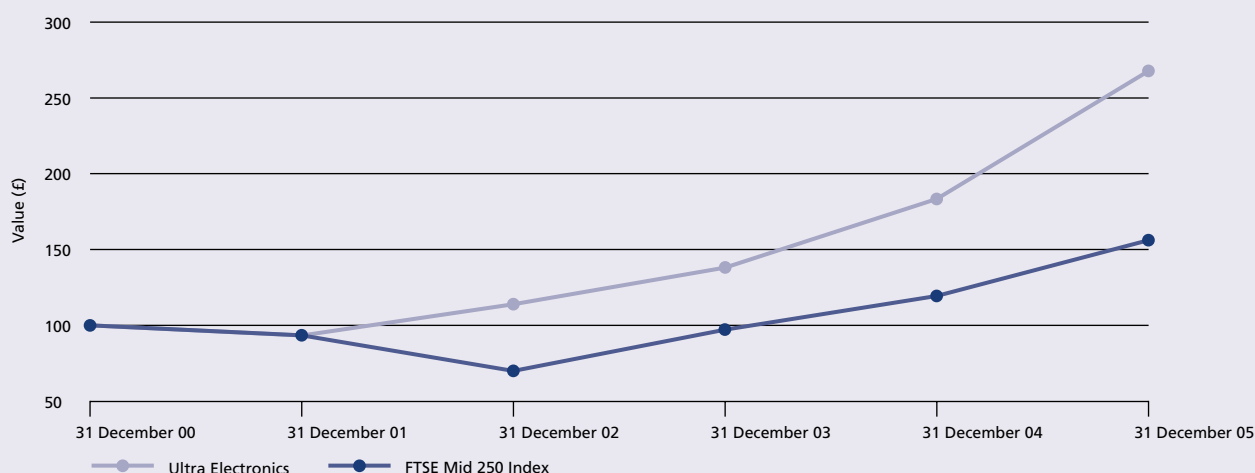
### Total Shareholder Return performance graph

The graph opposite shows the Total Shareholder Return ('TSR') performance of the Company in comparison to the FTSE Mid 250 over the past five years. The graph shows the value at the end of 2005 of £100 invested at the end of 2000, in the Company and in the Index.

The Committee considers the FTSE Mid 250 index a relevant index for TSR comparison as the index members represent a broad range of UK quoted companies.

**Total Shareholder Return performance graph (continued)****Total Shareholder Return**

Source: Datastream

**Directors' service contracts**

The service contracts of executive Directors have a notice period of one year, which the Committee considers appropriately reflects both current market practice and the balance between the interests of the Company and each executive Director. In the event of early termination, it is the Committee's policy that the amount of compensation paid to executive Directors will be considered in the light of all the relevant circumstances, subject to the overriding conditions that:

- the Committee's aim will be to avoid rewarding poor performance;
- the duty of the relevant executive Director to mitigate his loss will be taken into account; and
- no compensation payment can exceed one year's salary.

The following table provides more information on each Director's service contract:

Name	Date of contract	Notice period
C. Bailey	28 January 2005	N/A
J. Blogh	22 April 2005	N/A
D. Caster	25 September 1996	12 months
I. Griffiths	1 April 2004	N/A
A. Hamment	1 July 2000	12 months
F. Hope	1 January 1999	12 months
D. Jeffcoat	10 July 2000	12 months
A. Walker	1 January 2004	N/A

No executive Directors have provisions in their contracts for compensation on early termination other than the notice period. The non-executive Directors have fixed twelve-month contracts with no notice period. There are no provisions in their contracts for compensation on early termination.

**AUDITED INFORMATION****Directors' pension entitlements**

The Company operates a contributory pension scheme for current executive Directors. A pension equal to two-thirds of salary at retirement is provided at the normal retirement age of 63 years. Where pensionable service is less than 20 years, the pension is calculated at one-thirtieth of the retirement salary for each year of service. With the Company's consent, executive Directors may retire from age 50. After age 58, Company consent to early retirement is not required. Pensions are reduced in the event of early retirement. Death-in-service cover is a lump sum of four times pensionable earnings. In addition, a spouse's pension of 33% of pensionable earnings is payable, together with an allowance for dependent children up to a maximum of 33% of pensionable earnings where relevant. On the death of a retired Director, a spouse's pension of 50% of the Director's pension is payable. Once the pension is in payment, the part of the Director's pension above the Guaranteed Minimum Pension will be increased each year in line with the increase in the retail price index, capped at 7.5%, above which increases are at the Trustees' discretion.

The table below sets out the pension benefits earned by executive Directors for the year ended 31 December 2005:

	Age at year-end	Accrued benefit at beginning of period	Increase in period (net of indexation)	Transfer value of increase in period	Accrued benefit at end of period	Transfer value at beginning of period	Transfer value at end of period	Movement in transfer value during period*
		£'000	£'000	£'000	£'000	£'000	£'000	£'000
J. Blogh <sup>1</sup>	62	185	21	387	206	2,842	3,781	935
D. Caster	52	75	24	235	101	736	1,071	318
A. Hamment	51	46	4	33	52	424	514	82
F. Hope	51	30	3	25	35	276	339	56
D. Jeffcoat	55	15	4	38	19	172	238	58

\*Less Directors' contributions.

<sup>1</sup> J. Blogh's contributions were to his date of retirement on 22 April 2005.

**Directors' remuneration**

Directors' emoluments are detailed below:

	Basic salary	Other cash emoluments	Fees	Annual performance bonus	Benefits	2005 Total	2004 Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
P. Macfarlane	-	-	19	-	-	19	70
C. Bailey	-	-	27	-	-	27	-
J. Blogh <sup>1</sup>	66	-	89	29	11	195	344
D. Caster	239	-	-	107	23	369	297
I. Griffiths	-	-	29	-	-	29	27
A. Hamment	130	12	-	58	2	202	194
F. Hope	175	-	-	79	18	272	256
D. Jeffcoat	175	7	-	79	5	266	257
A. Walker	-	-	34	-	-	34	32
	<b>785</b>	<b>19</b>	<b>198</b>	<b>352</b>	<b>59</b>	<b>1,413</b>	<b>1,477</b>

<sup>1</sup> J. Blogh's basic salary, annual performance bonus and benefits covered his period of employment as Chief Executive from 1 January 2005 to 22 April 2005. His fees covered the period from 23 April 2005 to 31 December 2005.

Pension contributions to Directors of £102,905 (2004: £118,600) were paid by the Company, including £38,133 (2004: £33,075) in respect of the highest paid Director. Other benefits of executive Directors comprise a car (or allowance), provision of fuel and insurances for life, personal accident and family medical cover. Non-executive Directors are not eligible for pension scheme membership and do not participate in any of the Group's bonus or other incentive plans.

**Directors' interests under Long-Term Incentive Plans**

As described above, the Company operated the Old LTIP until its expiry and replacement by the New LTIP. Details of the Directors' interests in these arrangements are given on the following page:

**Directors' interests under Long-Term Incentive Plans (continued)****Interests under the Ultra Electronics Long-term Incentive Plan (the 'Old LTIP')**

Award periods	No. of shares					Market price of shares granted	Crystallising dates of outstanding awards
	J. Blogh	D. Caster	A. Hamment	F. Hope	D. Jeffcoat		
2002	52,170	31,302	24,662	29,879	32,013	£4.22	April 2005
Interests at 1 January 2005	52,170	31,302	24,662	29,879	32,013		
2002 award crystallised during the year	(43,822)	(26,293)	(20,716)	(25,098)	(26,890)		
2002 award lapsed during year	(8,348)	(5,009)	(3,946)	(4,781)	(5,123)		
<b>Interests at 31 December 2005</b>	-	-	-	-	-		

The 2002 award crystallised during the year as detailed above. This award was granted under the Old LTIP that was subject to the same performance conditions disclosed above in relation to the New LTIP. The actual date of the award was February 2002. The market price of the shares when granted was £4.22: the market price of the shares on vesting was £7.40. The aggregate gain made by the executive Directors under the Old LTIP during the year was £1,056,503 (2004: £762,325).

No awards were made under the Old LTIP in 2005, nor shall be made in the future.

**Interests under the Ultra Electronics Long-Term Incentive Plan 2002-2007 (the 'New LTIP')**

Award periods	No. of shares					Market price of shares granted	Crystallising dates of outstanding awards
	J. Blogh	D. Caster	A. Hamment	F. Hope	D. Jeffcoat		
2003	50,864	30,386	24,221	29,065	31,047	£4.54	April 2006
2004	49,443	29,084	23,267	27,727	29,278	£5.16	April 2007
Interests at 1 January 2005	100,307	59,470	47,488	56,792	60,325		
2005	26,280	26,954	16,576	22,237	21,832	£7.42	April 2008
<b>Interests at 31 December 2005</b>	<b>126,587</b>	<b>86,424</b>	<b>64,064</b>	<b>79,029</b>	<b>82,157</b>		

These awards are subject to the comparative EPS-based performance conditions described above. During the year, the Group purchased 79,155 shares (nominal value of £3,958) for a net £596,000 relating to the 2005 awards (2004: 196,878 shares – £1,124,000). This includes £481,000 worth of Ultra shares for the Directors (2004: £902,000). The Group purchased 79,155 shares for the 2005 award at the then mid-market price from Directors who sold shares on crystallisation of the 2002 awards as noted above. The mid-market price was £7.53 on the date of purchase. Shares were sold by J. Blogh (17,663), D. Caster (10,598), A. Hamment (20,716) and D. Jeffcoat (5,523).

On the 23 April 2005, J. Blogh retired as Chief Executive and became non-executive Chairman. The Remuneration Committee having taken appropriate external advice, made a discretionary decision to allow him to retain his existing LTIP entitlement at that time.

**Directors' interests under the All-Employee Share Ownership Plan**

As described above, the Company operates an All-Employee Share Ownership Plan ('AESOP') in which the executive Directors are eligible to participate. Details of the executive Directors' interests in this arrangement are given below:

Name of Director	Interests as at 1 January 2005	Partnership shares acquired during year	Interests as at 31 December 2005	Partnership shares acquired from 1 January 2006 to 27 February 2006	Interests as at 27 February 2006
D. Caster	1,181	209	1,390	25	1,415
A. Hamment	1,181	209	1,390	25	1,415
F. Hope	1,181	209	1,390	25	1,415
D. Jeffcoat	1,090	206	1,296	25	1,321
<b>Total</b>	<b>4,633</b>	<b>833</b>	<b>5,466</b>	<b>100</b>	<b>5,566</b>

**Directors' interests under the All-Employee Share Ownership Plan (continued)**

During the year, the Share Ownership Plan Trust, established and operated in connection with the AESOP, purchased 53,426 (2004: 65,672) Ultra Electronics Holdings plc shares (nominal value £2,671) for £431,750 (2004: £394,475). One executive Director, David Jeffcoat, is a trustee of the Plan Trust as well as participating in the AESOP.

**Directors' interests**

Details of Directors' shareholdings are given below:

	At start of year		At end of year		At 27 February 2006
	Direct ownership	Indirect beneficial ownership	Direct ownership	Indirect beneficial ownership	Direct ownership
C. Bailey	-	-	-	2,500	-
J. Blogh	232,000	884,921	258,159	884,921	258,159
D. Caster	520,590	500,576	536,494	500,576	536,519
I. Griffiths	-	-	-	-	-
A. Hamment	55,154	43,535	55,363	43,535	55,388
F. Hope	50,683	-	75,990	-	76,015
D. Jeffcoat	5,458	13,500	40,531	-	40,556
A. Walker	1,096	469	1,096	469	1,096

There were no changes in indirect beneficial ownership between 1 January 2006 and 27 February 2006.

**Andrew Walker**

*Chairman of the Remuneration Committee*

27 February 2006

**To the members of Ultra Electronics Holdings plc**

We have audited the Group financial statements (the “financial statements”) of Ultra Electronics Holdings plc for the year ended 31 December 2005 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of recognised income and expense, the related notes numbered 1 to 28 and the statement of accounting policies. These financial statements have been prepared under the accounting policies set out therein.

The Corporate governance statement and the Directors' Remuneration report are included in the individual Company Annual Report of Ultra Electronics Holdings plc for the year ended 31 December 2005. We have reported separately on the individual Company financial statements of Ultra Electronics Holdings plc for the year ended 31 December 2005 and on the information in the Directors' Remuneration report included in the Annual 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 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 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 in accordance with the relevant framework and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you if, in our opinion, the Directors' report is not consistent with the financial statements. We also report to you if 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 transactions with the Company and other members of the Group is not disclosed.

We read the Directors' report and the other information contained in the Annual Report for the above year as described in the contents section and we consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

**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. 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 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.

**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 affairs as at 31 December 2005 and of its profit for the year then ended; and
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.



**Deloitte & Touche LLP**  
Chartered Accountants and Registered Auditors  
London, England  
27 February 2006

**Notes:** An audit does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial statements since first published. These matters are the responsibility of the Directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

## Consolidated income statement

For the year ended 31 December 2005

	Note	2005 £'000	2004 £'000
<b>Continuing operations</b>			
Revenue	3	342,410	310,742
Cost of sales		(250,160)	(229,627)
<b>Gross profit</b>		<b>92,250</b>	<b>81,115</b>
Other operating income		4,805	3,828
Distribution costs		(825)	(777)
Administrative expenses		(48,393)	(40,599)
Other operating expenses		-	(273)
<b>Profit from operations</b>	4	<b>47,837</b>	<b>43,294</b>
Investment revenue	6	553	157
Finance costs	7	(7,688)	(3,362)
<b>Profit before tax</b>		<b>40,702</b>	<b>40,089</b>
Tax	8	(11,292)	(10,938)
<b>Profit for the year from continuing operations attributable to equity holders of the parent</b>		<b>29,410</b>	<b>29,151</b>
<b>Earnings per ordinary share (pence)</b>			
From continuing operations			
Basic	10	43.9	43.7
Diluted	10	43.5	43.4

The accompanying notes are an integral part of this consolidated income statement.

# Consolidated balance sheet

31 December 2005

	Note	2005 £'000	2004 £'000
<b>Non-current assets</b>			
Intangible assets	11	150,494	114,843
Property, plant and equipment	12	22,844	20,213
Deferred tax assets	20	17,301	14,000
		<b>190,639</b>	<b>149,056</b>
<b>Current assets</b>			
Inventories	13	25,937	22,557
Trade and other receivables	15	74,412	68,352
Cash and cash equivalents		40,193	24,060
		<b>140,542</b>	<b>114,969</b>
<b>Total assets</b>		<b>331,181</b>	<b>264,025</b>
<b>Current liabilities</b>			
Trade and other payables	16	(104,009)	(90,098)
Tax liabilities		(8,089)	(8,030)
Obligations under finance leases	17	(36)	(21)
Bank overdrafts and loans	18	-	(48,104)
Short-term provisions	21	(7,028)	(3,164)
		<b>(119,162)</b>	<b>(149,417)</b>
<b>Non-current liabilities</b>			
Retirement benefit obligations	26	(46,576)	(40,219)
Other payables	16	(930)	(1,115)
Deferred tax liabilities	20	(1,149)	(1,406)
Obligations under finance leases	17	(67)	(10)
Bank overdrafts and loans	18	(74,367)	-
Long-term provisions	21	(3,874)	(7,472)
		<b>(126,963)</b>	<b>(50,222)</b>
<b>Total liabilities</b>		<b>(246,125)</b>	<b>(199,639)</b>
<b>Net assets</b>		<b>85,056</b>	<b>64,386</b>
<b>Equity</b>			
Share capital	22	3,361	3,345
Share premium account	23	31,679	30,306
Own shares	23	(2,641)	(2,807)
Hedging and translation reserves	23	(990)	(1,098)
Retained earnings	23	53,647	34,640
<b>Total equity attributable to equity holders of the parent</b>		<b>85,056</b>	<b>64,386</b>

Signed on behalf of the Board

D. Caster, *Chief Executive*

D. Jeffcoat, *Finance Director*  
27 February 2006

The accompanying notes are an integral part of this consolidated balance sheet.

## Consolidated cash flow statement

For the year ended 31 December 2005

	Note	2005 £'000	2004 £'000
<b>Net cash from operating activities</b>	24	<b>48,217</b>	44,121
<b>Investing activities</b>			
Interest received		549	157
Purchase of property, plant and equipment		(7,311)	(5,246)
Proceeds on disposal of property, plant and equipment		100	3
Expenditure on product development and other intangibles		(2,909)	(1,919)
Acquisition of subsidiary undertakings (net of cash acquired)		(36,610)	(23,288)
<b>Net cash used in investing activities</b>		<b>(46,181)</b>	(30,293)
<b>Financing activities</b>			
Issue of share capital		1,389	2,237
Purchase of Long-Term Incentive Plan shares		(596)	(1,124)
Dividends paid		(9,567)	(8,531)
Increase/(repayments) of borrowings		21,747	(1,400)
Repayments of obligations under finance leases		(20)	(3)
New finance leases		92	-
<b>Net cash used in financing activities</b>		<b>13,045</b>	(8,821)
<b>Net increase in cash and cash equivalents</b>		<b>15,081</b>	5,007
<b>Cash and cash equivalents at beginning of year</b>		<b>24,060</b>	18,044
Effect of foreign exchange rate changes		1,052	1,009
<b>Cash and cash equivalents at end of year</b>		<b>40,193</b>	24,060

The accompanying notes are an integral part of this consolidated cash flow statement.

## Consolidated statement of recognised income and expense

For the year ended 31 December 2005

	Note	2005 £'000	2004 £'000
Exchange differences on translation of foreign operations		108	(1,098)
Actuarial losses on defined benefit pension schemes (net of deferred tax and exchange rate movements)	26	(3,580)	(7,492)
Fair value of derivatives at 1 January 2005		2,268	-
Loss on cash flow hedge		(144)	-
Tax on items taken directly to equity		(522)	95
<b>Net expense recognised directly in equity</b>		<b>(1,870)</b>	(8,495)
<b>Profit for the year</b>		<b>29,410</b>	29,151
<b>Total recognised income and expense for the year attributable to equity holders of the parent</b>	23	<b>27,540</b>	20,656

The accompanying notes are an integral part of this consolidated statement of recognised income and expense.

## 1 Segment information

	2005			2004		
	External revenue £'000	Internal revenue £'000	Total £'000	External revenue £'000	Internal revenue £'000	Total £'000
<b>Revenue</b>						
Aircraft & Vehicle Systems	84,370	982	85,352	76,593	1,072	77,665
Information & Power Systems	117,268	7,632	124,900	113,689	3,116	116,805
Tactical & Sonar Systems	140,772	8,035	148,807	120,460	11,719	132,179
Eliminations	-	(16,649)	(16,649)	-	(15,907)	(15,907)
<b>Consolidated revenue</b>	<b>342,410</b>	<b>-</b>	<b>342,410</b>	<b>310,742</b>	<b>-</b>	<b>310,742</b>

	2005 £'000	2004 £'000
<b>Profit from operations</b>		
Aircraft & Vehicle Systems	15,923	14,867
Information & Power Systems	18,094	15,038
Tactical & Sonar Systems	17,117	13,389
	<b>51,134</b>	<b>43,294</b>
Amortisation of intangibles arising on acquisition*	(3,297)	-
<b>Profit from operations</b>	<b>47,837</b>	<b>43,294</b>
Investment revenue	553	157
Finance costs	(7,688)	(3,362)
<b>Profit before tax</b>	<b>40,702</b>	<b>40,089</b>

\*All of the charge relating to the amortisation of intangibles arising on acquisition relates to Tactical & Sonar Systems.

**Capital expenditure, additions to intangibles, depreciation and amortisation**

Division	Capital expenditure and additions to intangibles (excluding goodwill)		Depreciation and amortisation	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Aircraft & Vehicle Systems	2,177	1,860	1,208	1,121
Information & Power Systems	4,420	2,711	3,233	2,186
Tactical & Sonar Systems	3,623	2,593	7,141	2,184
<b>Total</b>	<b>10,220</b>	<b>7,164</b>	<b>11,582</b>	<b>5,491</b>

The 2005 depreciation and amortisation expense includes £5,450,000 of amortisation charges (2004: £422,000) and £6,132,000 of property, plant and equipment depreciation charges (2004: £5,069,000). The increase in the amortisation charge results from the amortisation of intangible assets arising on the acquisition of the aircraft instrument business of Horizon Aerospace LLC (Horizon) and Audiopack Technologies Inc (Audiopack). These intangible assets (intellectual property, customer relationships and profit in opening order book) had a fair value at acquisition of £28,100,000. Both Horizon and Audiopack are included within Tactical & Sonar Systems.

**Total assets by segment**

	2005 £'000	2004 £'000
Aircraft & Vehicle Systems	67,144	64,222
Information & Power Systems	64,439	62,162
Tactical & Sonar Systems	141,441	99,581
	<b>273,024</b>	<b>225,965</b>
Unallocated	58,157	38,060
<b>Total assets</b>	<b>331,181</b>	<b>264,025</b>

Unallocated assets represent deferred tax assets, derivatives at fair value and cash and cash equivalents.

**1 Segment information (continued)****Total liabilities by segment (continued)**

	2005 £'000	2004 £'000
Aircraft & Vehicle Systems	(25,454)	(22,671)
Information & Power Systems	(38,528)	(41,833)
Tactical & Sonar Systems	(49,987)	(37,376)
	(113,969)	(101,880)
Unallocated	(132,156)	(97,759)
<b>Total liabilities</b>	<b>(246,125)</b>	<b>(199,639)</b>

Unallocated liabilities represent derivatives at fair value, tax payables, retirement benefit obligations and bank loans and overdrafts.

**Revenue by destination**

	2005 £'000	2004 £'000
United Kingdom	132,603	132,138
Continental Europe	38,938	32,948
North America	145,338	109,345
Rest of World	25,531	36,311
	342,410	310,742

**Other Information (by geographic location)**

	Total assets		Additions to Property, Plant & Equipment and intangible assets (excluding acquisitions)	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
United Kingdom	131,336	128,349	6,430	4,626
North America	141,688	97,616	3,790	2,538
	273,024	225,965	10,220	7,164

**2 Additional performance measures**

To present the underlying profitability of the Group on a consistent basis year on year, additional performance indicators have been used. These are calculated as follows:

	2005 £'000	2004 £'000
Profit from operations	47,837	43,294
Add: Amortisation of intangibles arising on acquisition	3,297	-
Operating profit (adjusted) <sup>(a)</sup>	51,134	43,294
Profit before tax	40,702	40,089
Add: Loss on fair value movements on derivatives	3,436	-
Add: Amortisation of intangibles arising on acquisition	3,297	-
Profit before tax (adjusted) <sup>(b)</sup>	47,435	40,089
Cash generated by operations (see note 24)	64,499	55,216
Purchase of property, plant and equipment	(7,311)	(5,246)
Proceeds on disposal of property, plant and equipment	100	3
Expenditure on product development and other intangibles	(2,909)	(1,919)
Purchase of Long-Term Incentive Plan shares	(596)	(1,124)
Operating cash flow (adjusted) <sup>(c)</sup>	53,783	46,930

## 2 Additional performance measures (continued)

Operating profit at <sup>(a)</sup> in the table opposite has been shown before the amortisation of intangible assets arising on acquisitions, which relates to acquired intellectual property, customer relationships and profit in acquired order book. Under UK GAAP this charge would have formed part of the amortisation of goodwill, which was also excluded from headline operating profit. Since the remainder of goodwill is no longer amortised, this charge has been excluded for consistency. Profit before tax as shown at <sup>(b)</sup> in the opposite table and adjusted earnings per share (see *note 10*) are also presented before the amortisation of intangible assets arising on acquisition.

IAS 39 requires the Group to fair value the derivative instruments used to manage Ultra's foreign exchange exposures. This creates volatility in the valuation of the outstanding instruments as exchange rates move over time. This will have minimal impact on profit over the full term of the instruments, but can cause significant volatility on particular balance sheet dates. Ultra is therefore stating profit before tax (<sup>(b)</sup> in the opposite table) and adjusted earnings per share (see *note 10*) before changes in the valuation of these instruments so that the underlying operating performance of the Group can more clearly be seen.

The Group is cash generative and reinvests funds to support the continuing growth of the business. It seeks to use an accurate and appropriate measure of the funds generated internally while sustaining this growth. For this, Ultra uses operating cash flow (adjusted)<sup>(c)</sup>, rather than cash generated by operations, as its preferred indicator of cash generated and available to cover non-operating expenses such as tax and interest payments. The Group believes that using cash generated by operations, with the exclusion of net expenditure in property, plant and equipment and outflows for capitalised product development and other intangibles, would result in an understatement of the true cash cost of sustaining a growing business.

## 3 Revenue

An analysis of the Group's revenue is as follows:

	2005 £'000	2004 £'000
Sales of goods	212,287	185,323
Revenue from long term contracts	130,123	125,419
	<b>342,410</b>	<b>310,742</b>

## 4 Profit from operations

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

	2005 £'000	2004 £'000
Raw materials and other bought in inventories expensed in the year	129,779	129,293
Depreciation and amounts written off property, plant and equipment	6,132	5,069
Amortisation of internally generated intangible assets	1,495	377
Amortisation of acquired intangible assets	3,955	45
Net foreign exchange (gains)/losses	(2,577)	687
(Profit)/loss on disposal of property, plant and equipment	(4)	58
Operating lease rentals		
– plant and machinery	1,073	1,147
– other	4,064	3,773
Research and development costs	15,124	13,561
Auditors' remuneration		
– Group audit fees and expenses	306	248
– other fees and expenses (see <i>below</i> )	109	46

Other fees paid to Deloitte & Touche LLP represent £107,000 in relation to IFRS audit work (2004: £43,000) and £2,000 in relation to audit related services (2004: £3,000). No fees were paid to Deloitte & Touche LLP during the year in respect of due diligence work connected with acquisitions (2004: £31,000, which was included in the cost of the relevant investments).

**5 Staff costs**

Particulars of employees (including executive Directors) are shown below.

Employee costs during the year amounted to:

	2005 £'000	2004 £'000
Wages and salaries	94,478	87,290
Social security costs	9,588	8,988
Other pension costs	6,353	5,469
	<b>110,419</b>	<b>101,747</b>

The average monthly number of persons employed by the Group during the year was as follows:

	2005 Number	2004 Number
Production	1,157	1,105
Engineering	1,143	1,048
Selling	190	163
Support services	390	362
	<b>2,880</b>	<b>2,678</b>

Information on Directors' remuneration is given in the section of the Remuneration report described as having been audited, and those elements required by the Companies Act 1985 and the Financial Services Authority form part of these accounts.

**6 Investment revenue**

	2005 £'000	2004 £'000
Interest revenue	553	157

**7 Finance costs**

	2005 £'000	2004 £'000
Amortisation of finance costs of debt	137	130
Interest payable on bank loans and overdrafts	3,164	2,700
Interest payable on finance leases	2	3
Total borrowing costs	3,303	2,833
Loss on fair value movement on derivatives	3,436	-
Retirement benefit scheme finance charges	949	529
	<b>7,688</b>	<b>3,362</b>

**8 Tax**

	2005 £'000	2004 £'000
<b>UK taxes</b>		
Corporation tax	7,415	8,277
Adjustment in respect of prior years	(161)	(1,307)
	<b>7,254</b>	<b>6,970</b>
<b>Overseas taxes</b>		
Current taxation	5,400	3,383
Adjustment in respect of prior years	405	688
	<b>5,805</b>	<b>4,071</b>
<b>Total current tax</b>	<b>13,059</b>	<b>11,041</b>
<b>Deferred tax</b>		
Origination and reversal of timing differences		
<b>UK and overseas deferred tax</b>	<b>(1,767)</b>	<b>(103)</b>
<b>Total tax charge</b>	<b>11,292</b>	<b>10,938</b>

Corporation tax in the UK is calculated at 30% (2004: 30%) of the estimated assessable profit for the year. Taxation for the other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

## 8 Tax (continued)

The amount of deferred tax charged to equity is shown in note 20.

The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2005 £'000	2004 £'000
Group profit before tax	40,702	40,089
Tax on Group profit at standard UK Corporation tax rate of 30% (2004: 30%)	12,211	12,027
Effects of:		
Tax effect of income/expenses that are not taxable/allowable in determining taxable profits	(1,105)	(1,359)
Tax effect of losses not previously recognised	(516)	(544)
Tax effect of different tax rates of subsidiaries operating in other jurisdictions	457	1,433
Tax effects of adjustments in respect of prior periods	245	(619)
<b>Tax expense for the year</b>	<b>11,292</b>	<b>10,938</b>

## 9 Dividends

Amounts recognised as distributions to equity holders in the year:

	2005 £'000	2004 £'000
Final dividend for the year ended 31 December 2004 of 9.2p (2003: 8.2p) per share	6,078	5,462
Interim dividend for the year ended 31 December 2005 of 5.2p (2004: 4.6p) per share	3,489	3,069
	<b>9,567</b>	<b>8,531</b>
<b>Proposed final dividend for the year ended 31 December 2005 of 10.7p (2004: 9.2p) per share</b>	<b>7,134</b>	<b>6,078</b>

The 2005 proposed final dividend was approved by the Board after 31 December 2005 and has not been included as a liability as at 31 December 2005.

## 10 Earnings per share

	2005 pence	2004 pence
Basic adjusted ( <i>see below</i> )	50.7	43.7
Diluted adjusted ( <i>see below</i> )	50.3	43.4
Basic	43.9	43.7
Diluted	43.5	43.4

The calculation of the basic, adjusted and diluted earnings per share is based on the following data:

	2005 £'000	2004 £'000
<b>Earnings</b>		
Earnings for the purposes of earnings per share being profit for the period from continuing operations	29,410	29,151
<b>Adjusted earnings</b>		
Profit for the period from continuing operations	29,410	29,151
Loss on fair value movements on derivatives (net of tax)	2,433	-
Amortisation of intangibles arising on acquisition (net of tax)	2,143	-
Earnings for the purposes of adjusted earnings per share	33,986	29,151
	<b>Number of shares</b>	<b>Number of shares</b>
The weighted average number of shares is given below:		
Number of shares used for basic EPS	67,074,121	66,645,930
Number of shares deemed to be issued at nil consideration following exercise of share options	524,441	450,434
<b>Number of shares used for fully diluted EPS</b>	<b>67,598,562</b>	<b>67,096,364</b>

## 11 Intangible assets

	Goodwill £'000	Intellectual property £'000	Customer relationships £'000	Development costs £'000	Other £'000	Total £'000
<b>Cost</b>						
Beginning of year	107,419	3,547	-	4,369	718	116,053
Exchange differences	1,807	558	354	186	41	2,946
Transfers	-	-	-	(167)	3,031	2,864
Additions	810	-	-	2,166	743	3,719
Disposals	-	-	-	(352)	-	(352)
Acquisitions	5,341	7,319	19,093	-	1,836	33,589
<b>End of year</b>	<b>115,377</b>	<b>11,424</b>	<b>19,447</b>	<b>6,202</b>	<b>6,369</b>	<b>158,819</b>
<b>Amortisation</b>						
Beginning of year	-	-	-	(1,007)	(203)	(1,210)
Exchange differences	-	(13)	(34)	(106)	(47)	(200)
Transfers	-	-	-	-	(1,817)	(1,817)
Charge	-	(726)	(864)	(1,495)	(2,365)	(5,450)
Disposals	-	-	-	352	-	352
<b>End of year</b>	<b>-</b>	<b>(739)</b>	<b>(898)</b>	<b>(2,256)</b>	<b>(4,432)</b>	<b>(8,325)</b>
<b>Carrying amount</b>						
Beginning of year	107,419	3,547	-	3,362	515	114,843
<b>End of year</b>	<b>115,377</b>	<b>10,685</b>	<b>18,549</b>	<b>3,946</b>	<b>1,937</b>	<b>150,494</b>

Other represents software and patents and trademarks. Amortisation of intangible assets is included within administrative expenses. Transfers relate to items previously included within property, plant and equipment.

Intangible assets, other than goodwill, are amortised on a straight line basis over their estimated useful lives, typically as follows:

Intellectual property	10 years
Customer relationships	10 years
Development costs	2 to 10 years
Software	3 to 5 years
Patents and trademarks	10 to 20 years

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. The carrying amount of goodwill was allocated as follows:

	2005 £'000	2004 £'000
<b>Aircraft &amp; Vehicle Systems</b>		
Datel	35,375	35,375
<b>Information &amp; Power Systems (comprising several CGUs)</b>		
	19,670	18,866
<b>Tactical &amp; Sonar Systems</b>		
UnderSea Sensor Systems Inc.	14,172	14,172
Tactical Communication Systems	19,305	19,305
DNE Technologies	16,012	14,380
Other	10,843	5,321
	<b>115,377</b>	<b>107,419</b>

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

## 11 Intangible assets (continued)

The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using rates that reflect current market assessments of the time value of money and the risks specific to the CGUs. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next five years and extrapolates cash flows for the following five years based on an estimated growth rate of nil per cent.

The rate used to discount the forecast cash flows is 8.4%.

A detailed review of the carrying value of goodwill at 31 December 2005 has been performed and the Directors consider that no adjustment is required.

### a) Acquisitions during the year

In aggregate, consideration of £36,832,000 was paid in respect of acquisitions, all of which was discharged by means of cash and cash equivalents. Aggregate assets and liabilities acquired comprised intangible assets of £28,248,000, property, plant and equipment of £1,701,000, cash of £222,000, inventories of £1,330,000, receivables of £1,359,000, current liabilities of £1,397,000 and provisions of £461,000.

#### Horizon Aerospace LLC

On 28 March 2005 the Group, through a subsidiary, purchased the trade and assets of Horizon Aerospace LLC, a business based in Victor, New York, USA, for a cash consideration before expenses of £2.4 million. This represents the fair value of the consideration payable. The aggregate net assets acquired and their provisional fair values, based on the Directors' initial assessment of net realisable value, were as follows:

	Book value	Revaluations	Fair value
	£'000	£'000	£'000
<b>Intangible assets</b>	-	476	476
<b>Property, plant and equipment</b>	361	(36)	325
<b>Current assets:</b>			
Inventories	660	(254)	406
Receivables	418	-	418
Current liabilities	(145)	-	(145)
<b>Provisions:</b>			
Warranty	(79)	(66)	(145)
Other	(31)	(161)	(192)
<b>Net assets acquired</b>	<b>1,184</b>	<b>(41)</b>	<b>1,143</b>
Goodwill capitalised at acquisition			1,276
<b>Purchase consideration, including acquisition costs</b>			<b>2,419</b>

Horizon made a contribution to Group profit after tax of £246,000 in the period from the date of acquisition to 31 December 2005. The goodwill arising on the acquisition is attributable to the anticipated future operating synergies deriving from the combination of businesses.

**11 Intangible assets (continued)*****Audiopack Technologies Inc.***

On 15 July 2005 the Group, through a subsidiary, purchased all of the share capital of Audiopack Technologies Inc., a Company based in Cleveland, Ohio, USA, for a cash consideration before expenses of £33.7 million. This represents the fair value of the consideration payable. The aggregate net assets acquired and their provisional fair values, based on the Directors' initial assessment of net realisable value, were as follows:

	Book value	Revaluations	Fair value
	£'000	£'000	£'000
<b>Intangible assets</b>	<b>105</b>	<b>27,667</b>	<b>27,772</b>
<b>Property, plant and equipment</b>	<b>1,461</b>	<b>(85)</b>	<b>1,376</b>
<b>Current assets:</b>			
Cash at bank	222	-	222
Inventories	1,760	(836)	924
Receivables	941	-	941
Current liabilities	(1,243)	(9)	(1,252)
<b>Provisions:</b>			
Warranty	(10)	(114)	(124)
<b>Net assets acquired</b>	<b>3,236</b>	<b>26,623</b>	<b>29,859</b>
Goodwill capitalised at acquisition			4,065
<b>Purchase consideration, including acquisition costs</b>			<b>33,924</b>

Audiopack contributed a loss after tax of £1,779,000 in the period from date of acquisition to 31 December 2005, after acquisition financing costs of £850,000 and amortisation of intangibles of £2,405,000. The goodwill arising on the acquisition is attributable to the anticipated profits resulting from the access to new markets for the Group's existing products.

If the above acquisitions had been completed on the first day of the financial year, Group revenues for the year would have been £350.0 million and Group profit attributable to equity holders of the parent would have been £30.5 million.

***b) Revisions to provisional fair values – Videcom***

Fair values on acquisition have been adjusted for Videcom which was purchased in July 2004. The revisions in value relate primarily to debtor provisions no longer required. These additional fair value adjustments have resulted in a reduction to goodwill at acquisition. Deferred consideration of £300,000 was paid during the year.

	Book value	Adjustments as at 31 December 2004	Further adjustments	Fair value
	£'000	£'000	£'000	£'000
<b>Intangible fixed assets</b>	-	-	-	-
<b>Property, plant and equipment</b>	<b>50</b>	<b>-</b>	<b>(25)</b>	<b>25</b>
<b>Current assets:</b>				
Inventories	264	-	-	264
Receivables	648	(259)	122	511
Current liabilities	(544)	(31)	58	(517)
<b>Provisions:</b>				
Warranty	(57)	-	-	(57)
<b>Net assets acquired</b>	<b>361</b>	<b>(290)</b>	<b>155</b>	<b>226</b>
Goodwill capitalised at acquisition				1,304
<b>Purchase consideration, including acquisition costs</b>				<b>1,530</b>

***c) Additional purchase consideration – SML Limited***

During the year contingent purchase consideration amounting to £958,000 became payable to the previous owners on the satisfaction of certain post acquisition performance targets, of which £189,000 was paid during the year. This amount had not previously been provided and resulted in additional goodwill arising in relation to SML Limited of £958,000.

## 12 Property, plant and equipment

	Land and Buildings		Plant and machinery £'000	Total £'000
	Freehold £'000	Short leasehold £'000		
<b>Cost</b>				
At 1 January 2004	6,223	4,012	41,280	51,515
Foreign exchange differences	(19)	(32)	(551)	(602)
Acquisition of subsidiary undertakings	-	186	956	1,142
Additions	34	187	5,059	5,280
Disposals	-	(51)	(537)	(588)
Transfers	-	(101)	101	-
<b>At 1 January 2005</b>	<b>6,238</b>	<b>4,201</b>	<b>46,308</b>	<b>56,747</b>
Foreign exchange differences	358	98	2,293	2,749
Acquisition of subsidiary undertakings	872	-	829	1,701
Additions	76	436	6,799	7,311
Disposals	-	-	(1,741)	(1,741)
Transfers	-	-	(2,864)	(2,864)
<b>At 31 December 2005</b>	<b>7,544</b>	<b>4,735</b>	<b>51,624</b>	<b>63,903</b>
<b>Accumulated Depreciation</b>				
At 1 January 2004	(1,170)	(2,361)	(28,814)	(32,345)
Foreign exchange differences	(3)	5	351	353
Charge	(162)	(284)	(4,623)	(5,069)
Disposals	-	-	527	527
<b>At 1 January 2005</b>	<b>(1,335)</b>	<b>(2,640)</b>	<b>(32,559)</b>	<b>(36,534)</b>
Foreign exchange differences	(127)	(28)	(1,700)	(1,855)
Charge	(207)	(357)	(5,568)	(6,132)
Disposals	-	-	1,645	1,645
Transfers	-	-	1,817	1,817
<b>At 31 December 2005</b>	<b>(1,669)</b>	<b>(3,025)</b>	<b>(36,365)</b>	<b>(41,059)</b>
<b>Carrying amount</b>				
<b>At 31 December 2005</b>	<b>5,875</b>	<b>1,710</b>	<b>15,259</b>	<b>22,844</b>
At 31 December 2004	4,903	1,561	13,749	20,213

Freehold land amounting to £3,115,000 (2004: £1,175,600) has not been depreciated. The net book value of plant and machinery held under finance leases was £101,000 (2004: £38,000).

## 13 Inventories

	2005 £'000	2004 £'000
Raw materials and consumables	17,578	11,491
Work in progress	6,376	8,836
Finished goods and goods for resale	1,983	2,230
	<b>25,937</b>	<b>22,557</b>

## 14 Long-term contract balances

	2005 £'000	2004 £'000
Contracts in progress at the balance sheet date:		
Amounts due from contract customers included in trade and other receivables	23,026	23,978
Amounts due to contract customers included in trade and other payables	(32,745)	(23,096)
	<b>(9,719)</b>	<b>882</b>
Contract costs incurred plus recognised profits less recognised losses to date	<b>438,452</b>	<b>464,731</b>

At 31 December 2005, retentions held by customers for contract work amounted to £2,206,000 (2004: £845,000). Advances received from customers for contract work amounted to £27,976,000 (2004: £22,696,000).

**15 Trade and other receivables**

	2005 £'000	2004 £'000
Trade receivables	47,052	40,482
Amounts due from contract customers	23,026	23,978
Derivatives at fair value	663	-
Other receivables	1,885	2,125
Prepayments and accrued income	1,786	1,767
	<b>74,412</b>	<b>68,352</b>

**Credit risk**

The Group's principal financial assets are bank balances, cash and trade and other receivables.

The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables.

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

**16 Trade and other payables**

	2005 £'000	2004 £'000
Amounts included in current liabilities:		
Trade payables	27,797	25,215
Amounts due to contract customers	32,745	23,096
Derivatives at fair value	1,975	-
Other payables	11,712	11,419
Accruals and deferred income	29,780	30,368
	<b>104,009</b>	<b>90,098</b>

Amounts included within accruals and deferred income include £7,401,000 (2004: £5,602,000) relating to customer funding of inventories.

Amounts included in non current liabilities:

Other payables	223	364
Accruals and deferred income	707	751
	<b>930</b>	<b>1,115</b>

**17 Finance leases**

Minimum lease payments

	2005 £'000	2004 £'000
Amounts payable under finance leases:		
Within one year	36	21
Between one and five years	75	12
	<b>111</b>	<b>33</b>
Less: future finance charges	<b>(8)</b>	<b>(2)</b>
	<b>103</b>	<b>31</b>

**18 Bank overdrafts and loans**

	2005 £'000	2004 £'000
Bank loans and overdrafts are payable as follows:		
Within one year or on demand	-	48,227
Between two and five years	74,708	-
	74,708	48,227
Less: unamortised finance costs of debt	(341)	(123)
	74,367	48,104

On 18 November 2005 the Group renewed its banking facilities that are provided by a small syndicate of banks, led by The Royal Bank of Scotland. The new facility, which provides up to £120 million of revolving credit over a five year period, is denominated in Sterling, US dollars and Canadian dollars and is used for balance sheet and operational needs. A further £10 million overdraft is available for short-term working capital funding.

All bank loans are unsecured. Interest is charged at 0.375% (2004: 0.75%) over base rate.

At 31 December 2005, the Group had available £45,292,000 (2004: £31,773,000) of undrawn committed borrowing facilities. These undrawn facilities all expire within five years (2004: within one year).

**19 Derivative financial instruments**

Exposure to currency and interest rate risks arise in the normal course of the Group's business. Derivative financial instruments are used to hedge exposure to fluctuations in foreign exchange rates and interest rates.

***Currency risk***

The Group utilises currency derivatives in the form of forward currency contracts to hedge its foreign currency risk. The currencies giving rise to this risk are primarily US dollars, Canadian dollars and Euros.

As noted in the Company's press release on 22 June 2005, the Group has applied IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement" prospectively from 1 January 2005. Consequently the relevant comparative information for 2004 does not reflect the impact of these standards and is accounted for on a UK GAAP basis. This note therefore includes the disclosures required by IAS 32 and IAS 39 for the year ended 31 December 2005 and the disclosures required by Financial Reporting Standard 13 for the year ended 31 December 2004.

At 31 December 2005, the fair value of the Group's currency derivatives is estimated to be a liability of approximately £1,168,000, comprising £663,000 assets included in trade and other receivables and £1,831,000 liabilities included in trade and other payables. At 1 January 2005 an asset of £2,268,000 was recognised. The loss on derivative financial instruments included in the Group's consolidated income statement for the period was £3,436,000 (2004: £nil).

The derivative financial instruments maturity dates are typically between one to eighteen months from the balance sheet date. Where specific risks are identified maturity dates can extend beyond eighteen months.

The nominal values of the derivative contracts as at the 31 December 2005 were as follows:

Australian dollars	Aus\$0.4m
Euros	€12.0m
New Zealand dollars	NZ\$25.9m
US dollars	US\$116.6m
Japanese yen	Yen297.3m

***Net investment hedges***

The Group has net investments in US and Canadian companies. The associated foreign currency translation risk is hedged by external borrowings in US and Canadian dollars. The value of the borrowings do not exceed the net investments, meeting the conditions required to qualify as effective hedges.

**19 Derivative financial instruments (continued)****Interest rate risk**

During the year the Group used interest rate swaps to manage its exposure to interest rate movements on its bank borrowings. The interest rate swaps, denominated in US dollars and Canadian dollars, have been entered into to achieve an appropriate mix of fixed and floating rate exposure reflecting the Group's policy. The swaps will mature over the next three years and have fixed swap rates ranging from 4.175 per cent to 4.815 per cent. The floating rates are US dollar LIBOR and Canadian dollar LIBOR. The nominal amounts of the interest rate swaps are US\$40m and CAD\$30m.

The interest rate swaps are designated effective cash flow hedges and the change in fair value has been charged to equity. At 31 December 2005, the net fair value of interest rate swaps was £144,000 (2004: £nil). There has been no offset in the income statement against hedged interest payments made in the period. The fair value will be realised in the income statement on a quarterly basis over the life of the swap as the interest is paid.

The effective interest rates and re-pricing dates of the Group's financial assets and liabilities were as follows:

	Effective interest rate	Total	Within 1 year	1 to 2 years	2 to 5 years
<b>2005</b>					
Cash and cash equivalents	2.95%	40,193	40,193	-	-
Unsecured bank loans:					
GBP loan	5.50%	19,159	-	-	19,159
US dollar loan	4.01%	33,990	-	-	33,990
Canadian dollar loan	3.14%	21,218	-	-	21,218
Finance lease liabilities	4.25%	103	36	67	-

**Fair values**

The fair values together with the carrying amounts shown in the balance sheet are as follows:

	Carrying amount	Fair value	Carrying amount	Fair value
	2005 £'000	2005 £'000	2004 £'000	2004 £'000
Cash and cash equivalents	40,193	40,193	24,060	24,060
Interest rate swaps	(144)	(144)	-	(134)
Foreign exchange contracts	(1,168)	(1,168)	-	2,268
Unsecured bank loans	(74,367)	(74,367)	(48,104)	-
Finance lease liabilities	(103)	(103)	(31)	(31)

**Estimation of fair values**

Forward exchange contracts are marked to market using listed market prices. For interest rate swaps broker quotes are used.

**FRS 13 disclosures for the year ended 31 December 2004**

As previously mentioned the Group has applied IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement" prospectively from 1 January 2005. Information for the year ended 31 December 2004 has not been re-stated and the additional disclosures required for that year under Financial Reporting Standard 13 are as follows:

**Interest rate profile**

	At floating interest rates 2004 £'000
<b>Financial assets</b>	
Sterling	5,994
US dollars	12,554
Canadian dollar	4,060
Korean Won	868
Euro	442
Other	142
	24,060

All of the financial assets of the Group comprised of cash.

## 19 Derivative financial instruments (continued)

	At fixed interest rates 2004 £'000	At floating interest rates 2004 £'000	Financial liabilities on which no interest is paid 2004 £'000	Total 2004 £'000
<b>Financial liabilities</b>				
Sterling	14,892	-	951	15,843
US dollars	16	13,292	62	13,370
Canadian dollar	-	19,935	102	20,037
	14,908	33,227	1,115	49,250

The benchmark rate for floating interest rates is the Royal Bank of Scotland base rate.

The financial liabilities of the Group comprised the following:

	2004 £'000
Total borrowings and finance leases	48,135
Creditors: Amounts falling due after more than one year	
– Other payables	1,115
	49,250

The weighted average profile for fixed rate liabilities at 31 December 2004 was as follows:

	Fixed rate financial liabilities	
	Weighted average interest rate %	Weighted average period for which rate is fixed Years
<b>Currency</b>		
Sterling	7.5	1

**Currency risk**

The table below shows the extent to which Group companies had monetary assets and liabilities in currencies other than their functional currencies.

Net foreign currency monetary assets

	US\$ 2004 £'000	C\$ 2004 £'000	Korean Won 2004 £'000	Other 2004 £'000	Total 2004 £'000
<b>Functional currency of Group operations</b>					
Sterling	7,700	1,382	834	100	10,016
Canadian dollar	1,591	-	-	-	1,591
	9,291	1,382	834	100	11,607

**Maturity of financial liabilities**

The maturity profile of the Group's financial liabilities, other than short-term creditors such as trade creditors and accruals, at 31 December 2004 was as follows:

	2004 £'000
In one year or less, or on demand	48,125
In more than one year but not more than two years	488
In more than two years but not more than five years	637
	49,250

**19 Derivative financial instruments (continued)****Gains and losses on hedges**

The gains and losses below were based on market values at 31 December 2004

	Gains £'000	Losses £'000	Total net gains/(losses) £'000
Unrecognised gains and (losses) on hedges at 31 December 2003	4,156	(3,109)	1,047
(Gains) and losses arising before 31 December 2003, recognised in 2004	(3,544)	2,154	(1,390)
Gains and (losses) arising before 31 December 2003, not recognised in 2004	612	(955)	(343)
Gains and (losses) arising in 2004, not recognised in 2004	3,038	(561)	2,477
Unrecognised gains and (losses) on hedges at 31 December 2004	3,650	(1,516)	2,134
<b>Of which:</b>			
Gains and (losses) expected to be recognised in 2005	2,757	(1,055)	1,702
Gains and (losses) expected to be recognised in 2006 and beyond	893	(461)	432

**20 Deferred tax**

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period.

	Accelerated tax depreciation £'000	Employee share options costs £'000	Derivatives £'000	Retirement benefit obligations £'000	Goodwill £'000	Other £'000	Tax losses £'000	Total £'000
At 1 January 2004	(530)	606	-	8,821	(1,260)	839	729	9,205
Credit/(charge) to income	11	194	-	99	(702)	814	(313)	103
Credit/(charge) to equity	-	285	-	3,191	(190)	-	-	3,286
At 1 January 2005	(519)	1,085	-	12,111	(2,152)	1,653	416	12,594
Credit/(charge) to income	(178)	378	1,003	269	37	22	236	1,767
Credit/(charge) to equity	-	693	(660)	1,620	138	-	-	1,791
<b>At 31 December 2005</b>	<b>(697)</b>	<b>2,156</b>	<b>343</b>	<b>14,000</b>	<b>(1,977)</b>	<b>1,675</b>	<b>652</b>	<b>16,152</b>

The Group has not recognised deferred tax assets of £0.61 million (2004: £1.04 million) relating to tax losses, due to uncertainty as to their recoverability.

There are no temporary differences which arise in respect of undistributed earnings.

**21 Provisions**

	Warranties £'000	Contract related provisions £'000	Total £'000
At 1 January 2005	8,462	2,174	10,636
Additional provision	1,044	1,024	2,068
Utilisation of provision	(1,475)	(1,102)	(2,577)
Acquisition of subsidiary undertaking	269	192	461
Exchange differences	120	194	314
<b>At 31 December 2005</b>	<b>8,420</b>	<b>2,482</b>	<b>10,902</b>
Included in current liabilities	5,966	1,062	7,028
Included in non current liabilities	2,454	1,420	3,874
	<b>8,420</b>	<b>2,482</b>	<b>10,902</b>

Warranty and contract related provisions will be utilised over the period as stated in the contract to which each specific provision relates.

## 22 Share capital

	No.	2005		2004	
		£'000	No.	£'000	No.
<b>Authorised:</b>					
5p ordinary shares	90,000,000	4,500	90,000,000	4,500	
<b>Allotted, called-up and fully paid:</b>					
5p ordinary shares	67,221,085	3,361	66,904,519	3,345	

316,566 ordinary shares having a nominal value of £15,828 were allotted during the year under the terms of the Group's various Share Option Schemes. The aggregate consideration received was £1,388,978.

### Share Options

During the year to 31 December 2005, the Group operated the following equity settled share options:

#### 1. Savings Related Share Option Scheme

A Savings Related Share Option Scheme is open to all US employees and provides for a purchase price equal to the daily average market price on the day before the grant less 10%. The vesting period is two years. If the options remain unexercised after a period of three months from the date of maturity, the options expire. Options are forfeited if the employee leaves the Group before the options vest.

A Savings Related Share Option Scheme is open to all Canadian employees and provides for a purchase price equal to the daily average market price on the day before the grant less 10%. The vesting period is three years. If the options remain unexercised after a period of six months from the date of maturity, the options expire. Options are forfeited if the employee leaves the Group before the options vest.

At 31 December 2005, share options outstanding under Ultra's Savings Related Share Option Schemes were as follows:

Options granted	Number of shares		Option price (£)	Exercise dates
	2005	2004		
2003	44,933	86,351	4.83	September 2005 - March 2006
2005	46,554	-	7.50	September 2007 - December 2007

#### 2. Company Share Option Plan

The Company Share Option Plan provides share options for nominated employees in the UK. The purchase price is set at a mid-market price on the date of grant. This is an approved scheme. From 2000 vesting has been unconditional. Options vest after three years and lapse after ten years from the date of grant.

At 31 December 2005, share options outstanding under Ultra's Company Share Option Plan were as follows:

Options granted	Number of shares		Option price (£)	Exercise dates
	2005	2004		
1996	3,452	10,624	2.87	March 2000 - November 2006
1998	12,805	15,891	4.05	March 2001 - March 2008
1999	27,805	34,733	4.15	March 2002 - March 2009
2000	24,976	32,967	3.855	May 2003 - May 2010
2001	24,751	31,436	4.385	March 2004 - March 2011
2002	41,983	74,196	4.485	March 2005 - March 2012
2003	53,078	54,798	4.525	March 2006 - March 2013
2004	62,717	66,703	5.97	March 2007 - March 2014
2005	53,953	-	7.28	March 2008 - March 2015

## 22 Share capital (continued)

### 3. Executive Share Option Plan

The Executive Share Option Plan provides share options for nominated employees in the UK, US and Canada. The purchase price is set at a mid-market price on the date of grant. This is an unapproved scheme. From 2000 vesting has been unconditional. Options vest after three years and lapse after seven years from the date of grant.

At 31 December 2005, share options outstanding under Ultra's Executive Share Option Scheme were as follows:

	Options granted	Number of shares		Option price (£)	Exercise dates
		2005	2004		
1999	21,175	43,095	4.15 to 4.265	March 2002 - September 2006	
2000	46,047	60,216	3.855	May 2003 - May 2007	
2001	77,753	119,866	4.385	March 2004 - March 2008	
2002	131,106	230,263	4.485	March 2005 - March 2009	
2003	249,664	267,988	4.525	March 2006 - March 2010	
2004	214,210	224,592	5.97	March 2007 - March 2011	
2005	199,465	-	7.28	March 2008 - March 2012	

The number and weighted average exercise price of share options is as follows:

	Weighted average exercise price (£)	Number of options	Weighted average exercise price (£)	Number of options
	2005	2005	2004	2004
Beginning of year	4.75	1,353,719	4.30	1,684,234
Granted during the year	7.31	309,194	5.97	296,865
Forfeited during the year	5.85	(28,115)	4.55	(59,123)
Exercised during the year	4.43	(298,371)	4.09	(568,257)
Outstanding at the end of the year	5.39	1,336,427	4.73	1,353,719
Exercisable at the end of the year	4.34	456,786	4.11	348,828

Share options were exercised on a regular basis throughout the year. The weighted average share price during the year was £8.21.

The Group's equity settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. Fair value is measured by use of an option pricing model using the following assumptions for both 2004 and 2005:

	Share save*	CSOP*	ESOS*	LTIP*
Weighted average share price (£)	6.42	5.94	5.80	5.50
Weighted average exercise price (£)	6.19	5.93	5.82	N/A
Expected volatility %	17.70	21.07	20.48	19.4
Expected option life (years)	2.19	6.00	5.00	3.00
Risk free interest rate %	4.13	4.43	4.34	4.20
Expected dividends %	1.95	2.17	2.23	2.11

\*Figures in the above table show an average across similar schemes.

### 4. Long-Term Incentive Plan

Details in relation to the LTIP are included in the Directors' Remuneration report on page 40.

The Group recognised total expenses of £1,212,000 and £797,000 related to equity-settled share based payment transactions in 2005 and 2004 respectively. Expected volatility was determined by calculating the historic volatility of the Group's share price.

## 23 Reserves

	Share premium account £'000	Reserve for own shares £'000	Hedging and translation reserve £'000	Retained earnings £'000
Balance at 1 January 2004	28,096	(2,483)	-	21,417
Total recognised income and expense	-	-	(1,098)	21,754
Own shares acquired	-	(1,124)	-	-
Disposal of own shares	-	800	-	-
Issue of new shares	2,210	-	-	-
Dividends to shareholders	-	-	-	(8,531)
<b>Balance at 31 December 2004</b>	<b>30,306</b>	<b>(2,807)</b>	<b>(1,098)</b>	<b>34,640</b>
Total recognised income and expense	-	-	108	27,432
Own shares acquired	-	(596)	-	-
Disposal of own shares	-	762	-	(762)
Equity settled employee share scheme	-	-	-	1,904
Issue of new shares	1,373	-	-	-
Dividends to shareholders	-	-	-	(9,567)
<b>Balance at 31 December 2005</b>	<b>31,679</b>	<b>(2,641)</b>	<b>(990)</b>	<b>53,647</b>

Cumulative goodwill written off directly to reserves is £33,294,000 (2004: £33,294,000).

## 24 Notes to the cash flow statement

	2005 £'000	2004 £'000
<b>Profit from operations</b>	<b>47,837</b>	<b>43,294</b>
Adjustments for:		
Depreciation of property, plant and equipment	6,132	5,069
Amortisation of intangible assets	5,450	422
Cost of equity settled employee share schemes	1,212	797
Increase/(decrease) in post employment benefit obligation	120	(55)
(Profit)/loss on disposal of property, plant and equipment	(4)	58
(Decrease)/increase in provisions	(366)	2,849
<b>Operating cash flows before movements in working capital</b>	<b>60,381</b>	<b>52,434</b>
Increase in inventories	(1,643)	(524)
Increase in receivables	(1,313)	(3,528)
Increase in payables	7,074	6,834
<b>Cash generated by operations</b>	<b>64,499</b>	<b>55,216</b>
Income taxes paid	(13,001)	(8,317)
Interest paid	(3,281)	(2,778)
<b>Net cash from operating activities</b>	<b>48,217</b>	<b>44,121</b>

Reconciliation of net movement in cash and cash equivalents to movements in net debt.

	2005 £'000	2004 £'000
<b>Net increase in cash and cash equivalents</b>	<b>15,081</b>	<b>5,007</b>
Cash (inflow)/outflow from (increase)/decrease in debt and finance leasing	(21,727)	1,403
<b>Change in net debt arising from cash flows</b>	<b>(6,646)</b>	<b>6,410</b>
Amortisation of finance costs of debt	(137)	-
Finance leases acquired with subsidiary undertakings	-	(19)
Finance leases	(92)	-
Translation differences	(3,327)	872
<b>Movement in net debt in the year</b>	<b>(10,202)</b>	<b>7,263</b>
<b>Net debt at start of year</b>	<b>(24,075)</b>	<b>(31,338)</b>
<b>Net debt at end of year</b>	<b>(34,277)</b>	<b>(24,075)</b>

**24 Notes to the cash flow statement (continued)**

Net debt comprised the following:

	2005 £'000	2004 £'000
Cash and cash equivalents	40,193	24,060
Bank overdrafts and loans included in current liabilities	-	(48,104)
Bank overdrafts and loans included in non-current liabilities	(74,367)	-
Obligations under finance leases included in current liabilities	(36)	(21)
Obligations under finance leases included in non-current liabilities	(67)	(10)
	<b>(34,277)</b>	<b>(24,075)</b>

Cash and cash equivalents comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less.

Cash and cash equivalents at the year end included deposits with banks of £1,047,000 held by a subsidiary that were not freely remittable to the holding Company because of currency restrictions. Steps are being taken to remove these restrictions.

**25 Guarantees and other financial commitments****a) Capital commitments**

At the end of the year capital commitments were:

	2005 £'000	2004 £'000
Contracted but not provided	728	748

**b) Lease commitments**

At 31 December 2005, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2005 £'000	2004 £'000
Within one year	555	341
Between two and five years	2,051	2,382
After five years	2,160	2,680
	<b>4,766</b>	<b>5,403</b>

**26 Retirement benefit schemes**

Most UK employees of the Group are members of the Ultra Electronics Limited defined benefit scheme which was established on 1 March 1994. The scheme was closed to new members in 2003. A new defined contribution plan has been introduced for other employees and new joiners in the UK. The Group also operates two defined contribution schemes for overseas employees. In addition to these schemes, the Group's Tactical Communications business based in Montreal, Canada has three defined benefit schemes.

**Defined contribution schemes**

The total cost charged to income in respect of the defined contribution schemes was £1,910,000 (2004: £1,319,000).

**Defined benefit schemes**

The UK defined benefit scheme was actuarially assessed at 31 December 2005 using the projected unit method. The Canadian defined benefit schemes were actuarially assessed at 31 December 2005 using the projected unit method.

Key financial assumptions used in the valuation of these schemes were as follows:

	UK 2005	Canada 2005	UK 2004	Canada 2004
Discount rate	4.8%	5.1%	5.5%	5.5%
Inflation rate	2.5%	2.5%	2.5%	2.5%
Expected rate of salary increases	3.75%	3.75%	3.75%	3.75%
Future pension increases	2.25%	2.25%	2.25%	2.25%

**26 Retirement benefit schemes (continued)**

Amounts recognised in the income statement in respect of these defined benefit schemes are as follows:

	UK 2005 £m	Canada 2005 £m	Total 2005 £m	UK 2004 £m	Canada 2004 £m	Total 2004 £m
Current service cost	(3.9)	(0.2)	(4.1)	(3.8)	(0.2)	(4.0)
Interest on pension scheme liabilities	(6.1)	(0.3)	(6.4)	(5.0)	(0.2)	(5.2)
Expected return on pension scheme assets	5.2	0.2	5.4	4.6	0.2	4.8
	<b>(4.8)</b>	<b>(0.3)</b>	<b>(5.1)</b>	<b>(4.2)</b>	<b>(0.2)</b>	<b>(4.4)</b>

Actuarial gains and losses have been reported in the statement of recognised income and expense.

The amount included in the balance sheet arising from the Group's obligations in respect of its defined benefit retirement schemes is as follows:

	UK 2005 £m	Canada 2005 £m	Total 2005 £m	UK 2004 £m	Canada 2004 £m	Total 2004 £m
Fair value of scheme assets	95.2	4.6	99.8	72.8	3.3	76.1
Present value of scheme liabilities	(139.9)	(6.5)	(146.4)	(111.5)	(4.8)	(116.3)
Scheme deficit	(44.7)	(1.9)	(46.6)	(38.7)	(1.5)	(40.2)
Related deferred tax asset	13.4	0.6	14.0	11.6	0.5	12.1
<b>Net pension liability</b>	<b>(31.3)</b>	<b>(1.3)</b>	<b>(32.6)</b>	<b>(27.1)</b>	<b>(1.0)</b>	<b>(28.1)</b>

Movements in the present value of defined benefit obligations during the year were as follows:

	UK 2005 £m	Canada 2005 £m	Total 2005 £m	UK 2004 £m	Canada 2004 £m	Total 2004 £m
Present value of obligation at 1 January	(111.5)	(4.8)	(116.3)	(91.7)	(4.3)	(96.0)
Service cost	(4.0)	(0.1)	(4.1)	(3.8)	(0.2)	(4.0)
Interest cost	(6.1)	(0.3)	(6.4)	(5.0)	(0.2)	(5.2)
Contributions from scheme members	(1.7)	-	(1.7)	(1.7)	-	(1.7)
Actuarial gains and losses	(19.0)	(0.4)	(19.4)	(11.3)	(0.1)	(11.4)
Exchange difference	-	(0.9)	(0.9)	-	-	-
Benefits paid	2.4	-	2.4	2.0	-	2.0
<b>Present value of obligation at 31 December</b>	<b>(139.9)</b>	<b>(6.5)</b>	<b>(146.4)</b>	<b>(111.5)</b>	<b>(4.8)</b>	<b>(116.3)</b>

Movements in the fair value of scheme assets during the year were as follows:

	UK 2005 £m	Canada 2005 £m	Total 2005 £m	UK 2004 £m	Canada 2004 £m	Total 2004 £m
Fair value at 1 January	72.8	3.3	76.1	64.0	2.8	66.8
Expected return on scheme assets	5.2	0.2	5.4	4.6	0.2	4.8
Actuarial gains and losses	14.1	-	14.1	0.5	-	0.5
Exchange differences	-	0.6	0.6	-	-	-
Employer contributions	3.9	0.5	4.4	4.0	0.3	4.3
Employee contributions	1.7	-	1.7	1.7	-	1.7
Benefits paid	(2.5)	-	(2.5)	(2.0)	-	(2.0)
<b>Fair value at 31 December</b>	<b>95.2</b>	<b>4.6</b>	<b>99.8</b>	<b>72.8</b>	<b>3.3</b>	<b>76.1</b>

**26 Retirement benefit schemes (continued)**

The analysis of the scheme assets and the expected rate of return at the balance sheet date were as follows:

	2005	2004
Expected return:		
Equities	7.5%	7.5%
Bonds	4.1%	4.6%
Other assets	4.5%	4.6%
Other policies	7.5%	7.5%

Scheme assets were as follows:

	UK 2005 £m	Canada 2005 £m	Total 2005 £m	UK 2004 £m	Canada 2004 £m	Total 2004 £m
Fair value:						
Equities	82.7	2.8	85.5	61.7	1.9	63.6
Bonds	12.0	1.8	13.8	9.2	1.4	10.6
Other assets	0.5	-	0.5	0.3	-	0.3
Other policies	-	-	-	1.6	-	1.6
	95.2	4.6	99.8	72.8	3.3	76.1

The analysis of the actuarial profit/(loss) in the consolidated statement of recognised income and expense were as follows:

	UK 2005 £m	Canada 2005 £m	Total 2005 £m	UK 2004 £m	Canada 2004 £m	Total 2004 £m
Actual return less expected return						
on pension scheme assets	14.1	-	14.1	2.1	-	2.1
Experience (losses)/gains arising on scheme liabilities	2.3	0.2	2.5	(1.6)	-	(1.6)
Changes in assumptions underlying the present value of the scheme liabilities	(21.3)	(0.5)	(21.8)	(11.2)	-	(11.2)
Exchange rate movement	-	(0.1)	(0.1)	-	-	-
	(4.9)	(0.4)	(5.3)	(10.7)	-	(10.7)

Cumulative actuarial losses, net of deferred tax, recognised in the consolidated statement of recognised income and expense at 31 December 2005 were £11.1 million (2004: £7.5 million).

The five-year history of experience adjustments is as follows:

	2005 £m	2004 £m	2003 £m	2002 £m	2001 £m
Present value of defined benefit obligations	(146.4)	(116.3)	(96.1)	(81.2)	(72.9)
Fair value of scheme assets	99.8	76.1	66.8	52.0	62.7
Scheme deficit	(46.6)	(40.2)	(29.3)	(29.2)	(10.2)
Experience adjustments on scheme liabilities	2.5	(1.6)	1.4	1.3	-
Percentage of scheme liabilities	1.7%	1.4%	1.5%	1.5%	-
Experience adjustment on scheme assets	14.1	2.1	5.4	(17.5)	-
Percentage of scheme assets	14.2%	2.5%	8.1%	32.3%	-

The expected amount of contributions expected to be paid to defined benefit schemes during the 2006 financial year is £4,300,000.

There is evidence to suggest that mortality rates are continuing to improve, meaning that people are living longer with the result that pensions will be payable for a longer period. The mortality assumptions used in the valuation of the UK scheme make prudent allowance for future improvements in longevity and are set out below.

	2005	2004	2003
Current pensioners (at 65) - males	18.4 years	18.4 years	17.0 years
Current pensioners (at 65) - females	21.4 years	21.4 years	20.7 years
Future pensioners (at 65) - males	19.9 years	19.9 years	17.0 years
Future pensioners (at 65) - females	22.8 years	22.8 years	20.7 years

**27 Related party transactions**

During the year, the Group made sales of £509,000 (2004: £192,000) to Interpacific Technologies Limited which were made under normal commercial terms. Amounts owed by Interpacific Technologies Limited to the Ultra Group at 31 December 2005 were £111,000 (2004: £56,000). Ultra owns 40% of Interpacific Technologies Limited.

**28 Post balance sheet date events**

On 12 January 2006, Ultra announced the acquisition of Polyflex Aerospace Ltd., a company based in Cheltenham, UK, for a cash consideration, subject to a net asset adjustment on completion of £4.0 million.

## Statement of accounting policies in respect of the Group's consolidated financial statements

A summary of the Group's principal accounting policies, all of which have been applied consistently throughout the year and preceding year, is set out below:

### **a) Basis of accounting**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) for the first time. The disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRSs are given on pages 85 to 86. The financial statements have also been prepared in accordance with IFRSs adopted for use in the European Union and therefore comply with Article 4 of the EU IAS regulations.

The consolidated financial information has been prepared under the historical cost convention except for derivatives which are measured at fair value.

### **b) Basis of consolidation**

The consolidated financial information includes the results, cash flows and assets and liabilities of Ultra Electronics Holdings plc ("the Company") and its subsidiaries (together, "the Group").

Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess 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 is credited to the income statement in the period of acquisition.

The results of subsidiaries acquired during the year are included in the consolidated income statement from the effective date of acquisition.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

### **c) Goodwill**

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary. Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

Goodwill arising on acquisitions before the date of transition to IFRSs has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and will not be included in determining any subsequent profit or loss on disposal.

### **d) Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Sales of goods are normally recognised when goods are delivered and title has passed.

### **e) Long-term contracts**

Where the outcome of a long-term contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is normally measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a long-term contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

### **f) Foreign currency**

Transactions denominated in foreign currencies are recorded in the local currency at the actual exchange rates at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in the income statement.

**f) Foreign currency (continued)**

The trading results and cash flows of overseas undertakings are translated into sterling, which is the functional currency of the Company, using the average rates of exchange during the relevant financial period. The balance sheets of overseas subsidiary undertakings are translated into sterling at the rates ruling at the year-end. Exchange differences arising from the re-translation of the opening balance sheets and results are classified as equity and transferred to the Group's translation reserve.

Goodwill and fair value adjustments on the acquisition of foreign entities are treated as assets and liabilities of the foreign entity and translated at the closing rate. The Group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of transition to IFRSs as sterling denominated assets and liabilities.

**g) Government grants**

Government grants are recognised in the profit and loss account so as to match them with the expenditure towards which they are intended to contribute, to the extent that the conditions for receipt have been met and there is reasonable assurance that the grant will be received.

**h) Retirement benefit costs**

The Group provides pensions to its employees and Directors through defined benefit and defined contribution pension schemes. The schemes are funded and their assets are held independently of the Group by trustees.

For defined benefit retirement schemes, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each balance sheet date. The actuarial gains and losses are recognised outside the income statement and presented in the statement of recognised income and expense.

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested. In accordance with IAS 19 actuarial gains and losses are recognised in full in the statement of recognised income and expense.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets.

**i) Research and development**

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Any internally generated intangible asset arising from development activities is recognised only if an asset is created that can be identified, it is probable that the asset created will generate future economic benefit and the development cost of the asset can be measured reliably.

Internally generated assets are amortised on a straight-line basis over their useful lives. Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

**j) Other intangible assets**

Costs associated with producing or maintaining computer software programmes for sale are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, that will generate economic benefits exceeding costs beyond one year and that can be measured reliably, are recognised as intangible assets. Capitalised software development expenditure is stated at cost less accumulated amortisation and impairment losses. Amortisation is provided on a straight-line basis over their useful lives.

Patents and trademarks are stated initially at historical cost. Patents and trademarks have definite useful lives and are carried at cost less accumulated amortisation and impairment losses.

Intangible assets arising from a business combination whose fair value can be reliably measured are separated from goodwill and amortised on a straight line basis over their remaining useful lives.

**k) Impairment**

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash generating unit to which the asset belongs. An intangible asset with an indefinite useful life is tested for impairment annually and whenever there is an indication that the asset may be impaired.

**k) Impairment (continued)**

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing the value in use, the estimated future cash flows are discounted to their present value. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

**l) Property, plant and equipment**

Property, plant and equipment are shown at original historical cost, net of depreciation and any provision for impairment.

Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows:

Freehold buildings	40 to 50 years
Short leasehold improvements	over remaining period of lease
Plant and machinery	3 to 20 years
Freehold land is not depreciated.	

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

**m) Leases**

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

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. 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. Finance charges are charged directly against income.

Operating lease rentals are charged to income on a straight-line basis over the term of the relevant lease.

**n) Inventories**

Inventories are valued at the lower of cost (determined on a first-in, first-out basis and including an appropriate proportion of overheads incurred in bringing the inventories to their present location and condition) and net realisable value. Provision is made for any obsolete, slow moving or defective items.

**o) Cash and cash equivalents**

Cash and cash equivalents comprise cash in-hand, call deposits and bank overdrafts, where there is right of set off. Bank overdrafts are presented as current liabilities to the extent that there is no right of offset with cash balances.

**p) Share-based payments**

The Group has applied the requirements of IFRS 2 "Share based payment." In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2005.

The Group issues equity settled share-based payments to certain employees. Equity settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. Fair value is measured by use of an option pricing model.

**q) Provisions**

Provision is made for the anticipated cost of repair and rectification of products under warranty, based on known exposures and historical occurrences. Provisions for restructuring costs are recognised when the Group has a detailed formal plan for the restructuring that has been communicated to affected parties.

**r) Taxation**

The tax expense represents the sum of the current tax payable and deferred tax.

The current tax payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities.

**s) Derivative financial instruments**

As permitted by IFRS 1 (paragraph 36a), Ultra has elected to apply IAS 32 "Financial Instruments: Disclosure and Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement" prospectively from 1 January 2005. As a result, the relevant comparative information for the year ended 31 December 2004 does not reflect the impact of these standards and is accounted for in accordance with UK GAAP.

Ultra uses derivative financial instruments, principally forward foreign currency contracts and interest rate swaps, to reduce its exposure to exchange rate and interest rate movements. Ultra does not hold or issue derivatives for speculative or trading purposes. Under UK GAAP, such derivative contracts are not recognised as assets and liabilities on the balance sheet and gains or losses arising on them are not recognised until the hedge item is itself recognised in the financial statements.

From 1 January 2005 onwards, derivative financial instruments are recognised as assets and liabilities measured at their fair values at the balance sheet date. Changes in their fair values are recognised in the income statement and this is likely to cause volatility in situations where the carrying value of the hedged item is not adjusted to reflect fair value changes arising from the hedged risk. Provided the conditions specified by IAS 39 are met, hedge accounting may be used to mitigate this income statement volatility. 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 will not generally be applied to transactional hedging relationships, such as hedges of forecast or committed transactions. However, hedge accounting will be applied to translational hedging relationships where it is permissible under IAS 39. When hedge accounting is used, the relevant hedging relationships will be classified as fair value hedges, cash flow hedges or net investment hedges.

Where the hedging relationship is classified as a fair value hedge, the carrying amount of the hedged asset or liability will be adjusted by the increase or decrease in its fair value attributable to the hedged risk and the resulting gain or loss will be recognised in the income statement where, to the extent that the hedge is effective, it will be offset by the change in the fair value of the hedging instrument.

Where the hedging relationship is classified as a cash flow hedge or as a net investment hedge, to the extent that the hedge is effective, changes in the fair value of the hedging instrument will be recognised directly in equity rather than in the income statement. Any gain or loss relating to the ineffective portion is recognised immediately in the income statement. For cash flow hedges of forecasted future transactions, when the hedged item is recognised in the financial statements, the accumulated gains and losses recognised in equity will be either recycled to the income statement or, if the hedged items results in a non-financial asset, will be recognised as adjustments to its initial carrying amount.

**To the members of Ultra Electronics Holdings plc**

We have audited the individual Company financial statements (the “financial statements”) of Ultra Electronics Holdings plc for the year ended 31 December 2005 which comprise the balance sheet, the related notes 29 to 39 and the statement of accounting policies for the Company. 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.

We have reported separately on the Group financial statements of Ultra Electronics Holdings plc for the year ended 31 December 2005.

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 individual Company financial statements in accordance with applicable United Kingdom law and United Kingdom Generally Accepted Accounting Practice 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 in accordance with the relevant framework 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. We report to you if, in our opinion, the Directors' report is not consistent with the financial statements. We also report to you if 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 transactions with the Company is not disclosed.

We also report to you if, in our opinion, the Company has not complied with any of the four Directors' Remuneration disclosure requirements specified for our review by the Listing Rules of the Financial Services Authority. These comprise the amount of each element in the remuneration package and information on share options, details of long term incentive schemes, and money purchase and defined benefit schemes. We give a statement, to the extent possible, of details of any non-compliance.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 FRC 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 Company's Corporate governance procedures or its risk and control procedures.

We read the Directors' report and the other information contained in the Annual Report for the above year and described in the contents section including the unaudited part of the Directors' Remuneration report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

**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 United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2005; and
- 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.

*Deloitte & Touche LLP*

**Deloitte & Touche LLP**

**Chartered Accountants and Registered Auditors**

London, England

27 February 2006

**Notes:** An audit does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial statements since first published. These matters are the responsibility of the Directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

# Company balance sheet

31 December 2005

	Note	2005 £'000	2004 £'000
<b>Fixed assets</b>			
Tangible assets	29	43	33
Investments	30	159,785	127,048
		<b>159,828</b>	<b>127,081</b>
<b>Current assets</b>			
Debtors: Amounts falling due within one year	31	20,035	23,901
Debtors: Amounts falling due after more than one year	31	6,978	5,252
Cash at bank and in hand		2	1
		<b>27,015</b>	<b>29,154</b>
<b>Creditors: Amounts falling due within one year</b>	<b>33</b>	<b>(45,953)</b>	<b>(93,498)</b>
<b>Net current liabilities</b>		<b>(18,938)</b>	<b>(64,344)</b>
<b>Total assets less current liabilities</b>		<b>140,890</b>	<b>62,737</b>
<b>Creditors: Amounts falling due after more than one year</b>	<b>34</b>	<b>(88,819)</b>	<b>(12,966)</b>
<b>Net assets</b>		<b>52,071</b>	<b>49,771</b>
<b>Capital and reserves</b>			
Called-up share capital	35	3,361	3,345
Share premium account	36	31,679	30,306
Profit and loss account	36	19,672	18,927
Own shares	37	(2,641)	(2,807)
<b>Equity shareholders' funds</b>		<b>52,071</b>	<b>49,771</b>

Signed on behalf of the Board

D. Caster, *Chief Executive*

D. Jeffcoat, *Finance Director*  
27 February 2006

The accompanying notes are an integral part of this balance sheet.

**29 Tangible fixed assets**

	Plant and machinery £'000
<b>Cost</b>	
At 1 January 2004	237
Additions	26
<b>At 1 January 2005</b>	<b>263</b>
Additions	24
<b>At 31 December 2005</b>	<b>287</b>
<b>Accumulated depreciation</b>	
At 1 January 2004	216
Charge	14
<b>At 1 January 2005</b>	<b>230</b>
Charge	14
<b>At 31 December 2005</b>	<b>244</b>
<b>Net book value</b>	
<b>At 31 December 2005</b>	<b>43</b>
At 31 December 2004	33

Plant and machinery includes IT hardware and software.

**30 Investments****a) Principal subsidiary undertakings**

The Company owns 100% of the ordinary share capital of the following principal subsidiary undertakings:

Name	Place of registration or incorporation
Ultra Electronics Limited	England and Wales
United Electronic Holdings (USA) LLC	USA
United Electronics Canada Defence Inc	Canada

The principal activity of the subsidiary undertakings is the design, development and manufacture of electronic systems.

**b) Investment in subsidiary undertakings**

	Total 2005 £'000
<b>Cost</b>	
<b>At 1 January 2005</b>	<b>127,048</b>
Foreign exchange differences	4,684
Additions	35,393
Redemption of long-term loans	(6,765)
Disposals	(575)
<b>At 31 December 2005</b>	<b>159,785</b>
<b>Net book value</b>	
<b>At 31 December 2005</b>	<b>159,785</b>
At 31 December 2004	127,048

Disposals relate to a reduction in the share capital of Ultra Electronics Canada Defence Inc.

**31 Debtors**

	2005 £'000	2004 £'000
<b>Amounts falling due within one year:</b>		
Amounts owed by subsidiary undertakings	19,560	23,299
Deferred tax assets	19	24
Other debtors	423	332
Prepayments and accrued income	33	246
	<b>20,035</b>	<b>23,901</b>
<b>Amounts falling due after more than one year:</b>		
Amounts owed by subsidiary undertakings	6,967	5,252
Other debtors	11	-
	<b>6,978</b>	<b>5,252</b>

**32 Deferred tax**

Movements in the deferred tax asset were as follows:

	Deferred Tax 2005 £'000	Deferred Tax 2004 £'000
Beginning of year	24	18
(Debit)/credit to the profit and loss account	(5)	6
	<b>19</b>	<b>24</b>

Deferred tax balances are analysed as follows:

	2005 £'000	2004 £'000
Deferred capital allowances	6	7
Other timing differences relating to current assets and liabilities	13	17
<b>Deferred tax asset</b>	<b>19</b>	<b>24</b>

These balances are shown as follows:

	2005 £'000	2004 £'000
Debtors: Amounts falling due within one year	19	24

**33 Creditors: Amounts falling due within one year**

	2005 £'000	2004 £'000
Bank loans and overdraft	40,577	87,204
Amounts owed to subsidiary undertakings	3,590	4,099
Other creditors:		
– VAT	95	178
– social security and PAYE	176	209
– other creditors	150	722
Accruals and deferred income	1,365	1,086
	<b>45,953</b>	<b>93,498</b>

**34 Creditors: Amounts falling due after more than one year**

	2005 £'000	2004 £'000
Bank loans	74,367	-
Amounts owed to subsidiary undertakings	14,452	12,966
	<b>88,819</b>	<b>12,966</b>

The bank loans are unsecured and due for repayment in 5 years. Interest is charged at LIBOR.

Borrowings fall due as analysed below:

	2005 £'000	2004 £'000
<b>Bank loans and overdraft</b>		
In one year or less, or on demand	40,577	87,327
In more than one year but less than five years	74,708	-
	<b>115,285</b>	<b>87,327</b>
Less: unamortised finance costs of debt	(341)	(123)
	<b>114,944</b>	<b>87,204</b>
Less: included in Creditors: Amounts falling due within one year	(40,577)	(87,204)
Less: included in Creditors: Amounts falling due after more than one year	(74,367)	-
	-	-

**35 Called-up share capital**

	2005		2004	
	No.	£'000	No.	£'000
<b>Authorised:</b>				
5p ordinary shares	90,000,000	4,500	90,000,000	4,500
<b>Allotted, called-up and fully paid:</b>				
5p ordinary shares	67,221,085	3,361	66,904,519	3,345

316,566 ordinary shares having a nominal value of £15,828 were allotted during the year under the terms of the Group's various Share Option Schemes. The aggregate consideration received by the Company was £1,388,978.

**36 Reserves**

	Share premium £'000	Profit and loss account £'000
<b>Beginning of year</b>	30,306	11,288
Prior year adjustment	-	7,639
Disposal of own shares	-	(762)
Share based payments	-	586
Retained profit for the year	-	921
Issue of new shares	1,373	-
<b>End of year</b>	<b>31,679</b>	<b>19,672</b>

Retained profit for the year is after dividends of £2,433,000.

The adoption of FRS 20 and 21 resulted in a prior year adjustment, the effects of which can be seen in note 39.

**37 Own shares**

	Long-Term Incentive Plan shares £'000
<b>Cost</b>	
Beginning of year	(2,807)
Additions	(596)
Disposals	762
<b>End of year</b>	<b>(2,641)</b>

The Company holds 545,663 own shares (2004: 643,375).

**38 Guarantees and other financial commitments****Lease commitments**

The minimum rentals for the next 12 months are as follows:

	Plant and machinery 2005 £'000	Plant and machinery 2004 £'000
Operating lease rentals which expire		
– within one year	12	20
– between two to five years	10	13
	<b>22</b>	<b>33</b>

**39 Prior year adjustments**

The effects of the implementation of FRS 20 and FRS 21 on the reported results was as follows:

**Profit and loss account**

	2004 £'000
Decrease in dividend	714
Increase in administrative expenses	(378)
Increase in retained profits	336

**Balance sheet**

	2004 £'000
Decrease in creditors	6,157
Increase in profit and loss account	7,639
Increase in own shares	(1,482)
	<b>6,157</b>

## Statement of accounting policies for the Company accounts

A summary of the Company's principal accounting policies, which has continued to apply United Kingdom accounting standards, all of which have been applied consistently throughout the year and preceding year in the separate financial information presented for the Company, is set out below:

### **a) Basis of accounting**

The Company accounts have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards. The Company has adopted FRS 20 and 21 during the year which reflect the accounting treatment contained within IFRS 2 share based payments and IAS 10 post balance sheet events.

No profit and loss account is presented for the Company, as permitted by section 230 of the Companies Act 1985. The Company's retained profit for the year is disclosed in note 36.

### **b) Fixed assets and depreciation**

Tangible fixed assets are shown at original historical cost, net of depreciation and any provision for impairment.

Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows:

Plant and machinery	3 to 20 years
IT hardware and software	3 to 5 years

### **c) Taxation**

UK Corporation tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future, or a right to pay less tax in the future, have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements. These arise from including gains and losses in tax assessments in different periods from those recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is not discounted.

### **d) Retirement benefit costs**

The Company provides pensions to its employees and Directors through defined benefit and defined contribution pension schemes. The schemes are funded and their assets are held independently of the Group by trustees.

The amount charged to the profit and loss account for defined benefit schemes is the estimated regular cost of providing the benefits accrued in the period adjusted to reflect variations from the cost. The regular cost is calculated so that it represents a substantially level percentage of current and future pensionable payroll.

Any difference between the amount charged to the profit and loss account and contributions paid to the pension scheme is shown as a separately identifiable liability or asset in the balance sheet.

Certain employees and Directors participated in the UK defined benefit scheme operated by Ultra Electronics Limited. Paragraph 9(b) of FRS 17 allows for a defined benefit scheme to be accounted for as a defined contribution scheme where there are multi-employers and one employer is unable to identify its share of the underlying assets and liabilities on a consistent and reasonable basis. The Ultra Electronics Limited defined benefit scheme has been accounted for on this basis. The deficit in the scheme at 31 December 2005 was £44.7m (2004: £38.7m). Further disclosures in relation to this pension scheme are given in note 26 to the financial statements.

### **e) Investment**

Fixed asset investments are shown at cost less provision for impairment.

**f) Foreign currency**

Transactions denominated in foreign currencies are recorded in the local currency at the actual exchange rates at the date of the transactions (or, where appropriate, at the rate of exchange in a related forward exchange contract). Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date (or, where appropriate, at the rate of exchange in a related forward exchange contract). Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in the profit and loss account.

**g) Leases**

Assets held under finance leases, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease term and their useful lives. The capital element of future lease obligations are recorded as liabilities, whilst the interest elements are charged to the profit and loss account over the period of the leases to produce a constant rate of charge on the balance of the capital repayments outstanding. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful lives.

Rentals under operating leases are charged on a straight line basis over the lease term, even if the payments are not made on such a basis.

**h) Share-based payments**

The Company has applied the requirements of FRS 20 to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2005. The Company issues equity settled share-based payments to certain employees. Equity settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Company's estimate of shares that will eventually vest. Fair value is measured by use of an option pricing model, using the assumptions disclosed within the Group accounts in note 22.

## Shareholder analysis

31 December 2005

### By category of shareholder

	Shares held	
	Number '000	% share capital
Unit trusts	27,104	40
Pension funds	14,358	21
Insurance companies	6,428	10
Private investors	3,234	5
Investment trusts and other funds	2,324	3
Charities	463	1
Other	13,310	20
	<b>67,221</b>	<b>100</b>

### By size of holding

	Holders		Shares held	
	Number	% of holders	Number '000	% share capital
1-100	92	6	5	-
101-500	479	34	128	-
501-1,000	269	19	203	-
1,001-5,000	279	20	550	1
5,001-10,000	40	3	296	1
10,001-50,000	99	7	2,326	4
50,001-100,000	41	3	2,986	4
100,001 and over	117	8	60,727	90
	<b>1,416</b>	<b>100</b>	<b>67,221</b>	<b>100</b>

### Financial calendar

18 April 2006	Record date for 2005 final dividend
27 April 2006	Annual General Meeting
5 May 2006	2005 final dividend paid
31 July 2006	Interim results announced
September 2006	2006 interim dividend paid

	UK GAAP			IFRS	
	2001 £m	Restated 2002 £m	Restated 2003 £m	2004 £m	2005 £m
<b>Revenue</b>					
Aircraft & Vehicle Systems	78.4	76.4	79.9	76.6	<b>84.4</b>
Information & Power Systems	74.4	82.9	95.5	113.7	<b>117.3</b>
Tactical & Sonar Systems	86.7	101.1	109.0	120.4	<b>140.7</b>
<b>Total revenue</b>	<b>239.5</b>	<b>260.4</b>	<b>284.4</b>	<b>310.7</b>	<b>342.4</b>
<b>Profit from operations<sup>1</sup></b>					
Aircraft & Vehicle Systems	13.0	12.5	13.9	14.9	<b>15.9</b>
Information & Power Systems	7.6	11.0	11.0	15.0	<b>18.1</b>
Tactical & Sonar Systems	11.1	10.0	12.6	13.4	<b>17.1</b>
<b>Total profit from operations</b>	<b>31.7</b>	<b>33.5</b>	<b>37.5</b>	<b>43.3</b>	<b>51.1</b>
<b>Margin<sup>1</sup></b>	<b>13.2%</b>	<b>12.8%</b>	<b>13.2%</b>	<b>13.9%</b>	<b>14.9%</b>
<b>Profit before tax</b>	<b>27.1</b>	<b>29.9</b>	<b>34.4</b>	<b>40.1</b>	<b>40.7</b>
<b>Profit after tax</b>	<b>16.3</b>	<b>17.9</b>	<b>20.4</b>	<b>29.2</b>	<b>29.4</b>
<b>Operating cash flow<sup>2</sup></b>	<b>35.2</b>	<b>38.7</b>	<b>48.3</b>	<b>46.9</b>	<b>53.8</b>
<b>Free cash flow before dividends, acquisitions and financing<sup>3</sup></b>	<b>21.8</b>	<b>28.0</b>	<b>35.7</b>	<b>36.0</b>	<b>38.1</b>
<b>Net debt at year-end<sup>4</sup></b>	<b>(40.6)</b>	<b>(39.3)</b>	<b>(30.3)</b>	<b>(24.1)</b>	<b>(34.3)</b>
<b>Headline earnings per share (p)<sup>5</sup></b>	<b>30.5</b>	<b>33.2</b>	<b>38.2</b>	<b>43.7</b>	<b>50.7</b>
<b>Dividends per share (p)</b>	<b>10.4</b>	<b>11.2</b>	<b>12.3</b>	<b>12.8</b>	<b>14.4</b>
<b>Average employee numbers</b>	<b>2,376</b>	<b>2,395</b>	<b>2,505</b>	<b>2,678</b>	<b>2,880</b>

<sup>1</sup> Before amortisation of goodwill and amortisation of intangibles arising on acquisition.

<sup>2</sup> Cash generated by operations, less net capital expenditure, R&D and LTIP share purchases.

<sup>3</sup> Free cash flow before dividends, acquisitions and financing has been adjusted to include the purchase of Long-Term Incentive Plan shares, which are included in financing activities.

<sup>4</sup> Bank overdrafts and loans less cash and cash equivalents.

<sup>5</sup> Before goodwill amortisation, amortisation of intangibles arising on acquisition and loss on derivative financial instruments.

## Explanation of transition to IFRS

This is the first year that the Group has presented its financial statements under IFRS. The following disclosures are required in the year of transition. The last financial statements under UK GAAP were for the year ended 31 December 2004 and the date of transition to IFRSs was therefore 1 January 2004.

### Reconciliation of equity

	1 January 2004			31 December 2004		
	UK GAAP IFRS format £'000	Effect of transition to IFRS £'000	IFRS £'000	UK GAAP IFRS format £'000	Effect of transition to IFRS £'000	IFRS £'000
<b>Non current assets</b>						
Intangible assets	90,847	1,214	92,061	107,281	7,562	114,843
Property, plant and equipment	19,170	-	19,170	20,213	-	20,213
Deferred tax assets	1,224	8,665	9,889	1,768	12,232	14,000
	<b>111,241</b>	<b>9,879</b>	<b>121,120</b>	<b>129,262</b>	<b>19,794</b>	<b>149,056</b>
<b>Current assets</b>						
Inventories	15,006	(197)	14,809	23,112	(555)	22,557
Trade and other receivables	64,895	(1,002)	63,893	68,758	(406)	68,352
Cash and cash equivalents	19,047	(1,003)	18,044	24,975	(915)	24,060
	<b>98,948</b>	<b>(2,202)</b>	<b>96,746</b>	<b>116,845</b>	<b>(1,876)</b>	<b>114,969</b>
<b>Total assets</b>	<b>210,189</b>	<b>7,677</b>	<b>217,866</b>	<b>246,107</b>	<b>17,918</b>	<b>264,025</b>
<b>Current liabilities</b>						
Trade and other payables	(82,492)	6,550	(75,942)	(96,403)	6,305	(90,098)
Tax liabilities	(5,019)	-	(5,019)	(8,030)	-	(8,030)
Obligations under finance leases	(5)	-	(5)	(21)	-	(21)
Bank overdrafts and loans	-	-	-	(48,104)	-	(48,104)
Short-term provisions	(3,881)	-	(3,881)	(3,164)	-	(3,164)
	<b>(91,397)</b>	<b>6,550</b>	<b>(84,847)</b>	<b>(155,722)</b>	<b>6,305</b>	<b>(149,417)</b>
<b>Non-current liabilities</b>						
Retirement benefit obligations	(809)	(28,439)	(29,248)	-	(40,219)	(40,219)
Other payables	-	-	-	(1,784)	669	(1,115)
Deferred tax liabilities	(102)	(120)	(222)	-	(1,406)	(1,406)
Obligations under finance leases	(7)	-	(7)	(10)	-	(10)
Bank overdrafts and loans	(49,370)	-	(49,370)	-	-	-
Long-term provisions	(3,830)	-	(3,830)	(7,472)	-	(7,472)
	<b>(54,118)</b>	<b>(28,559)</b>	<b>(82,677)</b>	<b>(9,266)</b>	<b>(40,956)</b>	<b>(50,222)</b>
<b>Total liabilities</b>	<b>(145,515)</b>	<b>(22,009)</b>	<b>(167,524)</b>	<b>(164,988)</b>	<b>(34,651)</b>	<b>(199,639)</b>
<b>Net assets</b>	<b>64,674</b>	<b>(14,332)</b>	<b>50,342</b>	<b>81,119</b>	<b>(16,733)</b>	<b>64,386</b>
<b>Equity</b>						
Share capital	3,318	-	3,318	3,345	-	3,345
Share premium account	28,096	-	28,096	30,306	-	30,306
Own shares	(1,106)	(1,387)	(2,493)	(1,325)	(1,482)	(2,807)
Hedging and translation reserve	-	-	-	-	(1,098)	(1,098)
Retained earnings	34,366	(12,945)	21,421	48,793	(14,153)	34,640
<b>Total equity attributable to equity holders and the parent</b>	<b>64,674</b>	<b>(14,332)</b>	<b>50,342</b>	<b>81,119</b>	<b>(16,733)</b>	<b>64,386</b>

The most significant adjustments to equity are the result of:

- inclusion of the pension deficit (net of deferred tax) on the balance sheet in accordance with IAS 19;
- reversal of goodwill amortisation charged post 1 January 2004 in accordance with the transitional provisions of IFRS 3;
- capitalisation and amortisation of development expenditure in accordance with IAS 38;
- revaluation of foreign exchange balances at actual rates in accordance with IAS 21, and
- accounting for dividends when approved in accordance with IAS 10.

**Reconciliation of profit**

	Year ended 31 December 2004		
	UK GAAP IFRS format £'000	Effect of transition to IFRS £'000	IFRS £'000
Revenue	319,669	(8,927)	310,742
Cost of sales	(235,017)	5,390	(229,627)
<b>Gross profit</b>	<b>84,652</b>	<b>(3,537)</b>	<b>81,115</b>
Other operating income	-	3,828	3,828
Distribution costs	(824)	47	(777)
Administrative expenses	(46,985)	6,386	(40,599)
Other operating expenses	(273)	-	(273)
<b>Profit from operations</b>	<b>36,570</b>	<b>6,724</b>	<b>43,294</b>
Investment revenue	157	-	157
Finance costs	(2,942)	(420)	(3,362)
<b>Profit before tax</b>	<b>33,785</b>	<b>6,304</b>	<b>40,089</b>
Tax	(10,308)	(630)	(10,938)
<b>Profit for the year from continuing operations attributable to equity holders of the parent</b>	<b>23,477</b>	<b>5,674</b>	<b>29,151</b>

The most significant adjustments to equity are the result of:

- reversal of goodwill amortisation charged post 1 January 2004 in accordance with the transitional provisions of IFRS 3;
- capitalisation and amortisation of development expenditure in accordance with IAS 38, and
- revaluation of foreign exchange transactions and balances at actual rates in accordance with IAS 21.

**Cash flow statement**

There were no material differences to the amounts recognised in the cash flow statement on transition to IFRS.