Ultra Electronics Holdings plc

Interim Report and Accounts **2004**

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

Ultra, which employs 2,800 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's products and services are used on aircraft, ships, submarines, armoured vehicles, surveillance systems, airports and transport systems around the world. Ultra also plays an important role in supporting prime contractors by undertaking specialist system and sub-system integration using the combined expertise of the Group businesses.

THE QUEEN'S AWARDS FOR ENTERPRISE: INNOVATION 2000

THE QUEEN'S AWARD FOR ENTERPRISE 2000 FOR THE MAGICARD PRINTER AT MANUFACTURING & CARD SYSTEMS

THE QUEEN'S AWARDS FOR ENTERPRISE: INTERNATIONAL TRADE 2003

THE QUEEN'S AWARD FOR ENTERPRISE 2003 FOR HiPPAG AT PRECISION AIR SYSTEMS

Chairman's Statement

Financial Results

Trading for the Group has remained strong in the first half of 2004, with continued sales growth and a strengthening of margins despite adverse currency effects.

Sales increased by 8% to £146.5m, compared to £135.7m for the same period last year. The increase was 12% in local currencies compared to the first half of 2003, offset by a 4% reduction in sterling terms for the translation effect of the US and Canadian dollars. The increase in sales was driven by the excellent growth in Information & Power Systems, fuelled by demand for airport information systems, rail power equipment, ID card printers and equipment related to the UK Army's Bowman communication system. This performance was aided by the 2003 acquisitions. Tactical & Sonar Systems also demonstrated growth with strong exports of sonobuoys contributing to the division's performance. In Aircraft & Vehicle Systems, trading was slightly behind that achieved in the first half of 2003, as anticipated. The primary cause was a slowdown in manufacture of equipment for Eurofighter to reflect the extended aircraft delivery programme.

Operating profit before goodwill amortisation was 11% higher at £19.3m (2003: £17.4m). The operating margin improved to 13.2% (2003: 12.8%) as a result of management focus being maintained on achieving operational efficiencies whilst delivering at the lowest cost the quality products and services demanded by customers. The interest charge was £1.4m (2003: £1.5m) and profit before tax and amortisation rose to £18.0m, a 13% increase when compared to last year's result of £15.8m. Earnings per share before amortisation of goodwill grew by 12% to 19.7p (2003: 17.6p). As previously advised, a small increase in the effective Group tax rate is predicted for the year.

Following the outstanding operating cash performance achieved over the last three years, there was a small increase in working capital levels in the period under review. Nonetheless, operating cash generation in the period was £16.2m (2003: £18.4m) after capital expenditure and LTIP investment of £1.1m (2003: £0.9m), a conversion rate from operating profit of 84% (2003: 106%). After non-operating payments including interest, taxation and dividends, net debt was £22.4m at the period-end, a reduction of £8.0m since the beginning of the year. The strength of the Group's balance sheet is demonstrated by a first half interest cover of approximately 14 times.

An interim dividend of 4.6p (2003: 4.1p) will be paid on 27 September 2004 to those shareholders on the register at the close of business on 27 August 2004.

Markets

Consistent trends have been evident in the Group's defence markets over recent years. Attention has been focused on mobility and speed of deployment together with the rapid and secure management of vital battlespace information. US defence budgets continue to grow with particular stress on electronics and communication systems. In the UK, there is a shift of emphasis towards battlespace IT, light armoured vehicles and unmanned vehicles for air, land and sea. Interoperability with the United States and other allies remains a high priority. The number of platforms in service will reduce although some existing platforms will be upgraded. Homeland security is becoming more important worldwide and this is reflected in an increasing demand for coastal and border surveillance systems.

The civil aerospace sector appears to be recovering, despite the generally poor financial performance of airlines around the world, with aircraft build rates expected to increase this year and again in 2005. In the UK, Network Rail's requirement to upgrade its Southern Region to accommodate new rolling stock is underpinning continued demand for power equipment.

Operational Review

Tactical & Sonar Systems

Includes secure tactical line-of-sight radio systems, multiplexers and switches; communication network access control equipment; tactical data links; cryptographic equipment; active, passive and multi-static sonobuoys; sonobuoy receivers and processors; distributed underwater surveillance arrays; ships' sonar and torpedo defence systems.

Total sales increased by 8% to £57.6m (2003: £53.3m) and operating profit before goodwill amortisation was £6.6m (2003: £5.4m). The order book at the end of the period remained at £192m (2003: £192m).

Chairman's Statement

Ultra's Surface Ship Torpedo Defence programme continued according to plan during the period with the successful completion of trials involving the detection and tracking of torpedoes. The system is expected to enter service with the Royal Navy later this year. At the end of the period, the Group's expertise in torpedo defence systems was acknowledged by the US Navy selecting Ultra for a demonstration contract relating to a potential US requirement for similar systems.

Success by the Group in its international sonobuoy markets contributed to Ultra's sales growth in the period. Significant orders were received for enhancements to existing high capacity tactical radio designs and for the supply of further systems for the armies of the USA and the Republic of Korea.

Importantly, Ultra won the first ever offshore contract awarded by the US DoD for cryptographic equipment, an achievement that holds considerable potential for future production contracts. In addition, the Group won a contract to demonstrate the feasibility of a new communication system for submarines that should allow high speed data transfer without compromising stealth.

Within the period the intention to acquire DNE Systems Inc. ("DNE") was announced, subject to regulatory approvals. This acquisition, for a cash consideration of $40.0m, has since been completed. DNE, based in Connecticut, USA, designs, manufactures and supports battlespace IT products that control access to military tactical communications networks. Products include voice and data multiplexers, multi-service access concentrators and communication switches, and protocol converters used by all branches of the US armed forces. DNE has strong synergies with Ultra's existing Tactical Communication Systems and APC businesses and is highly complementary to the Group's tactical communication and data link market positions.

Aircraft & Vehicle Systems

Includes miniature airborne compressors; high integrity software and systems; aircraft system electronics; aircraft noise and vibration control; propeller de-icing, balancing and control systems; armoured vehicle electronic information and control systems, human/computer interface equipment and shared working environment solutions.

Total sales decreased by 10% to £36.7m (2003: £40.6m) and the operating profit before goodwill amortisation was £6.6m compared with £7.1m last year. The order book increased by 2% to £81.8m (2003: £80.1m).

The primary reason for the decrease in the division's sales was the slowdown in deliveries of Ultra's Eurofighter equipment to align with the extended aircraft build programme. In the period, development of the HiPPAG airborne compressor for the F-35 Joint Strike Fighter aircraft programme continued to plan. The division also benefited from increasing sales of armoured vehicle equipment, particularly the indirect vision equipment for the Alvis Vickers Engineer Tank System programme.

There have been contract awards in the period that will underpin future growth. Ultra, teamed with Goodrich in the US, has been selected to supply the proximity sensing system for Boeing's new 7E7 aircraft. In addition, Ultra has signed long-term agreements with Airbus that secure the Group's position on the single aisle and long range aircraft programmes for at least the next ten years. Also in the aircraft equipment sector, a contract to adapt HiPPAG for Boeing's Small Diameter Bomb ("SDB") programme was received. This programme is intended to retrofit existing USAF aircraft with the capability to launch small, smart, individually targeted munitions. During the next 15 years, the USAF intends to procure 2,000 SDB carriage systems, each containing a HiPPAG airborne compressor.

Information & Power Systems

Includes command and control systems; weapons interfacing electronics; coastal surveillance systems; naval data processing and distribution equipment; airport and airline information management systems; passenger baggage reconciliation systems; ID card systems; naval power conversion products; signature management systems for naval vessels; transit system power conversion and control equipment.

Information & Power Systems recorded an excellent performance in the first half, with sales growth of 25% to £52.2m (2003: £41.8m) and a 27% increase in operating profit before goodwill amortisation to £6.1m (2003: £4.8m). The order book increased by 28% to £111.2m (2003: £87.1m).

Airport Systems had a strong first half performance reflecting the demand for its products. The acquisition of Videcom in July for a cash consideration of £1.5m further enhances our capability in this growing sector. Videcom supplies a variety of IT products to airline and airport customers, most of which complement Ultra's existing offerings. These include common user systems that manage seat allocation, passenger boarding, departure control, baggage tracking and aircraft load and balance calculations. The business will be integrated into Airport Systems over the coming months.

Ultra's power system equipment was ordered for further sub-stations as part of the power supply upgrade for Network Rail's Southern Region. Continuing deliveries against this programme helped drive the improvement in the division's performance.

Sales of equipment relating to the UK Army's Bowman battlespace digitisation programme increased substantially during the first half of 2004. In our ID card printer business there has been good market acceptance of a new range of printers that extends our addressable market.

Reflecting the focus in the US on attaining interoperability of data, Ultra received a contract to develop its ADSI™ real time command and control system as an airborne version which will be fitted to a number of specialist US aircraft.

The strength of the naval shipbuilding programme in the US was demonstrated by Ultra receiving contracts for its specialist power equipment for a further five Virginia class submarines and for two fleet support ships.

Most recently, Ultra has been awarded a contract to supply an advanced coastal and land surveillance system to a Middle Eastern country, using the specialist expertise of SML, acquired last year. This is an important early success in the growing international homeland security sector.

Prospects

Defence expenditure in Ultra's main markets is rising and demand remains strong for the Group's broad range of specialist products and services. As noted above, within these markets there is an increasing focus on mobility and speed of response, together with exerting the maximum military effect from the use of advanced battlespace IT systems. Ultra is well positioned to benefit from these trends as the Group's traditional skills and capabilities have been augmented by businesses acquired in recent years, thereby allowing Ultra to capture a larger share of the market.

Ultra's secure position on existing Airbus programmes, for which build rates are increasing, together with its selection to work on the Boeing 7E7 aircraft, give confidence in the Group's long-term growth in the civil aerospace sector. Ultra's position on continuing transport infrastructure investment programmes such as Network Rail Southern Region and Heathrow's fifth terminal also help to underpin the future performance of the Group.

The Group's order book, valued at £385m and representing approximately 15 months of future sales, provides good visibility of future earnings. The wide range of programmes with which Ultra is involved gives robustness to its future performance.

The acquisitions of DNE Technologies and of Videcom enhance the Group's expertise and breadth of product offering in areas in which activity levels are rising. Ultra has the financial headroom to continue its policy of making acquisitions that complement and enhance the Group's existing operations.

In summary, Ultra remains well placed to meet expectations in 2004 and beyond.

Peter Macfarlane **Chairman**
2 August 2004

Ultra Electronics Holdings plc

Consolidated Profit & Loss Account

	Note	**Six months to 30 June 2004** £000	Six months to 30 June 2003 £000	Year to 31 December 2003 £000
Turnover				
– existing operations	1, 2	**146,509**	135,669	284,350
Operating profit before goodwill amortisation				
– existing operations		**19,339**	17,365	37,543
Goodwill amortisation				
– existing operations		**(2,676)**	(2,320)	(4,878)
Operating profit				
– existing operations		**16,663**	15,045	32,665
Net interest payable		**(1,380)**	(1,518)	(3,173)
Profit before taxation		**15,283**	13,527	29,492
Taxation	3	**(4,849)**	(4,231)	(9,086)
Profit after taxation		**10,434**	9,296	20,406
Dividends	4	**(3,085)**	(2,731)	(8,173)
Retained profit		**7,349**	6,565	12,233
Earnings per share (pence)				
After goodwill amortisation				
– Basic	5	**15.7**	14.1	30.8
– Diluted	5	**15.6**	14.0	30.7
Before goodwill amortisation				
– Basic	5	**19.7**	17.6	38.2

Consolidated Balance Sheet

	Note	**At 30 June 2004** £000	Restated (see note 7) At 30 June 2003 £000	At 31 December 2003 £000
Fixed assets				
Tangible assets		**18,472**	16,829	19,170
Intangible assets – patents and trademarks		**537**	582	560
Intangible assets – goodwill		**87,619**	78,630	90,287
		106,628	96,041	110,017
Current assets				
Stocks		**16,941**	21,004	17,364
Debtors		**60,714**	58,636	63,761
Cash at bank and in hand		**20,672**	13,104	19,047
		98,327	92,744	100,172
Creditors: Amounts falling due within one year		**(79,801)**	(73,633)	(87,516)
Net current assets		**18,526**	19,111	12,656
Total assets less current liabilities		**125,154**	115,152	122,673
Creditors: Amounts falling due after more than one year		**(43,724)**	(50,377)	(50,186)
Provisions for liabilities and charges		**(8,620)**	(5,589)	(7,813)
Net assets		**72,810**	59,186	64,674
Capital and reserves				
Called-up share capital		**3,332**	3,312	3,318
Share premium account		**29,269**	27,626	28,096
Profit and loss account	6	**42,008**	29,775	34,366
Treasury shares	7	**(1,799)**	(1,527)	(1,106)
Shareholders' funds		**72,810**	59,186	64,674

Ultra Electronics Holdings plc

Consolidated Cash Flow Statement

	Note	Six months to 30 June 2004	Restated (see note 7) Six months to 30 June 2003	Year to 31 December 2003
	Note	£000	£000	£000
Net cash inflow from operating activities	8	**19,233**	22,636	55,986
Returns on investments and servicing of finance		**(1,432)**	(1,586)	(3,125)
Taxation		**(2,994)**	(4,750)	(9,452)
Capital expenditure		**(1,908)**	(3,344)	(6,806)
Acquisitions		**222**	(79)	(18,258)
Equity dividends paid		**(5,462)**	(4,959)	(7,676)
Cash inflow before use of liquid resources and financing		**7,659**	7,918	10,669
Financing		**(5,597)**	(3,544)	(66)
Increase in cash in the period		**2,062**	4,374	10,603
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT				
Increase in cash in the period		**2,062**	4,374	10,603
Cash outflow from decrease in debt and lease financing		**5,675**	3,453	427
Change in net debt resulting from cash flows		**7,737**	7,827	11,030
Amortisation of finance costs of debt		**(65)**	(49)	(260)
Finance leases acquired with subsidiary undertakings		**-**	-	(14)
Finance leases		**(15)**	-	-
Translation difference		**308**	(2,377)	(1,835)
Decrease in net debt in the period		**7,965**	5,401	8,921
Net debt at start of period		**(30,335)**	(39,256)	(39,256)
Net debt at end of period		**(22,370)**	(33,855)	(30,335)
ANALYSIS OF NET DEBT				
Cash at bank and in hand		**20,672**	13,104	19,047
Debt due within one year		**-**	126	-
Debt due after one year		**(43,021)**	(47,085)	(49,370)
Finance leases		**(21)**	-	(12)
		(22,370)	(33,855)	(30,335)

Consolidated Statement of Total Recognised Gains and Losses

	Six months to 30 June 2004	Six months to 30 June 2003	Year to 31 December 2003
	£000	£000	£000
Group profit for the period	**10,434**	9,296	20,406
Gain/(loss) on foreign currency translation	**293**	(2,278)	(3,355)
Total recognised gains and losses relating to the period	**10,727**	7,018	17,051

Notes to the Interim Statement

1. Divisional analysis

	Six months to 30 June 2004	Six months to 30 June 2003	Year to 31 December 2003
	£000	£000	£000
Turnover			
Aircraft & Vehicle Systems	**36,702**	40,620	79,890
Information & Power Systems	**52,202**	41,769	95,474
Tactical & Sonar Systems	**57,605**	53,280	108,986
	146,509	135,669	284,350
Profit			
Aircraft & Vehicle Systems	**6,613**	7,125	13,901
Information & Power Systems	**6,112**	4,796	10,972
Tactical & Sonar Systems	**6,614**	5,444	12,670
	19,339	17,365	37,543
Goodwill amortisation	**(2,676)**	(2,320)	(4,878)
Operating profit	**16,663**	15,045	32,665

2. Turnover by geographical destination

	Six months to 30 June 2004	Six months to 30 June 2003	Year to 31 December 2003
	£000	£000	£000
United Kingdom	**61,787**	55,916	122,074
Continental Europe	**18,883**	17,384	36,799
North America	**49,892**	49,261	99,532
Rest of World	**15,947**	13,108	25,945
	146,509	135,669	284,350

3. Taxation

	Six months to 30 June 2004	Six months to 30 June 2003	Year to 31 December 2003
	£000	£000	£000
United Kingdom			
– Corporation tax	**3,284**	3,096	6,326
– Deferred tax	**414**	268	794
	3,698	3,364	7,120
Overseas			
– Corporation tax	**1,258**	1,098	2,019
– Deferred tax	**(107)**	(231)	(53)
	1,151	867	1,966
Total tax on profit on ordinary activities	**4,849**	4,231	9,086

The tax charge for the six months to 30 June 2004 has been based on an estimated effective rate, before amortisation of goodwill, for the year to 31 December 2004 of 27% (30 June 2003: 26.7%).

4. The proposed interim dividend of 4.6p per ordinary share (30 June 2003: 4.1p) will be paid on 27 September 2004 to shareholders on the register on 27 August 2004.

5. Earnings per share

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

	Six months to 30 June 2004	Six months to 30 June 2003	Year to 31 December 2003
	No. of shares	No. of shares	No. of shares
Number of shares used for basic EPS	**66,418,878**	66,005,283	66,204,198
Number of shares deemed to be issued at nil consideration following exercise of share options	**354,811**	180,770	290,515
Number of shares used for fully diluted EPS	**66,773,689**	66,186,053	66,494,713

Notes to the Interim Statement (continued)

5. Earnings per share (continued)

Earnings attributable to ordinary shareholders:

	Six months to 30 June 2004	Six months to 30 June 2003	Year to 31 December 2003
	£000	£000	£000
After goodwill amortisation	**10,434**	9,296	20,406
Before goodwill amortisation	**13,110**	11,616	25,284

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 useful economic life. 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 as a matter of accounting policy, depending on the Directors' assessment of its likely future value to the Group. This reserve, amounting to £33,294,000 at 30 June 2004, 31 December 2003 and at 30 June 2003, has since been offset against the profit and loss account.

7. In accordance with UITF Abstract 37 – Purchases and sales of own shares, the Group has reclassified own shares held and shares held under the Long-term Incentive Plan as Treasury shares. These have been offset against equity shareholders' funds. Investments and net assets have reduced by £1,799,000 as at 30 June 2004, £1,527,000 at 30 June 2003 and £1,106,000 at 31 December 2003. There is no impact on the Group's profit for the current period or prior year.

8. Cash flow information

Reconciliation of operating profit to operating cash flow

	Six months to 30 June 2004	Six months to 30 June 2003	Year to 31 December 2003
	£000	£000	£000
Operating profit	**16,663**	15,045	32,665
Depreciation and amounts written off tangible fixed assets	**2,364**	2,032	4,249
Amortisation of goodwill	**2,676**	2,320	4,878
Amortisation of patents and trademarks	**23**	23	45
Provision against LTIP awards	**431**	359	774
Loss on disposal of tangible fixed assets	**-**	14	39
Decrease in stocks	**259**	3,466	8,313
Decrease/(increase) in debtors	**2,256**	(409)	(272)
(Decrease)/increase in creditors	**(6,100)**	(404)	3,492
Increase in provisions	**384**	323	1,803
Other	**277**	(133)	-
Net cash inflow from operating activities	**19,233**	22,636	55,986

9. The financial information contained in this statement does not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985, and has not been audited or reviewed.

The unaudited accounts for the half years ended 30th June 2004 and 30th June 2003 have been prepared on a basis consistent with the statutory accounts for the year ended 31st December 2003. Those statutory accounts received an unqualified auditor's report and have been filed with the Registrar of Companies. A copy of this interim statement is being sent to all shareholders, and will shortly be available on Ultra's web site: www.ultra-electronics.com. Further copies may be obtained from Ultra's registered office: 417 Bridport Road, Greenford, Middlesex, UB6 8UA.

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