Ultra Electronics Holdings plc

Interim Report and Accounts **2002**

Ultra ELECTRONICS

Ultra Electronics is a group of specialist businesses designing, manufacturing and supporting electronic and electromechanical systems, sub-systems and products for international defence and aerospace markets.

The Group, which employs 2,400 people in the UK and North America, focuses on high integrity sensing, control, communication and display systems with an emphasis on integrated Information Technology solutions.

The Group concentrates on obtaining a technological edge in niche markets, with many of its products and technologies being market leaders in their field.

Ultra has an increasing role of supporting prime contractors by undertaking specialist system and sub-system integration using the combined expertise of the Group businesses.

PRODUCTS MILLENNIUM

HIPSS
IN THE HUB,
POWER GENERATION
FOR PROPELLER
DE-ICING

PRODUCTS MILLENNIUM

ULTRAQUIET CABIN
AIRCRAFT CABIN
NOISE REDUCTION
SYSTEM

THE QUEEN'S AWARDS FOR ENTERPRISE 2000

THE QUEEN'S AWARD
FOR ENTERPRISE 2000
FOR THE
MAGICARD PRINTER
AT OCEAN SYSTEMS

Chairman's Statement

Financial Results

Ultra's performance in the first half of 2002 was very encouraging with record sales and profits and strong cash generation.

Sales increased by 9% to £125.6m, compared to £114.9m last year. This growth reflected a strong performance in the Information and Sea Systems division, driven by a high level of US defence spending in the Battlespace IT sector. Ultra's naval systems businesses also performed well as a result of the good order intake in previous periods. With no acquisitions, all the growth during the period was organic.

Operating profit before goodwill amortisation was 4.8% higher at £15.6m (2001: £14.9m). There was a modest reduction in the operating margin to 12.4% (2001: 12.9%) which was due mainly to a lower level of higher margin civil aerospace spares and repairs activity. The interest charge dropped by £0.6m and profit before tax and amortisation rose to £13.8m, a 10% increase when compared to last year's result of £12.5m.

Earnings per share before amortisation of goodwill grew by 9%. Ultra has now adopted the new deferred tax accounting standard FRS19 and has restated the tax charge for 2001 as a result. The effect is a small reduction in the Group's effective tax rate, taking basic earnings per share to 14.1p for the first half of 2001, compared to 13.9p as originally reported. The corresponding figure for 2002 is 15.3p.

Ultra achieved excellent operating cash generation in the period of £11.9m (2001: £6.5m) after capital expenditure, a conversion rate of 77%. After non-operating payments including interest, taxation and dividends of £8.2m (2001: £9.6m), net debt was £36.9m at the period end, a reduction of £3.7m since the beginning of the year. The strength of the Group's balance sheet is demonstrated by a first half interest cover of nearly nine times.

An interim dividend of 3.7p (2001: 3.4p) will be paid on 27 September 2002 to those shareholders on the register at the close of business on 30 August 2002.

Markets

A focus on defence equipment that provides mobility and the rapid and secure management of vital information has continued in all of Ultra's main markets, with a particular emphasis on Battlespace IT systems that facilitate the exchange and interoperability of data. In the USA, which accounts for around 30% of Ultra's sales, the defence budget is rising rapidly. Real budget growth has been less rapid in the UK, although expenditure on specific equipment programmes is rising as key projects, such as Eurofighter and Astute, enter full-scale production. Worldwide, budgeted levels of expenditure on Anti-Submarine Warfare (ASW) equipment remain broadly constant, although a significant number of new ASW aircraft are currently under development.

In civil aerospace, passenger numbers around the world, especially North America, remain below the levels of twelve months ago. This has led to a reduction in build rates for new aircraft and has also depressed airline demand for after-market products and services. However infrastructure investment at selected airports around the world has continued in anticipation of a medium-term increase in passenger traffic. There is an increased focus on systems, including IT, that can enhance the travel process whilst maintaining an appropriate level of security and control.

Operational Review

Air & Land Systems

Total sales increased by 5% to £85.6m (2001: £81.2m) and the operating margin was 13.3% (2001: 14.8%). This resulted in an operating profit before goodwill amortisation of £11.4m compared with £12.0m last year. The order book was almost unchanged at £237.3m (December 2001: £237.6m) despite the softness in the civil aerospace sector.

The sales growth resulted primarily from higher levels of sonobuoy sales in North America and a significant increase in sales of the HiPPAG airborne compressor. In the period, HiPPAG entered service on the US F/A 18 E/F "Super Hornet" aircraft and early operational feedback is excellent. First production deliveries were also made to support the Eurofighter programme. In the UK, sonobuoy production rates have declined from a peak in 2001 and activity is also running at a lower level on the Nimrod acoustic system contract as it reaches maturity. The result is an overall reduction in the profit contribution from ASW this year. However, Ultra has maintained its 100% share of the UK market having been awarded a development and production contract for the Barra sonobuoy by the MoD.

Activity levels in civil aerospace were 18% down compared to the same period last year with a marked impact on the higher-margin spares and repair sales. The adverse impact on margins was minimised by the restructuring of the affected businesses that took place in late 2001. Further successes in this division included:

- the contract with Vickers Defence Systems to supply the indirect vision system and other vehicle electronics for the MoD's Engineer Tank System. This award is now worth £12m to the Group.
- the first flight of the new Pilatus PC21 trainer aircraft. Ultra's ability to develop customer specific cockpit display software is a key selling feature of this aircraft.
- the contract was signed, with a value of £20m, for the supply of the bow sonar for the UK's new Type 45 destroyer.
- since the period end, Ultra has received the main contract, valued at £51m, to develop and supply the UK Navy's new torpedo defence system for its surface ships. This followed successful in-water trials of critical elements of the total system.

Information & Sea Systems

Information & Sea Systems recorded an excellent performance in the half-year, with sales growth of 19% to £40.0m (2001: £33.7m). The order book increased by 6% to close at £81.9m (December 2001: £77.1m).

Operating profit before goodwill amortisation rose by 48% to £4.2m (2001: £2.8m) and the operating margin increased to 10.4% (2001: 8.4%).

This result reflected the rapid growth in the Group's Battlespace IT activities, with sales up 37% on the equivalent period in 2001. In the USA, development has started of MTP, a new tactical datalink information processor. This product is intended for fitment to all US Navy major combatant vessels. Sales of the ADSI real-time command and control system were significantly higher. This reflects its increased use by US and Joint forces at the heart of major in-theatre operations in managing complex flows of tactical data. In the UK, Ultra responded to an urgent operational requirement for specialist Battlespace IT equipment, winning the contract and completing shipment five months later.

The level of development activity for command and control equipment for international naval programmes has increased, following contract wins in 2001. Production deliveries for naval programmes in both the UK and USA are rising and, as these programmes mature, their contribution to profit increases.

In Airport IT, Ultra is now involved in a higher number of contracts including several where it has responsibility for complete system integration, such as at Kansas City International airport in the USA. This higher activity level has ensured an increase in profitability. The level of bid activity in this market sector is also increasing reflecting the resurgence of airport investment programmes.

Reflecting an enhanced focus on security, market acceptance of Ultra's new range of ID card printers has been good during the first half. Sales of the associated expendable products have also continued to rise.

Prospects

The Group's order book stood at £319m at the end of June (December 2001: £315m) representing approximately 15 months of future sales. The order book reflects the continuing supply of equipment on existing platforms for which there are firm contracts as well as new programmes won.

No recovery in civil aerospace activity levels before the end of 2003 is assumed although the airport infrastructure investment programmes in which Ultra is involved will continue.

For Ultra's ASW businesses, activity levels will flatten in 2003 beyond which advanced new systems are expected to enter development. Additional ASW platforms are being developed, incorporating Ultra equipment, which are expected to drive a longer-term increase in sonobuoy usage.

Strong growth in expenditure on defence equipment in the USA is forecast to continue and Ultra is well positioned to benefit from this. In the UK, Ultra is expected further to increase market share due to its position on key programmes. The Group also anticipates increased activity levels on programmes for which it is already selected, such as Type 45 destroyer, Eurofighter, Astute submarine, SSTD and Heathrow Terminal 5.

The Board believes that, with its solid order book and with its strong position on new programmes, Ultra is well placed to continue its growth in the medium-term and expects its results for the full year to be broadly in line with market expectations.

Peter Macfarlane **Chairman**
5 August 2002

Ultra Electronics Holdings plc

Consolidated Profit & Loss Account

	Note	Six months to 30 June 2002	Restated Six months to 30 June 2001	Restated Year to 31 December 2001
		£000	£000	£000
Turnover	1, 2	**125,597**	114,939	239,540
Operating profit before goodwill amortisation		**15,588**	14,868	31,685
Goodwill amortisation		**(1,809)**	(1,811)*	(3,652) *
Operating profit		**13,779**	13,057	28,033
Net interest payable		**(1,794)**	(2,356)	(4,624)
Profit before taxation		**11,985**	10,701	23,409
Taxation	3	**(3,724)**	(3,276)*	(7,086) *
Profit after taxation		**8,261**	7,425	16,323
Dividends	4	**(2,438)**	(2,229)	(6,835)
Retained profit		**5,823**	5,196	9,488
Earnings per share (pence)				
After goodwill amortisation				
– Basic	5	**12.6**	11.3 *	24.9 *
– Diluted	5	**12.5**	11.3 *	24.8 *
Before goodwill amortisation				
– Basic	5	**15.3**	14.1 *	30.5 *

* Restated to reflect the introduction of FRS 19 (see note 8).

Consolidated Balance Sheet

	Note	At 30 June 2002	Restated (see note 8) At 30 June 2001	Restated (see note 8) At 31 December 2001
		£000	£000	£000
Fixed assets				
Tangible assets		**14,484**	15,534	15,426
Intangible assets – patents and trademarks		**628**	553	650
Intangible assets – goodwill		**62,603**	65,763	64,412
Investments		**1,346**	1,025	836
		79,061	82,875	81,324
Current assets				
Stocks		**26,130**	25,647	22,030
Debtors		**53,384**	57,580	55,224
Cash at bank and in hand		**9,503**	9,606	15,992
		89,017	92,833	93,246
Creditors: Amounts falling due within one year		**(89,602)**	(96,103)	(94,834)
Net current liabilities		**(585)**	(3,270)	(1,588)
Total assets less current liabilities		**78,476**	79,605	79,736
Creditors: Amounts falling due after more than one year		**(25,060)**	(37,156)	(32,907)
Provisions for liabilities and charges		**(3,246)**	(3,344)	(3,165)
Net assets		**50,170**	39,105	43,664
Capital and reserves				
Called-up share capital		**3,294**	3,278	3,288
Share premium account		**26,225**	24,997	25,788
Profit and loss account	6	**20,651**	10,830	14,588
Shareholders' funds		**50,170**	39,105	43,664

Consolidated Cash Flow Statement

	Note	Six months to 30 June 2002 £000	Six months to 30 June 2001 £000	Year to 31 December 2001 £000
Net cash inflow from operating activities	7	**13,878**	8,555	39,328
Returns on investments and servicing of finance		**(1,527)**	(2,422)	(4,972)
Taxation		**(3,122)**	(2,373)	(8,383)
Capital expenditure and financial investment		**(1,934)**	(2,027)	(4,172)
Acquisitions		**(50)**	(60)	(130)
Equity dividends paid		**(4,606)**	(4,256)	(6,485)
Cash inflow/(outflow) before use of liquid resources and financing		**2,639**	(2,583)	15,186
Financing		**(9,015)**	(858)	(11,963)
(Decrease)/Increase in cash in the period		**(6,376)**	(3,441)	3,223
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT				
(Decrease)/Increase in cash in the period		**(6,376)**	(3,441)	3,223
Cash outflow from decrease/(increase) in debt and lease financing		**9,458**	1,132	12,689
Change in net debt resulting from cash flows		**3,082**	(2,309)	15,912
Amortisation of finance costs of debt		**(190)**	(28)	(57)
Translation difference		**733**	(717)	(521)
Decrease/(Increase) in net debt in the period		**3,625**	(3,054)	15,334
Net debt at start of period		**(40,562)**	(55,896)	(55,896)
Net debt at end of period		**(36,937)**	(58,950)	(40,562)
ANALYSIS OF NET DEBT				
Cash at bank and in hand		**9,503**	9,606	15,992
Debt due within one year		**(25,345)**	(32,510)	(23,536)
Debt due after one year		**(21,000)**	(35,839)	(32,868)
Finance leases		**(95)**	(207)	(150)
		(36,937)	(58,950)	(40,562)

Consolidated Statement of Total Recognised Gains and Losses

		Restated (see note 8)	
	Six months to 30 June 2002	Six months to 30 June 2001	Year to 31 December 2001
	£000	£000	£000
Group profit for the period	**5,823**	5,196	9,488
Gain/(loss) on foreign currency translation	**240**	(243)	(480)
Adjustment in respect of the adoption of FRS 19 for prior years	**1,162**	–	–
Total recognised gains and losses relating to the period	**7,225**	4,953	9,008

Notes to the Interim Statement

1. Divisional analysis

		Restated (see note 8)	
	Six months to 30 June 2002	Six months to 30 June 2001	Year to 31 December 2001
	£000	£000	£000
Turnover			
Air & Land Systems	**85,598**	81,210	165,121
Information & Sea Systems	**39,999**	33,729	74,419
	125,597	114,939	239,540
Profit			
Air & Land Systems	**11,416**	12,039	24,050
Information & Sea Systems	**4,172**	2,829	7,635
	15,588	14,868	31,685
Goodwill amortisation	**(1,809)**	(1,811)	(3,652)
Operating profit	**13,779**	13,057	28,033

2. Turnover by geographical destination

	Six months to 30 June 2002	Six months to 30 June 2001	Year to 31 December 2001
	£000	£000	£000
United Kingdom	**55,023**	55,011	110,680
Continental Europe	**15,947**	13,706	32,014
North America	**49,513**	41,466	84,144
Rest of World	**5,114**	4,756	12,702
	125,597	114,939	239,540

3. Taxation

		Restated (see note 8)	
	Six months to 30 June 2002	Six months to 30 June 2001	Year to 31 December 2001
	£000	£000	£000
United Kingdom	**3,015**	2,648	6,146
Overseas	**578**	734	1,192
Deferred tax	**131**	(106)	(252)
	3,724	3,276	7,086

The tax charge for the six months to 30 June 2002 has been based on an estimated effective rate, before amortisation of goodwill, for the year to 31 December 2002 of 27.0% (30 June 2001: 26.2%).

4. The proposed interim dividend of 3.7p per ordinary share (30 June 2001: 3.4p) will be paid on 27 September 2002 to shareholders on the register on 30 August 2002.

5. Earnings per share

The number of shares and earnings used to calculate earnings per share (EPS) is given below:

	Six months to 30 June 2002	Six months to 30 June 2001	Year to 31 December 2001
	No. of shares	No. of shares	No. of shares
Number of shares used for basic EPS	**65,706,837**	65,475,129	65,543,566
Number of shares deemed to be issued at nil consideration following exercise of share options	**285,826**	272,758	168,697
Number of shares used for fully diluted EPS	**65,992,663**	65,747,887	65,712,263

Earnings attributable to ordinary shareholders:

		Restated (see note 8)	
	Six months to 30 June 2002	Six months to 30 June 2001	Year to 31 December 2001
	£000	£000	£000
After goodwill amortisation	**8,261**	7,425	16,323
Before goodwill amortisation	**10,070**	9,236	19,975

6. Profit and loss account

Goodwill, representing the excess of the fair value of consideration given over the fair value of separable net assets acquired, is capitalised as an intangible asset and is amortised over a period of 20 years, being the Directors' assessment of its likely future value. Provision is made for any impairment. For acquisitions made prior to 30 December 1997, goodwill was considered separately for each acquisition and was written off immediately to the goodwill reserve, reflecting the Directors' assessment of its likely future value to the Group. This reserve, amounting to £33,294,000 at 30 June 2002, 31 December 2001 and at 30 June 2001, has since been offset against the profit and loss account.

7. Cash flow information

Reconciliation of operating profit to operating cash flow

		Restated (see note 8)	
	Six months to 30 June 2002	Six months to 30 June 2001	Year to 31 December 2001
	£000	£000	£000
Operating profit	**13,779**	13,057	28,033
Depreciation and amounts written off tangible fixed assets	**1,948**	2,027	4,024
Amortisation of goodwill	**1,809**	1,811	3,652
Amortisation of patents and trademarks	**22**	14	37
Provision against Long Term Incentive Plan	**272**	141	372
(Profit)/Loss on disposal of tangible fixed assets	**(7)**	31	56
Increase in stocks	**(4,435)**	(6,072)	(2,649)
Decrease/(Increase) in debtors	**1,445**	(4,503)	(2,520)
(Decrease)/Increase in creditors	**(876)**	1,984	8,366
(Decrease)/Increase in provisions	**(76)**	34	95
Other	**(3)**	31	(138)
Net cash inflow from operating activities	**13,878**	8,555	39,328

8. Restatement in accounts

In previous years, the Group complied with the Statement of Standard Accounting Practice 15 – Deferred Taxation (SSAP 15) which has been superseded by the introduction of the Financial Reporting Standard 19 (FRS 19) – Deferred Tax. FRS 19 has been adopted for the first time by the Group in this Interim Report.

SSAP 15 required provision for deferred tax to be made using the liability method to the extent that net deferred tax assets or liabilities were likely to crystallise in the foreseeable future, i.e. a partial provisioning approach. FRS 19 requires a full provisioning approach.

The effect of the implementation of FRS 19 on the reported results is as follows:

	Six months to 30 June 2002	Six months to 30 June 2001	Year to 31 December 2001
	£000	£000	£000
Profit & Loss Account			
Goodwill amortisation	**(9)**	(24)	(33)
Tax on profits	**(131)**	106	252
(Reduction)/increase in retained profits	**(140)**	82	219
Balance Sheet			
Goodwill	**331**	349	340
Deferred tax assets	**1,275**	1,282	1,243
Deferred tax liabilities	**(584)**	(658)	(421)
Net assets	**1,022**	973	1,162

The adoption of FRS 19 has resulted in a provision for additional deferred tax assets primarily in respect of losses and tax deductible goodwill in the US. In addition, deferred tax liabilities arise on accelerated capital allowances and other short-term timing differences which were not recognised previously under SSAP 15.

The increase in goodwill is in respect of deferred tax liabilities previously unrecognised on the acquisition of the DF Group Limited in 2000.

9. The interim statement is unaudited and does not constitute full accounts within the meaning of the Companies Act 1985. It has been prepared on a basis consistent with the 2001 statutory accounts with the exception of the adoption of the FRS 19 for the first time (see note 8). The 2001 full year figures have been extracted from those accounts, which include an unqualified audit report and have been filed with the Registrar of Companies. A copy of this Interim statement is being sent to all shareholders. Further copies may be obtained from Ultra's registered office.

Ultra ELECTRONICS

Registered Office:
Ultra Electronics Holdings plc
417 Bridport Road Greenford Middlesex UB6 8UA England
Tel: +44 (0) 20 8813 4321 Fax: +44 (0) 20 8813 4322
www.ultra-electronics.com e-mail: information@ultra-scs.com

Design: HAT Associates +44 (0) 1242 253112