Ultra Electronics Holdings plc

Preliminary results for the year ended 31 December 2014

positioned for **growth**...

through portfolio **strength**...

focused on customer **need**

Results presentation and script

Rakesh Sharma, Chief Executive
Mary Waldner, Group Finance Director

2 March 2015

making a difference

Ultra ELECTRONICS

Ultra Electronics is a **Group of businesses** which manage a **portfolio of specialist capabilities**, generating **highly differentiated** solutions and products in the **defence & aerospace**, **security & cyber**, **transport** and **energy markets**…

DEFENCE & AEROSPACE

SECURITY & CYBER

TRANSPORT

ENERGY

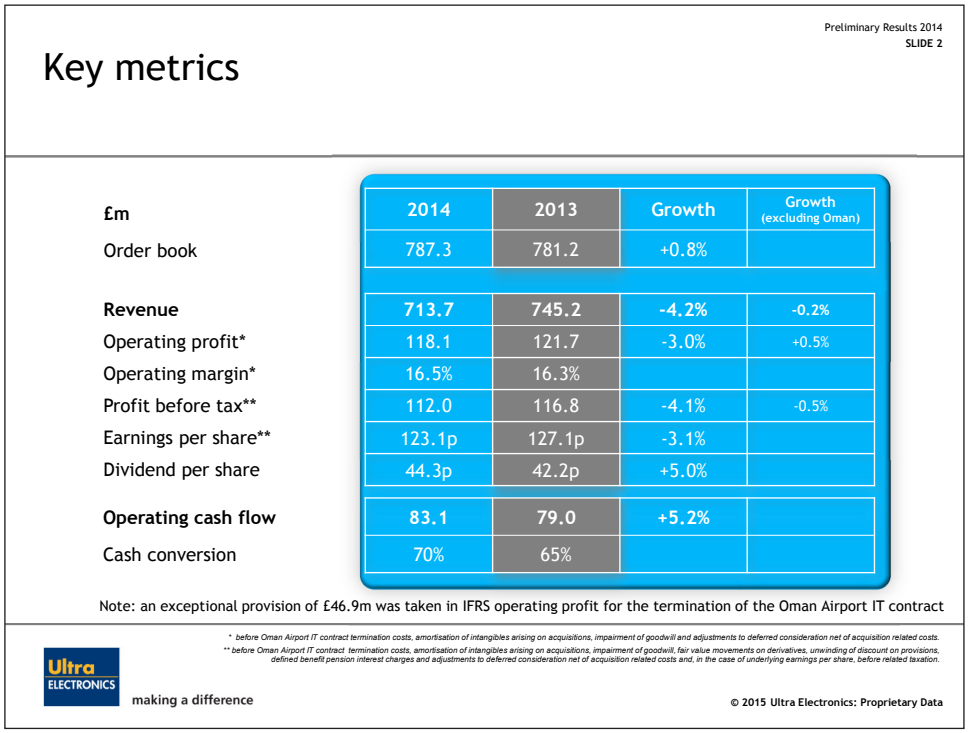
…by applying **electronic** and **software technologies** in **demanding and critical** environments to meet **customer needs**

Cautionary statement

This document contains forward looking statements that are subject to risk factors associated with, amongst other things, the economic and business circumstances occurring from time to time in the countries and sectors in which the Group operates. It is believed that the expectations reflected in these statements are reasonable but they may be affected by a wide range of variables which could cause actual results to differ materially from those currently anticipated.

Rakesh Sharma, Ultra's Chief Executive provided an overview of the results.

Good morning everyone it's good to see you all and welcome to Ultra's presentation of the Prelim results for 2014. We have slightly changed the format of the presentation today: to give you more insight into the 2014 results and address Oman; to set out the drivers and guidance for 2015; and to set out what Ultra is doing internally to position for medium-term organic growth. As usual the presentation and script will be available later this afternoon on our website. So let me now handover to Mary to cover the financials.



Preliminary Results 2014
SLIDE 2

Key metrics

£m	2014	2013	Growth	Growth (excluding Oman)
Order book	787.3	781.2	+0.8%	
Revenue	**713.7**	**745.2**	**-4.2%**	**-0.2%**
Operating profit*	118.1	121.7	-3.0%	+0.5%
Operating margin*	16.5%	16.3%		
Profit before tax**	112.0	116.8	-4.1%	-0.5%
Earnings per share**	123.1p	127.1p	-3.1%	
Dividend per share	44.3p	42.2p	+5.0%	
Operating cash flow	**83.1**	**79.0**	**+5.2%**	
Cash conversion	70%	65%		

Note: an exceptional provision of £46.9m was taken in IFRS operating profit for the termination of the Oman Airport IT contract

* before Oman Airport IT contract termination costs, amortisation of intangibles arising on acquisitions, impairment of goodwill and adjustments to deferred consideration net of acquisition related costs.
** before Oman Airport IT contract termination costs, amortisation of intangibles arising on acquisitions, impairment of goodwill, fair value movements on derivatives, unwinding of discount on provisions, defined benefit pension interest charges and adjustments to deferred consideration net of acquisition related costs and, in the case of underlying earnings per share, before related taxation.

Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

Mary Waldner, Group Finance Director, presented the review of Ultra's financial performance for 2014.

Good morning to everyone.

Lets start with the key metrics;

The order book at the end of 2014 was £787.3m compared to £781.2m in the prior year, this despite a £97m reduction relating to the removal of the Oman contract from the 2014 order book. Excluding Oman, order intake of £760.0m, up 21% on the prior year, led to underlying order book growth of 7.2%. This was supplemented by acquisition growth of 6.8% and a foreign exchange benefit of 1.1%.

Revenue, at £713.7m, was 4.2% down on last year, including a £30m decline relating to Oman and underlying operating profit at £118.1m saw a 3.0% decline.

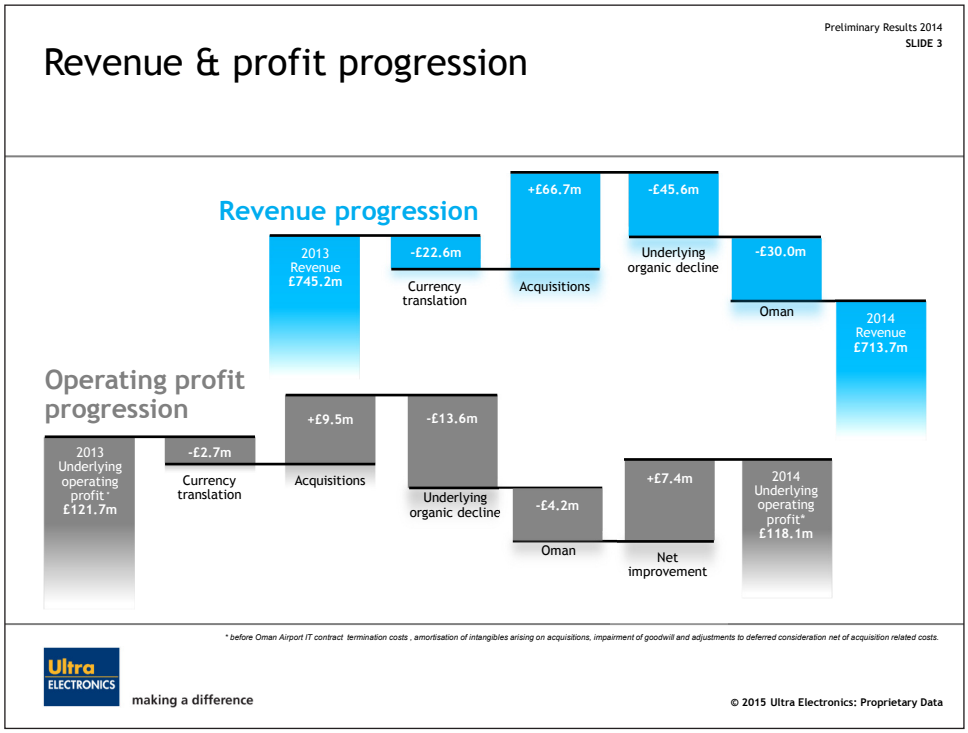
As we have announced, the termination of the Oman Airport IT contract has resulted in a one-off provision of £47m, comprising £37m of bad debt provision and £10m of provision for future liabilities.

Also excluding the impact of Oman, revenue and underlying profit were broadly flat.

Excluding the Oman provision, profit before tax was down by 4.1% but earnings per share declined by only 3.1% as the tax rate reduced to 23.2% from 24.3% last year.

Reflecting confidence in the medium term, the dividend has increased by 5% to 44.3p.

Cash conversion during the period was 70% compared to 65% last year.



Moving to the revenue progression. If you follow the slide from left to right, it highlights the main reasons for the year on year revenue movement.

Currency translation resulted in a decline of £22.6m or 3.0% – Sterling was on average just under 6% stronger against the US Dollar at 1.65 compared to 1.56.

Acquisitions added £66.7m with 3 Phoenix and Forensic Technology contributing the majority.

Year on year Oman revenue reduced by £30m as we have only recognised £11.7m of revenue in the first half of 2014. Excluding Oman, there was an organic reduction in revenue of £45.6m or 6.1%. Whilst US anti-submarine warfare and commercial aerospace saw growth, a number of factors contributed to the reduction and I'll cover them in a moment.

Turning to the profit, at the bottom of the slide.

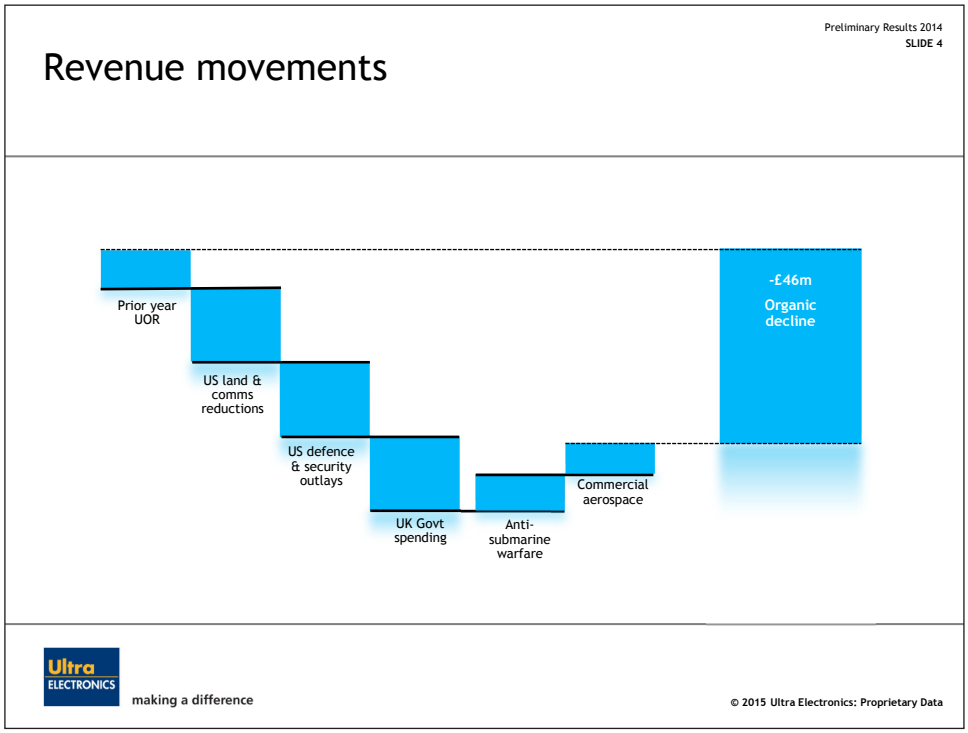
Again, if you follow the slide from left to right, it highlights the main reasons for the reduction in profit from £121.7m to £118.1m.

Currency reduced profit by £2.7m, again due to the relative weakness of the US Dollar against Sterling.

Acquisitions added £9.5m, with 3 Phoenix and Forensic Technology performing particularly strongly.

We took no underlying profit in Oman this year, compared to £4.2m in the prior year. Excluding Oman, there was an organic volume decline of £13.6m representing the effect of lower revenue at last year's margin.

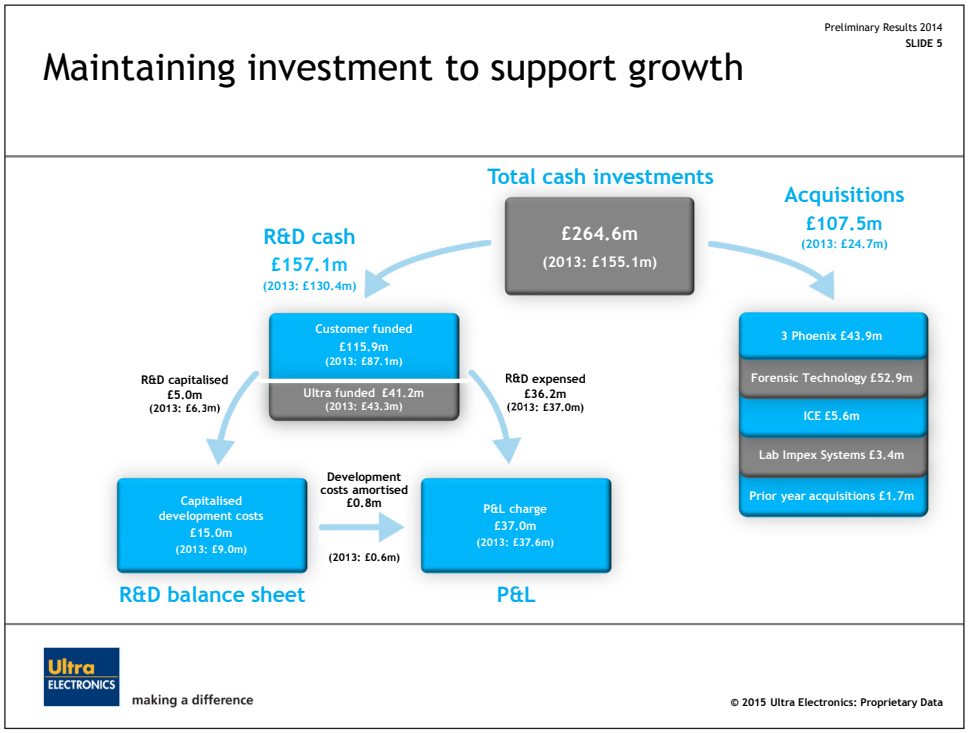
After allowing for the currency, volume and acquisition effects, there was a net improvement of £7.4m reflecting mitigating actions which I will discuss shortly.



This slide summarises the main drivers behind the organic revenue reduction. To the right of the slide you can see the increase in commercial aerospace and in ASW revenue.

However the prior year one off Urgent Operational Requirement for the British Army had an £8m impact and there was approximately a £15m reduction in sales of US conflict-related communication and land systems.

A reduction in US outlays and the Continuing Resolution in the second half led to a delay in sales of other defence and security products, accounting for a decline of around £20m. Finally delays in UK government spending in power management and in cyber led to a further £15m decline.



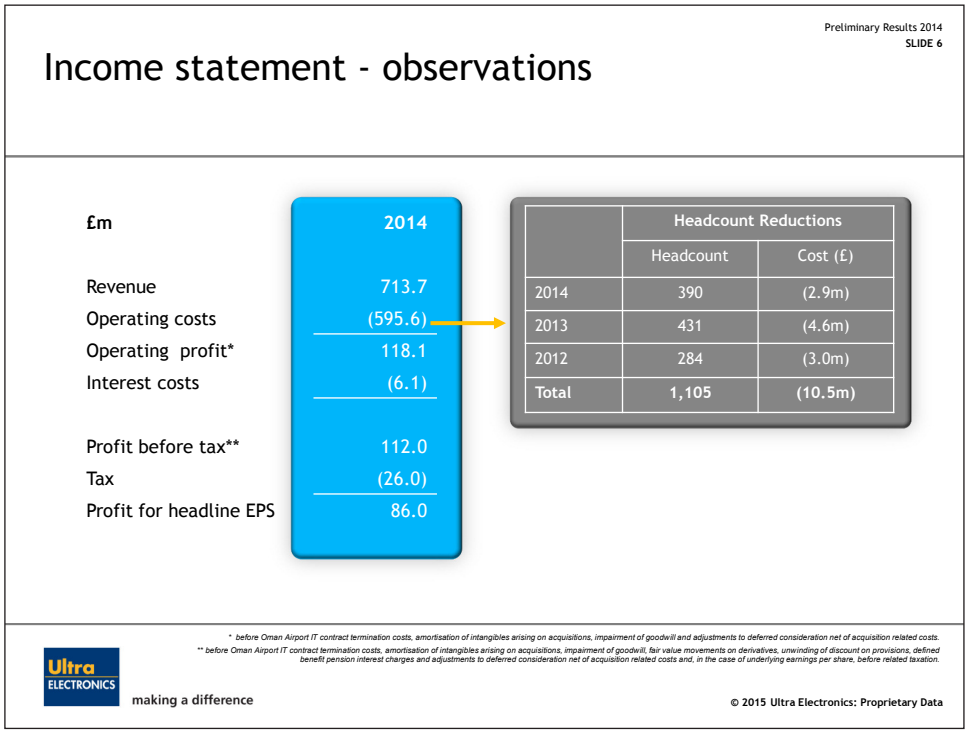
Turning to our investments to support future growth.

You will see to the right of the slide that we spent £107.5m on acquisitions, on four companies all of which provide both complementary capability and access to adjacent markets. We spoke in detail at the interim presentation about the two larger acquisitions of 3 Phoenix and Forensic Technology. We also completed two smaller acquisitions, Ice Corporation and Lab Impex Systems.

Research and development spend increased in total by 20% to £157.1m. Customer funded development increased by £28.8m to £115.9m primarily reflecting the impact of the 3 Phoenix acquisition.

Ultra funded development was £41.2m or 5.8% of revenue. Expensed R&D was £36.2m and capitalised R&D net of amortisation £1.5m lower than the prior year at £4.2m. This is well within our usual range of self-funded R&D being between 5 to 6% of revenue. We expect capitalised R&D to reduce further to around £2m net of amortisation in 2015.

As a result, capitalised development costs on the balance sheet stand at £15m.



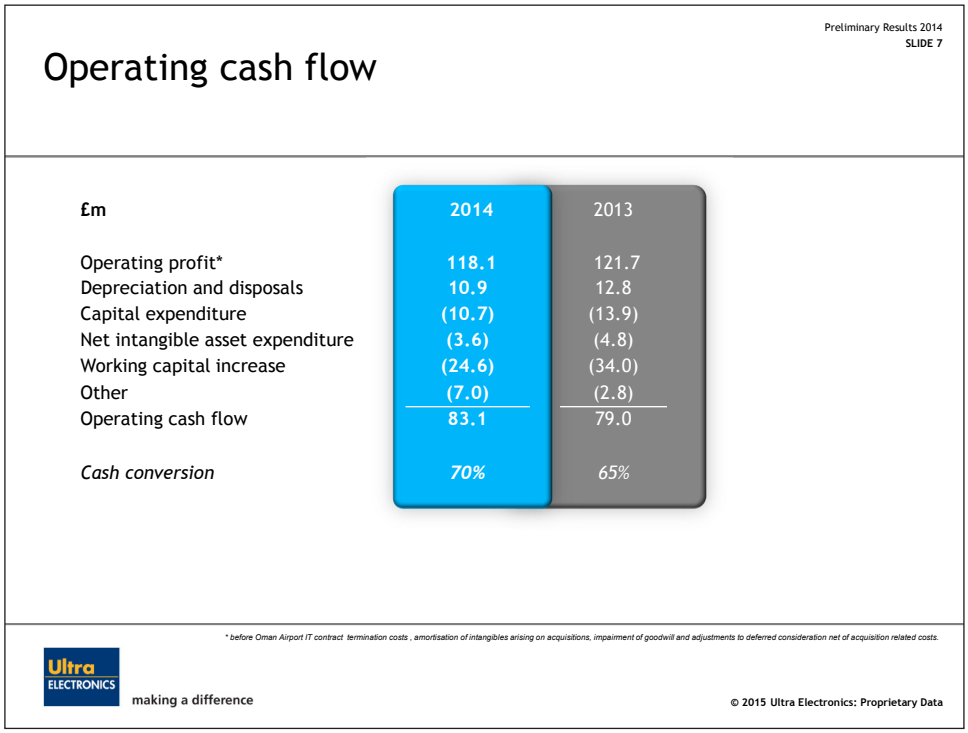
Moving to the income statement, I want to highlight elements of the cost reduction programme.

As we discussed earlier, we have continued to cut costs across the Group to protect the margin in the face of declining revenues.

In the period there have been a total of 390 headcount reductions at a cost of £2.9m compared with 431 during 2013 at a cost of £4.6m. These measures include reductions in both direct and indirect headcount reductions and will generate an annualised benefit of around £10m going forward.

We continue to monitor the rest of the cost base across the Group and have consolidated businesses where this has been appropriate. AEP our commercial crypto business, is being aligned with CIS, our high-grade crypto business, eliminating a further set of overheads. Additionally, the ProLogic and SOTECH businesses under the US Proxy Board are operating with shared support services. During this year we will also be integrating Surveillance & Security systems into Communication & Integrated Systems.

Finally a word about tax – the rate continues to reduce as the headline rate of corporation tax falls in the UK, and is at 23.2% down from 24.3% last year. We expect it to remain around 23% going forward.



Turning to cash.

Operating cash flow was £83m, taking cash conversion to 70%, compared with 65% last year. We expect short term cash conversion, excluding Oman impacts, to remain around 70% reflecting the unwind of advanced payments on long term contracts such as ECU before returning to around 80% over the cycle.

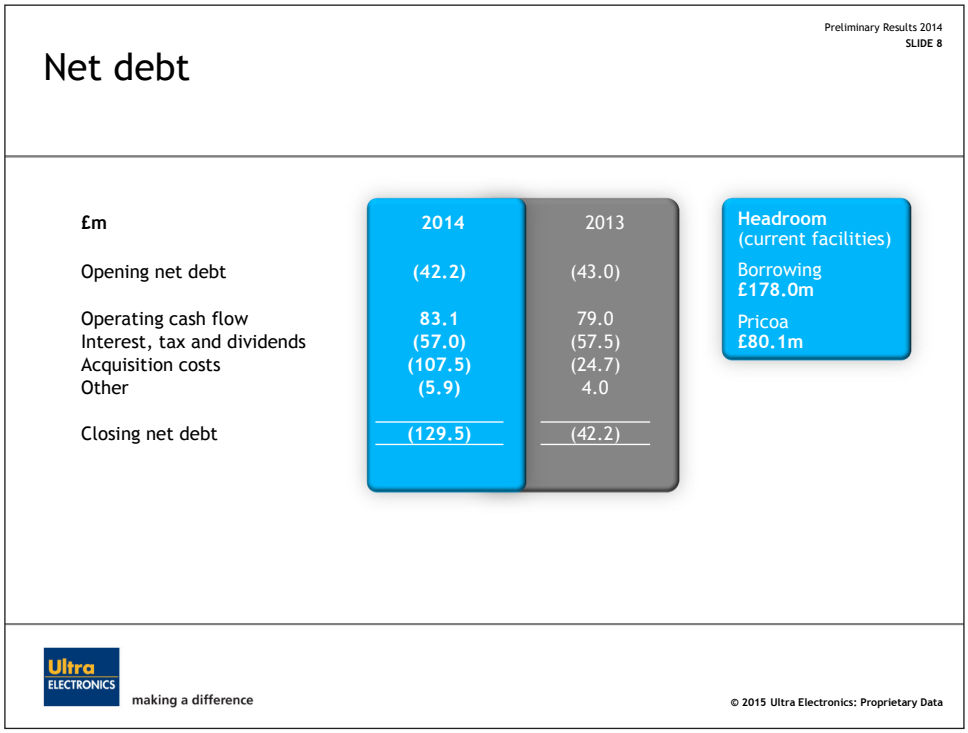
Depreciation and disposals were around £2m lower than last year, reflecting the disposal of the old Precision Air & Land Systems building in the prior year.

Capital expenditure including on systems was £10.7m, £3m lower than last year which included investment in the Neutron Flux Detector facility at Wimborne as well as the Cyber facility and the completion of the Precision Air & Land Systems move to Cheltenham. This year's expenditure included a new ERP system for our US Ocean Systems business and replacement of equipment across a number of UK businesses.

The net outflow on intangible capital expenditure was £3.6m, mainly resulting from the capitalised development I referred to previously.

Working capital increased by £24.6m, compared with £34.0m in the prior year. Debtors reduced reflecting the expected reversal of the prior year position. However payables also reduced following the expected unwind of advanced payment balances. Inventories increased due to customer requirements at a number of our commercial aerospace businesses.

The other outflow primarily represents the pension deficit reduction payments of £8.0m agreed with the trustees. The increase of £4m against last year reflects an increase in the pension payment and a lower dividend from Al Shaheen.

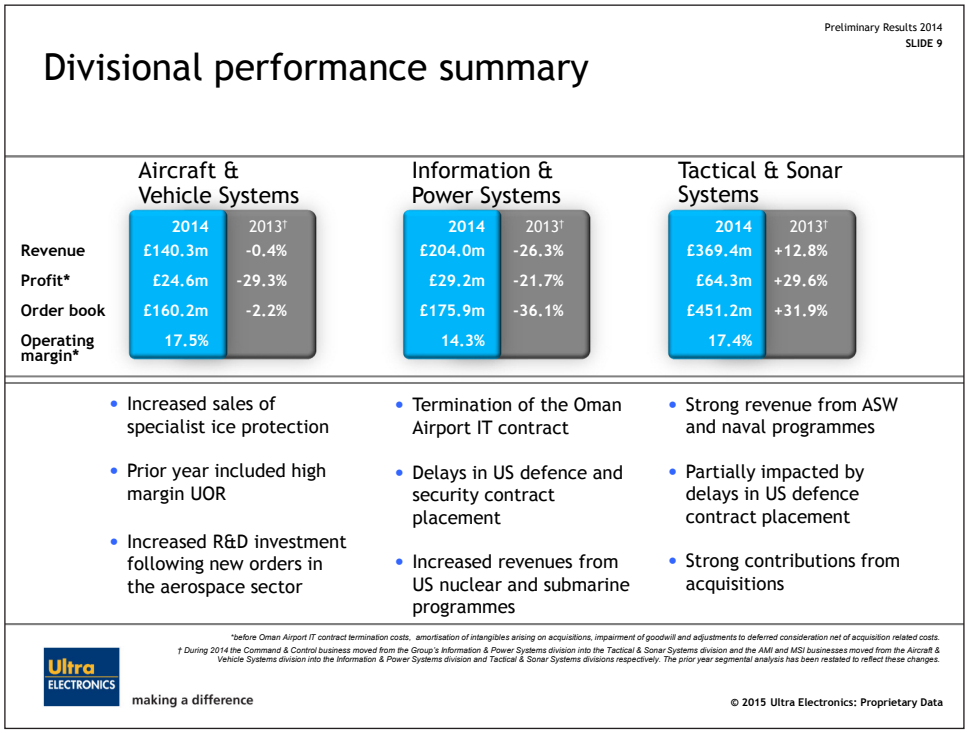


Moving on to net debt. Interest tax and dividends were in line with the prior year.

Acquisition costs were up reflecting the £104m invested in the four businesses acquired this year against two last year. We retain acquisition firepower of £100m to £150m per annum.

Within other debt movements, the impact of currency reflected the strength of the US Dollar at year end, and took closing net debt to £129.5m.

During the period we took advantage of a strong borrowing market and refinanced our £90m facility a few months early. In order to preserve our headroom we increased the available facility to £200m. This takes headroom on current facilities to £178m, with an additional £80.1m on our uncommitted Pricoa bilateral facility. We also reduced the RCF rate by 65 basis points from LIBOR plus 150 to LIBOR plus 85.



Moving on to how the three divisions performed and starting with Aircraft & Vehicle Systems on the left.

Revenue was steady as growth in specialist ice protection systems and sales of the Airbus A400M cargo handling system were offset by 2013 benefiting from an £8m UOR and a foreign exchange headwind in the year.

Lower margins in the year were driven by three factors:

- Firstly, increased R&D following the success in winning a number of new contracts to develop products for the aerospace sector
- Secondly, lower margins in the engineering phases of certain projects including Embraer KC390 and MRJ
- And finally, the benefit in 2013 of the higher margin UOR

As a result the divisional margin was 17.5%.

The order book reflects increased orders for commercial aerospace products and services offset by the trading of the Lockheed Martin Warrior contract.

In Information & Power Systems, sales were down, with the Oman termination in particular driving a £30m reduction in revenue. Following the termination we recognised only £11.7m of revenue and no operating profit in the year.

This division is also the one most impacted by delays in the US defence and security sector with reduced demand for both high margin law enforcement and security products, particularly legal intercept, and also communication systems.

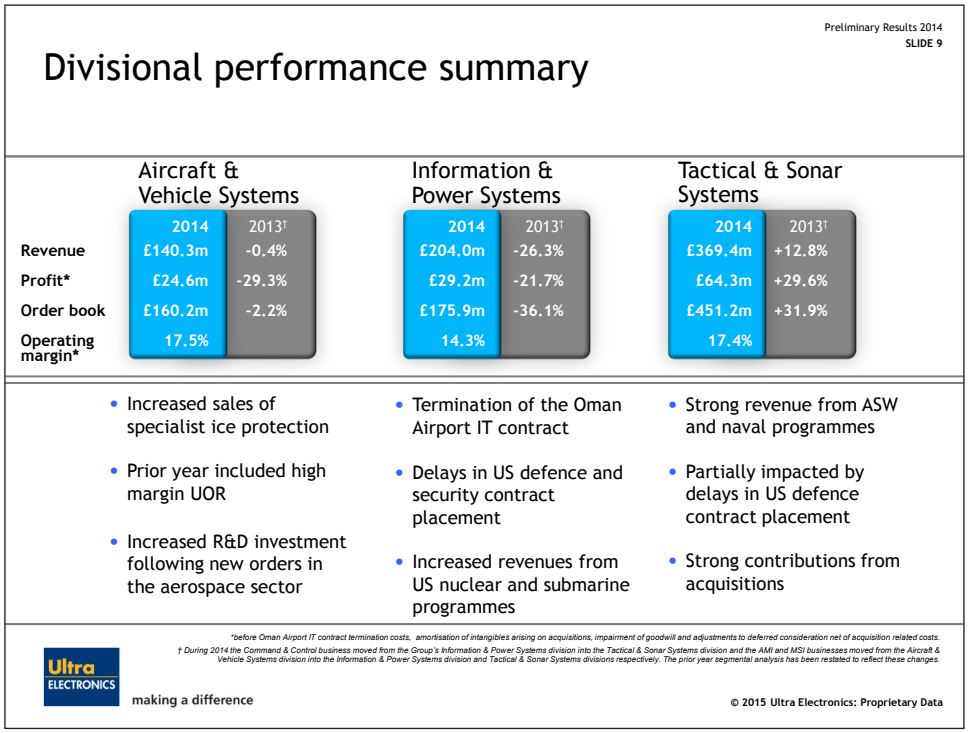
There was also a reduction in revenue from our rail power management business and from EDF following their issues with the UK reactor programme. However this was partially offset by increased revenues from nuclear temperature sensors in the US and also from the Virginia Class submarine programme.

In this division, margins increased reflecting cost savings and the reduction in dilutive revenue from Oman.

The order book change primarily reflected the removal of the Oman order.

And finally in this division as mentioned at the half year, we have moved the Command & Controls business from this division into Tactical & Sonar Systems, around £30m of revenue and £4m of profit going forward.

continued on next page

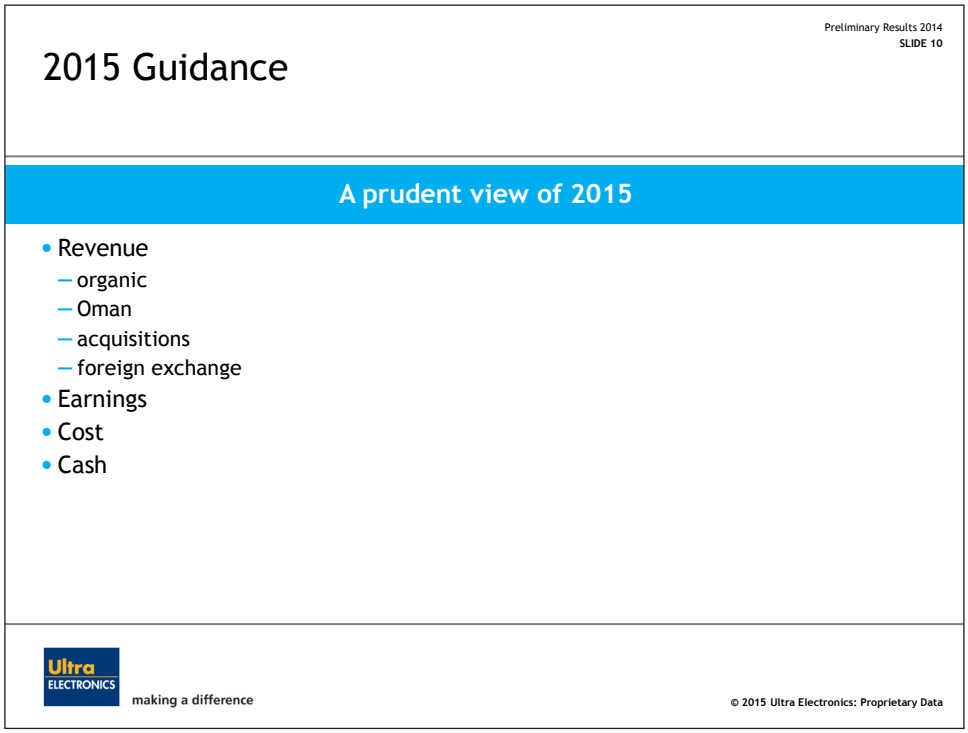


continued from previous page

And moving to Tactical & Sonar Systems, revenue from US and international ASW was strong, and there was an increase in sales on the Fatahillah and other international command and control programmes. These factors were partially offset by reduced sales of Litening Pods, and fewer radio spares sales together with the impact of US budget cuts and contract delays. The two larger acquisitions made in 2014, 3 Phoenix and Forensic Technology have been integrated into this division.

Profit increased by 30% reflecting increased volume and margins on sonobuoys together with savings from the prior year restructuring at Ultra's TCS radio business. Further benefit was derived from overhead cost savings across the division. The acquisitions also made a significant contribution to profit, although this was partially offset by the impact of foreign exchange translation.

The order book increase included the first year's order from the IDIQ sonobouy award from the US Navy, as well as the Litening Pod CLS extension.



And finally on to outlook.

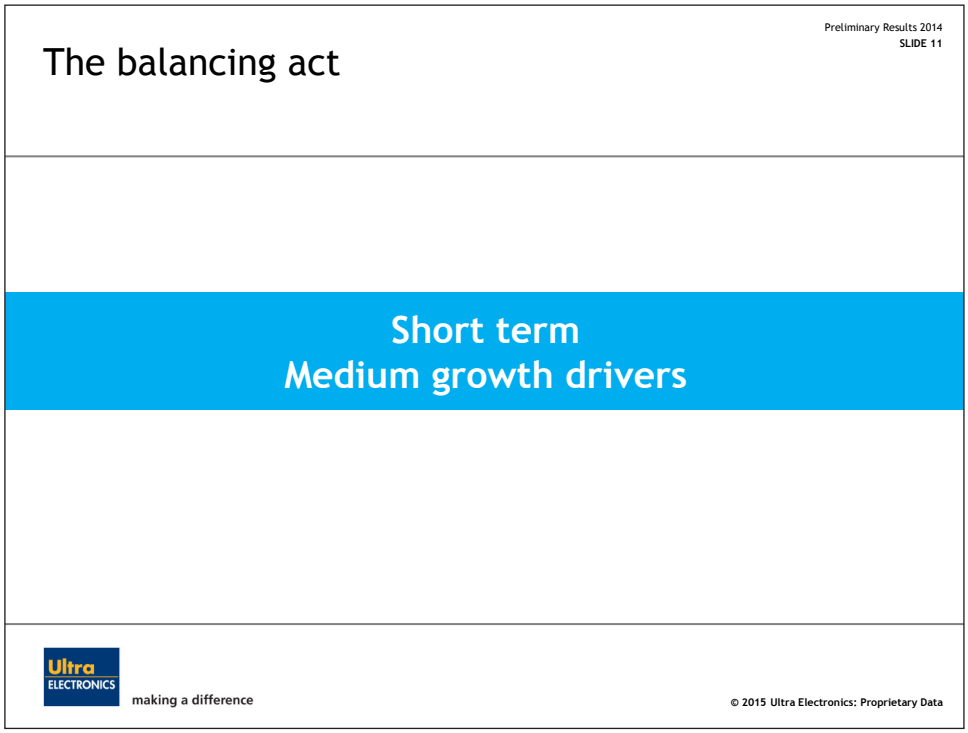
Rakesh will cover the short term market challenges in a moment, but these, taken together with the year on year impact of Oman, mean we remain prudent about the outlook for revenues in 2015.

Performance will benefit from acquisitions made in 2014 and from foreign exchange translation at current rates. However, set against the current market backdrop of uncertainty over the timing and feasibility of proposed US DoD budgets, together with election activity in both the US and UK, overall we expect 2015 performance to be broadly stable. We will continue to balance investment for future growth with focus on efficiencies and managing our costs to support profitability.

Excluding Oman we expect cash conversion to remain around the 70% level. However there is likely to be short term outflow relating to supplier payments and costs of claims, both following to the Oman termination, which will be offset in the medium term by the recovery of amounts due to us. The timing of recovery will be determined by whether we settle amicably or proceed to arbitration.

Looking at the Half 1/Half 2 splits, these outflows mean that our operating cash flow for the year will be strongly half two weighted. On revenue and profit, the 2014 order profile mirrored 2013, so, as a consequence, we can expect a similar H1/H2 weighting in 2015 to 2014.

On that note I will now hand over to Rakesh to discuss future prospects.



Rakesh Sharma, Ultra's Chief Executive, continued by explaining how Ultra will balance short term performance whilst positioning for medium term growth.

Thank you Mary.

My presentation is going to have three distinct sections, these being:

- Addressing the Oman Airport IT contract termination and
- Providing detail to support the 2015 guidance
- Highlighting the drivers to support medium-term growth in 2016 and beyond

Market conditions in the last few years have given us conflicts which dictate a set of actions for short-term performance whilst balancing the strategic direction of travel to deliver medium-term organic growth. These conflicts have required the executives to perform a balancing act of investing for the future which also impacts the short-term financial performance. Further, as we have experienced a decline in organic revenue there has been an increased focus on business efficiency. Add on top of this the difficult position in Oman where the contract was wrongfully terminated. This all makes for a very complex situation.

So let me first discuss the Oman Airport IT contract. Before I cover the termination I would like to take a few moments to run through the contract. There are three areas to explain:

- Contract specifics
- Programme execution and
- Claims

First, the contract specifics. The contract was awarded in June 2011 to Ithra, a JV between Ultra and Oman Investment Corporation (OIC), at an initial value of OMR128m. The scope not only included the airport operational software but many other systems including the Royal Omani Police Comms network, CCTV and surveillance and a Tetra Comms System to name a few. In all, the contract required 37 different systems to be integrated by Ithra prior to installation in the buildings. The contract is governed by international construction laws of FIDIC.

Significantly, there is no Project Manager but a number of involved parties. The Employer is the Ministry of Transport and Communication, the Engineer is a US claims company, Hill International, and the project consultant is AdPI. The original Engineer, Cowie Larsen was replaced by Hill International around three years ago. All Master Contractors, Ithra included, report to the Technical Committee which is a branch of the Ministry. The Technical Committee acts as the Project Manager. Another significant point is that as Systems Integrators, Ithra is the last link in the chain and has to interface with all the other Master Contractors.

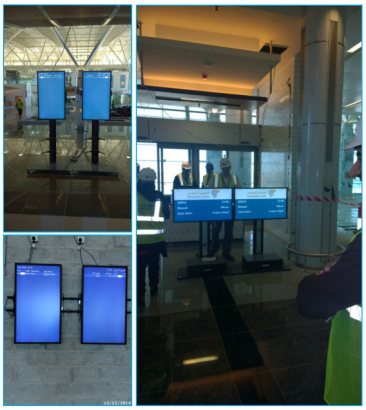
Second, programme execution. Ithra's ability to perform under the contract has been dependent upon building work progression. Building delays began early in the project. As these delays extended, Hill International and the Employer sought to vary the planned works without a formal change to the contracted schedule seemingly to avoid liability for an Extension of Cost. In order to protect its commercial position, Ithra has steadfastly refused to alter the contracted schedule without a formal Engineer's Instruction. To do so, would be to accept liability for the time difference as the new schedule would then take contractual precedence. Instead it has been working to target programmes retaining its right to claim for prolongation costs. Towards the end of 2014 Ithra was taking a more robust commercial approach with the Engineer.

continued on next page

Preliminary Results 2014
SLIDE 12

Oman contract basics

- Contract awarded in June 2011
- Initial value OMR 128m (£207m at 2011 rates)
- 37 individual IT systems to be integrated and installed
- No overall project manager
  - all programme direction is with Ministry of Transport & Communication
- Contract governed by international FIDIC form of contract
- By April 2012 the overall Airport programme was already six months late
- Ultra's contract expired in April 2014
- Minister on public record saying Muscat airport building will not be finished until March 2016



Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

continued from previous page

Third, Claims. Under FIDIC law a Notice of Claim must be submitted to the Engineer as soon as a contractor is aware of an event that requires a claim for additional costs of some sort. Claims must be updated on a monthly basis and can only be submitted as a final claim when the costs have stopped increasing. The claims may overlap and are not additive. At the point of termination, Ithra had:

- 47 notice of claims
- 0 final claims agreed
- 3 claims which had received an Engineer's determination and were proceeding through arbitration

An extension of time was received to September 2014, two weeks prior to the termination, but not an associated extension of costs. Turning the page...

Now that the contract has been terminated, all of Ithra's claims have come to a head and it is currently assessing its commercial and legal position with its lawyers and claims consultants. As a result, I am limited in what I can say about possible outcomes. However, let me tell you what I can.

You can see that this programme is politically charged. It is why I have been visiting Oman on a monthly basis to try to find a way to execute the contract while maintaining our commercial position so that we were not left with a slew of costs, which weren't of our making. We pride ourselves on 'meeting our commitments', it is one of our strategic guidelines. However, this does not mean that we behave as a doormat when it comes to commercial discussions. The corollary to this guideline is that our customers must also 'meet their commitments'. We cannot fit sensitive IT equipment in an open air desert environment.

So why did we believe, when we issued our IMS, that good progress was being made? Both at Head Office and Divisional level, we were in almost daily contact with our team in country. As you can see from this newsletter Ithra was able to demonstrate a fully operational system at Salalah Airport interfacing to Muscat and the Oman Air network. In fact, the Employer was so pleased that they wrote to the Ministry of Finance to support a payment on account in December. The substantive reasons given in the notice of termination are related to Ithra not completing interim stages of our work by contractual milestones and not completing the entire installation by the Extension of Time date of September 2014. Ithra's assessment is that the termination is unjustified, wrongful and invalid.

Currently Ithra is assisting the Employer in a handover process to what is termed a 'Completion Contractor', who is yet to be announced. Once the handover is complete there will be a final settlement account. If this is not to Ithra's satisfaction then the next step would be to proceed to arbitration to achieve settlement in court. I'd like to point out that this will not be under the jurisdiction of the Omani court and is likely to be in London.

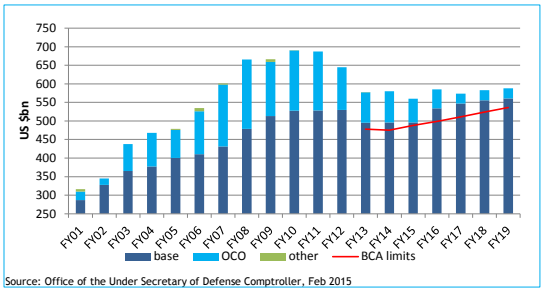
So why were we terminated? It is difficult to comprehend the Employer's motivation in terminating the contract given Ithra's advanced stage of completion and the complexity of the network. Putting aside the question of the validity of the termination, the decision is not in the best interests of the project or the people of Oman.

All I know is that we believe Ithra has a strong legal case. I would also add that Ithra's reputation in Oman and the region remains strong. Few people can make sense of this decision which appears arbitrary and inconsistent with the myriad of discussions I have had with key stakeholders in Oman. We will continue to do business in the Middle East and Ultra is expecting new non-Airport IT contracts in the region.

Preliminary Results 2014
SLIDE 14

Short-term market challenges for Ultra

- Energy, Transport, Security & Cyber markets remain stable
  - and continue to offer opportunities
- UK defence
  - uncertainty given forthcoming elections, CSR and SDSR
- US defence
  - FY16 Presidential budget request unlikely to be approved
  - BCA still enacted in law
  - continuing uncertainty over outlays
  - Continuing Resolution
- Rest of world defence
  - broadly unchanged
  - potential impact of oil price



Source: Office of the Under Secretary of Defense Comptroller, Feb 2015

Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

Turning to the short term and the corresponding markets challenges.

The Energy, Transport, Security and Cyber markets remain stable and have not substantially changed. So my comments from the 2014 Interim presentation are still valid.

The UK defence market is about to enter into a period of uncertainty as the country gears up for a general election in May this year. Whichever party or parties form the new Government, an SDSR will be initiated. We believe, from the work-streams that have already begun, that it will build on the last one instead of being a drains up review. The MoD has been to an extent protected, suffering only a 17% cut compared to other departments, such as the Home Office at 24%. Consequently, we anticipate the next Government will cut the defence budget by up to £1.5b to fund investment in health and education. Since the MoD has been underspent annually by a similar amount and so long as the budget is not cut by more than this, we do not forecast a change to current spending habits.

I expect 2015 to be another difficult year in the US defence market. It is overly optimistic to expect the President's 2016 budget request at $534b to be accepted by a Republican House and Senate. Don't forget the Budget Control Act is still law and therefore the sequestration caps will still apply. Therefore, I anticipate that the 2016 budget will be approved at $499b and that an OCO budget, which is un-capped, will be approved at $58-$60b. It is also the last year for the two parties to "rattle their sabers" prior to the start of a Presidential election campaign commencing in January 2016. The effect that this budget fight will have on 2015 procurement is:

- Uncertainty will cause a drop in defense outlays commencing 3rd Quarter calendar year
- The 2016 budget will not get agreed until January 2016
- Consequently a 3 months Continuing Resolution will be required causing uncertainty into the 4th Quarter of 2015
- Big ticket items will get awarded but smaller contracts will move to the right.

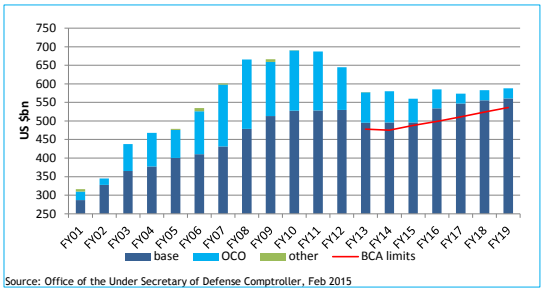
Our expectations are based on the reality of big political battles. We prefer to be more cautious than others as despite our previous past optimism we have overestimated the ability of politicians to get their act together. If however, they do spend more, then we will benefit as it will be the smaller contracts that will get awarded and as you will see in a minute this is much of Ultra's business.

continued on next page

Preliminary Results 2014
SLIDE 14

Short-term market challenges for Ultra

- Energy, Transport, Security & Cyber markets remain stable
  - and continue to offer opportunities
- UK defence
  - uncertainty given forthcoming elections, CSR and SDSR
- US defence
  - FY16 Presidential budget request unlikely to be approved
  - BCA still enacted in law
  - continuing uncertainty over outlays
  - Continuing Resolution
- Rest of world defence
  - broadly unchanged
  - potential impact of oil price



Source: Office of the Under Secretary of Defense Comptroller, Feb 2015

Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

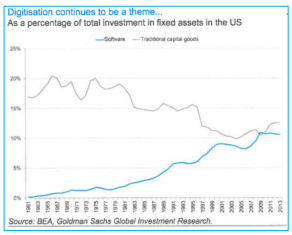
continued from previous page

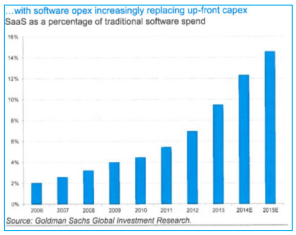
As far as the rest of the world is concerned, we don't expect a massive change to defence spending as long as the oil price does not dip below current levels. At these levels the major Middle Eastern oil producers can pump through the current trough and so maintain their re-armament against potential insurgents. Moving on.

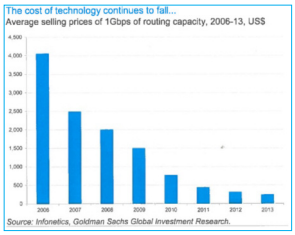
Preliminary Results 2014
SLIDE 15

Technology drivers

- Software is becoming more of the product value added than the hardware
- Pricing models are changing towards licencing rather than capital purchase
  - already happening in commercial sector
  - moving to the defence sector
- Cost of hardware continues to decline
- Safety critical software is expensive to write and test
- Cost of development is rising just as customers are cutting their R&D







Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

Another element that impacts our markets is technology disruption which necessitates different skills as well as different market strategies. A key change which affects most of our end markets is the inexorable march towards digitisation that began three decades ago. I have included three charts on this slide, courtesy of Goldman Sachs, to demonstrate this effect.

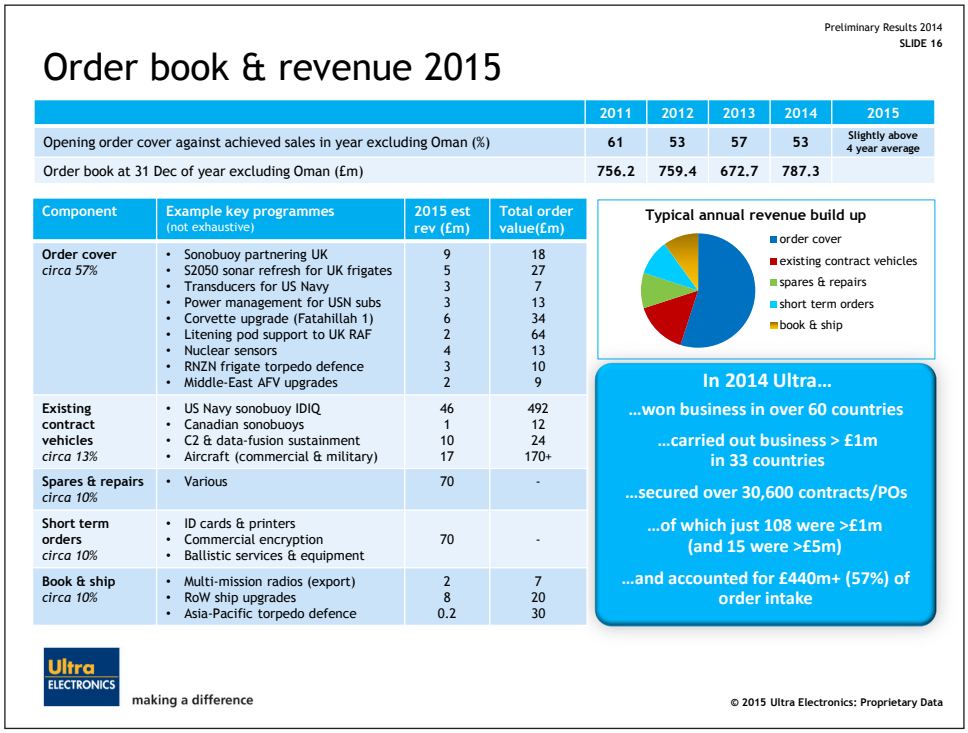
In the past, Ultra was hardware heavy and software light. A decade ago we used to have more than two production people to every engineer. As the engineering value-added has grown as a percentage of the product price, within which the cost of intangible software has grown even faster still, the ratio has now dropped to less than one production person to every engineer. The consequences of this technological change are many fold but include:

- Good engineers are now even scarcer
- A change to pricing models which includes educating the customer when cost audits are completed to determine "value for money" and the
- Cost of safety critical software rising geometrically

All this at a time when there is less customer funded engineering available.

So not only are we dealing with market driven changes but also technology driven ones. I have referred in the past that Ultra is at an inflexion point. This lends itself to that argument.

As you would expect Ultra has anticipated and tackled this change head on. Not only are we growing our own engineers starting with 13 year olds but we have been developing the business to deal with this technological change. One such example is a new software technique that has first been applied to our commercial aerospace market. It is a critical component of why we have been so successful in that market, taking significant market share from our competitors. This new process has been approved by the FAA and EASA and is patent pending. We are rolling this technique out to our other businesses hopefully to the same effect on our competitiveness. I am unable to go into the detail at this time as it is a trade secret until we obtain a patent.



Preliminary Results 2014
SLIDE 16

Order book & revenue 2015

	2011	2012	2013	2014	2015
Opening order cover against achieved sales in year excluding Oman (%)	61	53	57	53	Slightly above 4 year average
Order book at 31 Dec of year excluding Oman (£m)	756.2	759.4	672.7	787.3	

Component	Example key programmes (not exhaustive)	2015 est rev (£m)	Total order value(£m)
Order cover *circa 57%*	• Sonobuoy partnering UK • S2050 sonar refresh for UK frigates • Transducers for US Navy • Power management for USN subs • Corvette upgrade (Fatahillah 1) • Litening pod support to UK RAF • Nuclear sensors • RNZN frigate torpedo defence • Middle-East AFV upgrades	9 5 3 3 6 2 4 3 2	18 27 7 13 34 64 13 10 9
Existing contract vehicles *circa 13%*	• US Navy sonobuoy IDIQ • Canadian sonobuoys • C2 & data-fusion sustainment • Aircraft (commercial & military)	46 1 10 17	492 12 24 170+
Spares & repairs *circa 10%*	• Various	70	-
Short term orders *circa 10%*	• ID cards & printers • Commercial encryption • Ballistic services & equipment	70	-
Book & ship *circa 10%*	• Multi-mission radios (export) • RoW ship upgrades • Asia-Pacific torpedo defence	2 8 0.2	7 20 30

Typical annual revenue build up

In 2014 Ultra…

…won business in over 60 countries

…carried out business > £1m in 33 countries

…secured over 30,600 contracts/POs

…of which just 108 were >£1m (and 15 were >£5m)

…and accounted for £440m+ (57%) of order intake

Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

I am very aware of the need at this point in particular to give you more reassurance about our short term revenue and in a break from our normal content, would like to be more explicit on revenue sources in 2015.

First, let me remind you that we only book firm orders into the order-book. We do not book options or agreements. Second, Oman is the first contract we have had terminated in this way and it is not just unusual in Ultra, it is unique.

In preparing this slide we reviewed some of the core statistics that characterise our annual revenue, and which are shown at the bottom right of the slide. They make a pertinent case about the Ultra model that sets us apart from many of our peers and helps explains why certain market developments affect us differently.

The top table also shows you the opening order cover of achieved sales in year, excluding Oman, over the last four years.

The numbers shown exclude anything from the Oman Airport IT contract. Ultra's 2015 revenue is made up of five categories being:

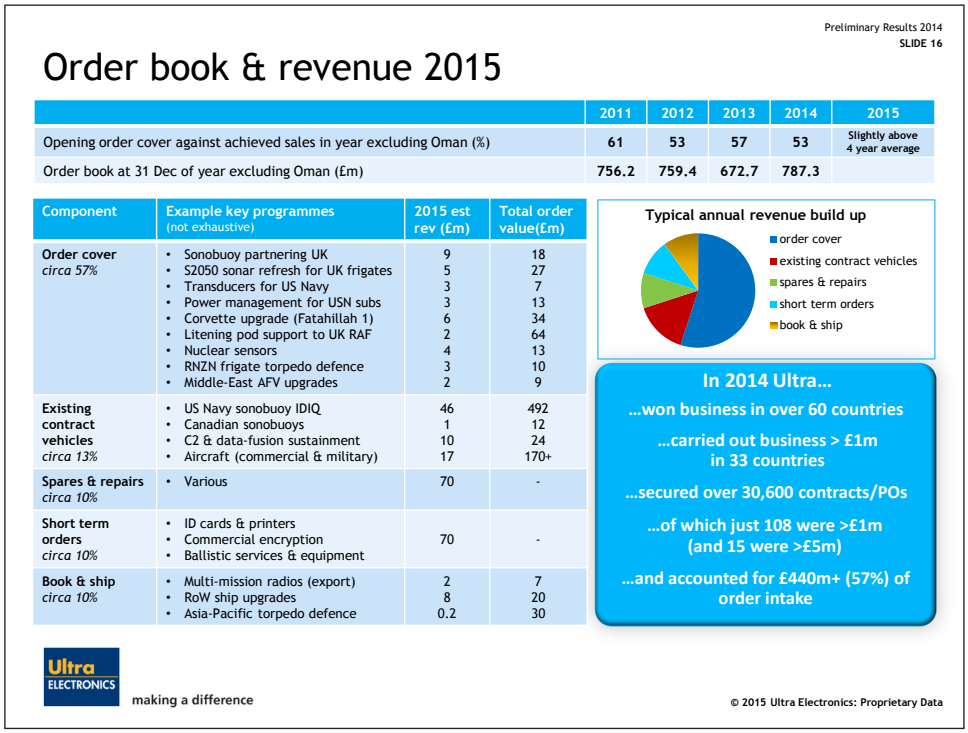
- Execution of the order book representing up to 57% of revenue
- Annual contract vehicles being typically 13% of revenue
- Short cycle businesses in the commercial sector representing 10% of revenue
- Spares and repairs at 10% of revenue, and
- Book and ship at 10% of revenue

This is represented by the pie chart on the upper right of this slide.

Over the last three years we have been working to extend the order book by securing; long-term platform agreements, IDIQs, partnering arrangements and logistics support contracts. This has helped to reduce the book and ship element of our business. Five years ago it would have been more than 15% of revenue now it is just above 10%. This explains why the book to bill and the order intake growth has been so positive yet we continue to see 2015 as a difficult year. We have supported the medium term revenue outlook by these long term contracts.

In the table I have further amplified these categories to give you the detail of the contracts already won or anticipated that make up the 2015 revenue. These contracts and revenue numbers have been taken directly from the businesses' budgets. You will notice that there are few big ticket items. Even the large contracts that we have won are executed over a number of years.

continued on next page



Preliminary Results 2014
SLIDE 16

Order book & revenue 2015

	2011	2012	2013	2014	2015
Opening order cover against achieved sales in year excluding Oman (%)	61	53	57	53	Slightly above 4 year average
Order book at 31 Dec of year excluding Oman (£m)	756.2	759.4	672.7	787.3	

Component	Example key programmes (not exhaustive)	2015 est rev (£m)	Total order value(£m)
Order cover *circa 57%*	• Sonobuoy partnering UK • S2050 sonar refresh for UK frigates • Transducers for US Navy • Power management for USN subs • Corvette upgrade (Fatahillah 1) • Litening pod support to UK RAF • Nuclear sensors • RNZN frigate torpedo defence • Middle-East AFV upgrades	9 5 3 3 6 2 4 3 2	18 27 7 13 34 64 13 10 9
Existing contract vehicles *circa 13%*	• US Navy sonobuoy IDIQ • Canadian sonobuoys • C2 & data-fusion sustainment • Aircraft (commercial & military)	46 1 10 17	492 12 24 170+
Spares & repairs *circa 10%*	• Various	70	-
Short term orders *circa 10%*	• ID cards & printers • Commercial encryption • Ballistic services & equipment	70	-
Book & ship *circa 10%*	• Multi-mission radios (export) • RoW ship upgrades • Asia-Pacific torpedo defence	2 8 0.2	7 20 30

Typical annual revenue build up

In 2014 Ultra…

…won business in over 60 countries

…carried out business > £1m in 33 countries

…secured over 30,600 contracts/POs

…of which just 108 were >£1m (and 15 were >£5m)

…and accounted for £440m+ (57%) of order intake

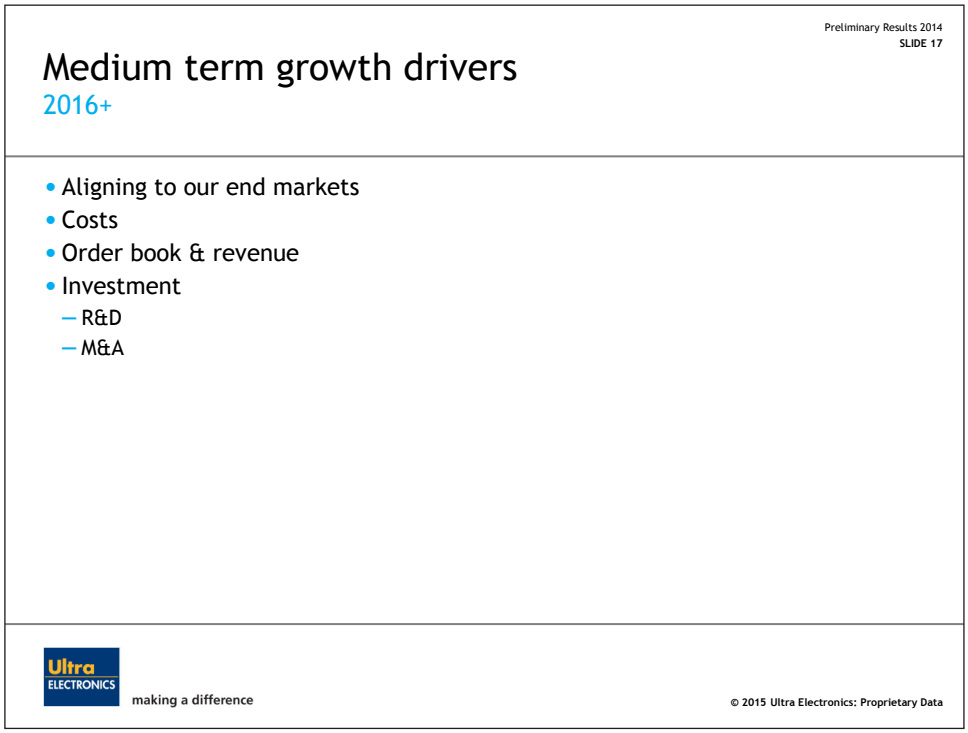
Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

continued from previous page

If you add the revenue values up you will see that it falls very short of the 2015 revenue expectation. To include everything would require 10's of slides as a full year's revenue typically consists of 30,000 separate contracts. This is our strategy of "many eggs in many baskets" in operation. It also explains why we don't have many big wins to announce, these contracts get won on a weekly basis across our businesses. It should also be remembered that if the US defence budget is bigger than we anticipate or the outlays are more on target, these are the sorts of contracts that will benefit.

This covers all of the background that I wanted to explain about 2015 and it explains the guidance provided by Mary.

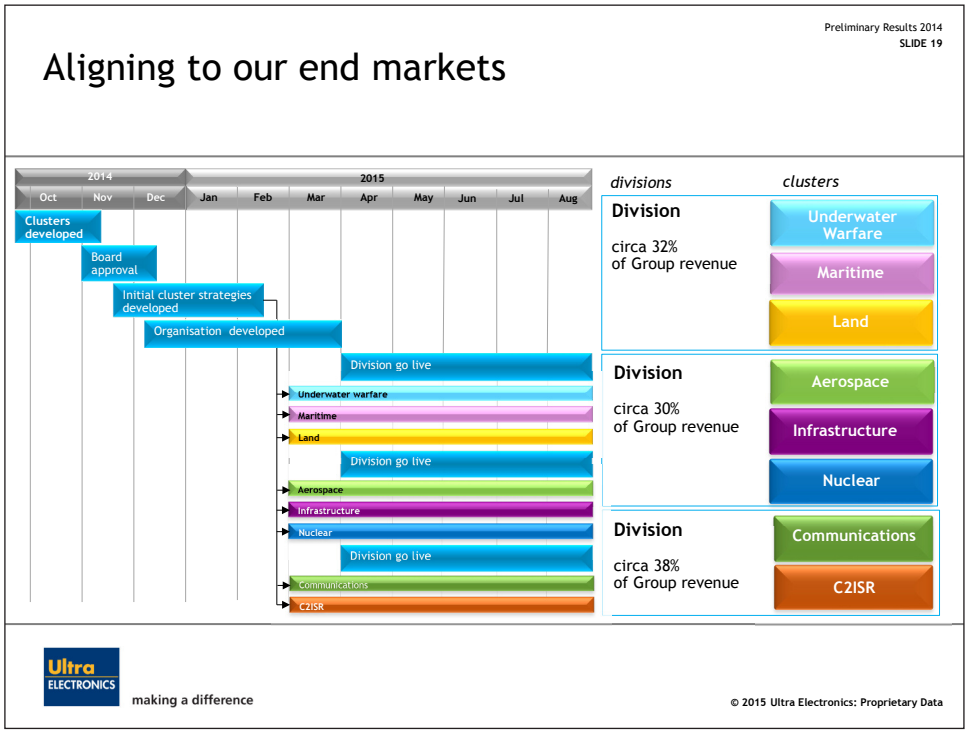


Now I would now like to discuss the internal drivers that we are pursuing to return to medium-term organic growth, starting with aligning to our end markets.

You have all heard me describe Ultra as a portfolio manager of specialist capabilities. You will also remember Doug's picket fence metaphor that each capability can be thought of as a slat on a very long picket fence. As Ultra has grown, both through acquisition and organic means, capability slats have been added to that picket fence. Once there were huge gaps between slats. Businesses could operate completely autonomously, as there was little synergy to be extracted and the organisational complexity was very low. Today we have areas of that picket fence where no gap exists between slats – we refer to these areas as Clusters and there are eight of them as presented on this slide. We have been working to this point for some time. Clusters are a consequence of the niche business model that we operate. We first considered Clusters in 2001 but did not proceed as we recognised that the portfolio was not complete enough to make this evolutionary step work.

Organising our businesses by clusters will take our strategic approach to a new level. It will make it easier to extract synergies across the group and ensure companies with complementary technologies can work together to compete and win more and larger contracts as well as reach up the supply chain to Tier 2. An added advantage is that it improves our outward facing organisation, a critical success factor for Ultra. It also reduces the internal complexity. Currently the inter-divisional revenue is greater than 30%. With the new organisation it will be less than 10%. In the new organisation, 15 businesses operate in only one Cluster, seven operate in two Clusters and only two operate in three Clusters. Collaborative Autonomy, LEAP and LAUNCH were the interim stages to help get us to this point.

We are not throwing the entire organisation up in the air; this would be too high a risk. What we are doing is simply moving the reporting lines of each business so that all of the Cluster constituents report to the same divisional team. This will allow a coherency of strategy as well as ensuring that people have the authority, responsibility and accountability for the performance of their clusters. Turning over the page.



There is not enough time to go into this today. We intend to give a detailed presentation on Clusters later this year in May so please don't go changing your models just yet. To re-assure you that this change has been well thought out and planned, this slide presents the schedule of roll-out of the cluster organisation. Obviously, we will show traceability so that we can convince you that we are not muddying the water but that this is truly a value enhancing evolution. So now to the costs.

Preliminary Results 2014
SLIDE 20

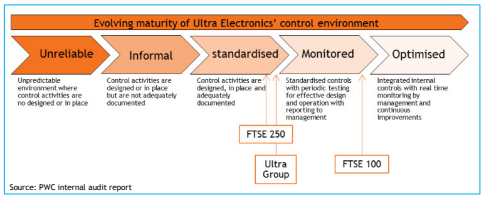
Cost efficiencies

Continues

- Individual businesses focus on direct and indirect cost in response to market challenges

New

- Launch of pan-Ultra business transformation initiative
- Leadership
  - Director of Business Transformation appointed at Exec Team Level
  - Chief Operating Officer responsible
- Objectives
  - review operations and associated cost base across business
  - standardise systems and processes where possible
  - review opportunities to share services and facilities
- Scope
  - to include, Finance, HR, IT and commercial



- Benefits
  - cost savings
  - efficiency
  - control improvements
- Why now
  - clusters allows further opportunity
  - evolution of collaborative autonomy

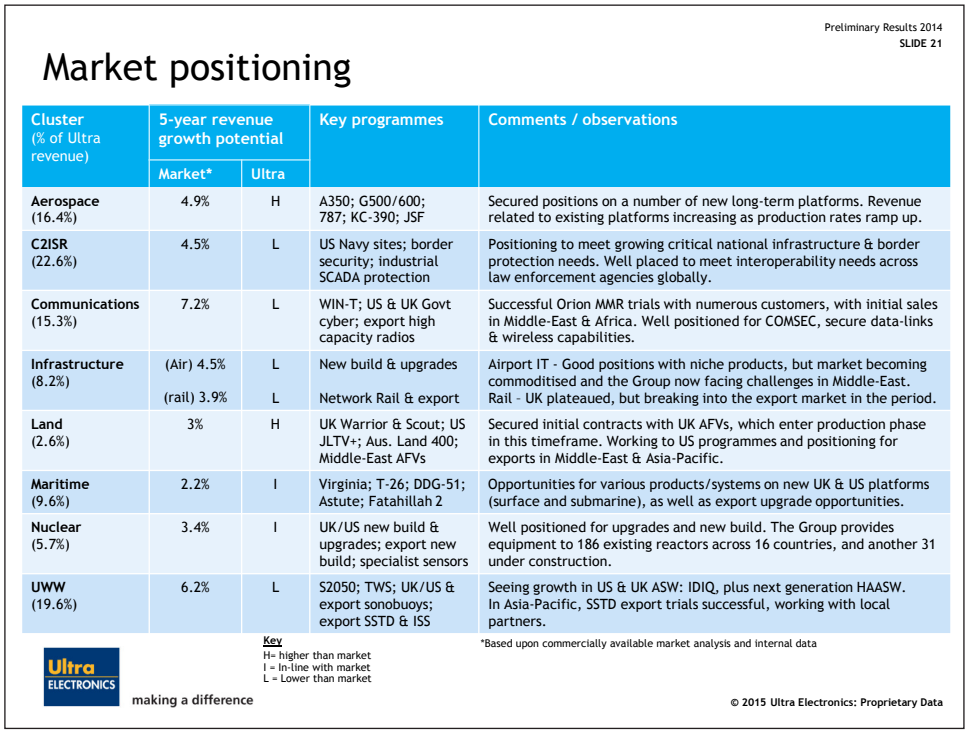
Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

During the period, Ultra has continued to focus on costs, with individual businesses focusing on their direct and indirect cost bases and also driving through business consolidation where appropriate. However this year, building on the work of the individual businesses we are commencing a group-wide focus to standardise our systems and some of our processes. This will allow us to go beyond individual business efficiencies, whilst retaining Ultra's critical success factors of autonomy and agility.

From our early analysis this presents a very strong investment case. We have appointed one of our Divisional MDs to lead the programme at Exec Team level, under Carlos Santiago our COO, and we go into more detail about this in May.

The objectives are to review all operations and their associated cost base across the Group, to standardise where possible and thereby give opportunities to share services, systems, and facilities. The scope is unlimited across the Group but is likely to include Finance, HR, IT and Commercial. The benefits are likely to be around cost savings, but also improved efficiency, effectiveness and controls. I would like to re-emphasise that this is about standardisation not centralisation. The enabling factor is our transition to a cluster framework and ensures that securing efficiencies can be done at a lower risk and is an evolutionary approach as indicated by this chart. It is part of Ultra growing up.



Preliminary Results 2014
SLIDE 21

Market positioning

Cluster (% of Ultra revenue)	5-year revenue growth potential		Key programmes	Comments / observations
	Market*	Ultra		
Aerospace (16.4%)	4.9%	H	A350; G500/600; 787; KC-390; JSF	Secured positions on a number of new long-term platforms. Revenue related to existing platforms increasing as production rates ramp up.
C2ISR (22.6%)	4.5%	L	US Navy sites; border security; industrial SCADA protection	Positioning to meet growing critical national infrastructure & border protection needs. Well placed to meet interoperability needs across law enforcement agencies globally.
Communications (15.3%)	7.2%	L	WIN-T; US & UK Govt cyber; export high capacity radios	Successful Orion MMR trials with numerous customers, with initial sales in Middle-East & Africa. Well positioned for COMSEC, secure data-links & wireless capabilities.
Infrastructure (8.2%)	(Air) 4.5% (rail) 3.9%	L L	New build & upgrades Network Rail & export	Airport IT - Good positions with niche products, but market becoming commoditised and the Group now facing challenges in Middle-East. Rail - UK plateaued, but breaking into the export market in the period.
Land (2.6%)	3%	H	UK Warrior & Scout; US JLTV+; Aus. Land 400; Middle-East AFVs	Secured initial contracts with UK AFVs, which enter production phase in this timeframe. Working to US programmes and positioning for exports in Middle-East & Asia-Pacific.
Maritime (9.6%)	2.2%	I	Virginia; T-26; DDG-51; Astute; Fatahillah 2	Opportunities for various products/systems on new UK & US platforms (surface and submarine), as well as export upgrade opportunities.
Nuclear (5.7%)	3.4%	I	UK/US new build & upgrades; export new build; specialist sensors	Well positioned for upgrades and new build. The Group provides equipment to 186 existing reactors across 16 countries, and another 31 under construction.
UWW (19.6%)	6.2%	L	S2050; TWS; UK/US & export sonobuoys; export SSTD & ISS	Seeing growth in US & UK ASW: IDIQ, plus next generation HAASW. In Asia-Pacific, SSTD export trials successful, working with local partners.

Key
H= higher than market
I = In-line with market
L = Lower than market

*Based upon commercially available market analysis and internal data

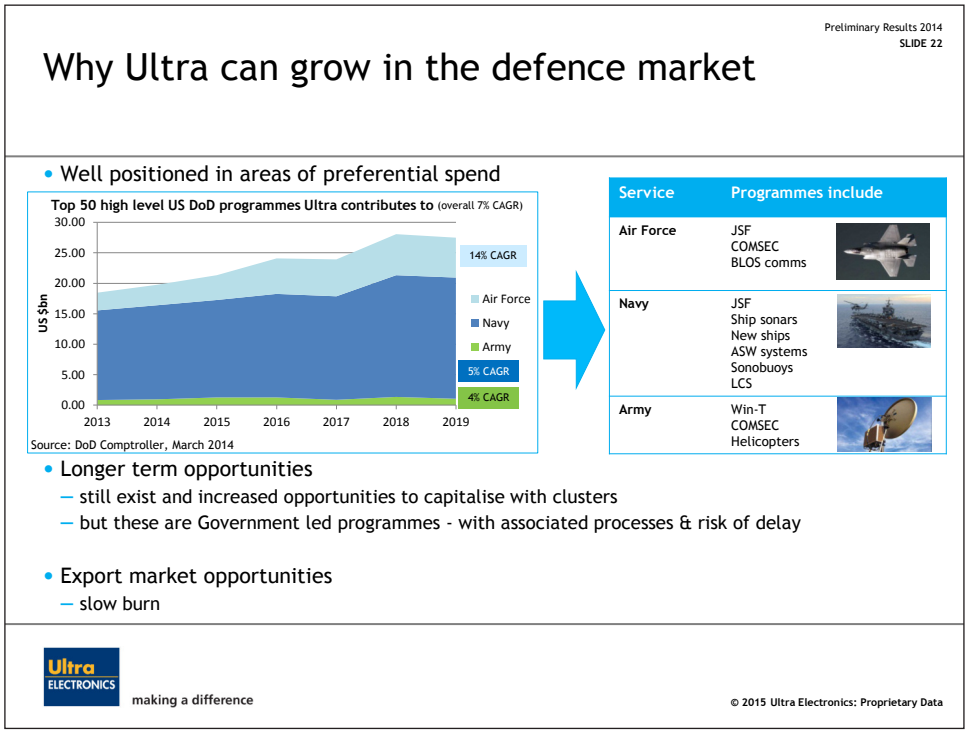
Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

We are constantly being asked about the organic growth rates by end markets that we have used in our forecast. This has always proven to be difficult as the revenue was split amongst three divisions. However, segmenting by Clusters has enabled us to pull this analysis together and is presented on this slide.

You will notice that we are being more prudent or at least in line with market norms in all of our Clusters. The one exception is the Aerospace Cluster where our anticipated growth rate is much higher than the market. This is because of our recent successes in winning market share from competitors and explains the high level of investment required in Company Funded R&D in our Aircraft & Vehicle Systems division. In the five year period to 2019 these aerospace programmes will transition from R&D and rapidly ramp up in production delivering a faster than market sector growth rate.

This slide details the larger contracts that will help drive revenue by Cluster for 2016 and beyond. Remember though, that we will still look to the many smaller contracts as well. As we announce big contract wins you will be able to tick these off and follow the revenue curve. Of course, there are back-ups and stretch targets to these opportunities but these are the ones that are included in Ultra's five-year business plan. Again, as was true in 2015, there are no big ticket items other than the US Sonobuoy IDIQ contract.



The short-term political difficulties in the UK and US does not detract from the medium to longer term growth prospects that we see in the defence market.

I have previously commented that even though the US defence market is set to grow, according to the Office of Management and Budget, by 1.8% CAGR Ultra can grow at a faster rate because we are in the sweet spot of 'smart electronics and software'. Faster growth is about having the right offerings in areas of preferential spend. This slide puts some data behind that assertion.

Unlike others in our sector, Ultra has continued to invest in both defence R&D and acquisitions. I have told you for some time that I am not overly concerned about budget cuts. I am more concerned about uncertainty. Over the next five years, the programmes of interest for Ultra are set to grow at a 7% CAGR, three times the macro rate. Since 41% of Ultra's revenue is derived from the DoD, that is the equivalent of a 3% organic CAGR for the whole of Ultra. This is the medium-term recovery that I have been talking about. The specific programmes that we are tracking are in the box on the right-hand side of the slide.

Preliminary Results 2014
SLIDE 23

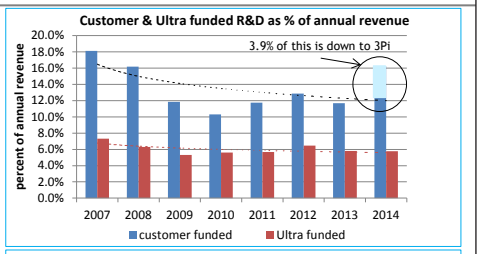
Investment

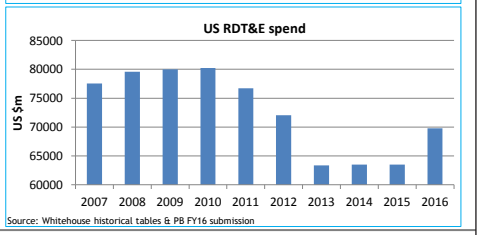
Research & Development

- Continues to be core part of strategy
- Still aim for 5% of revenue
- Trend is 'declining customer funded PV'
  - requires more company PV
  - clusters will allow gearing of PV spend
    - more "bang for buck"

Mergers & Acquisitions

- Continues to be core part of strategy
- Focus is on developing cluster capabilities
  - consider divesting non-core capabilities
- Pipeline process





Source: Whitehouse historical tables & PB FY16 submission

Ultra ELECTRONICS making a difference

© 2015 Ultra Electronics: Proprietary Data

Investment into R&D and acquisitions continues to be a core part of Ultra's strategy.

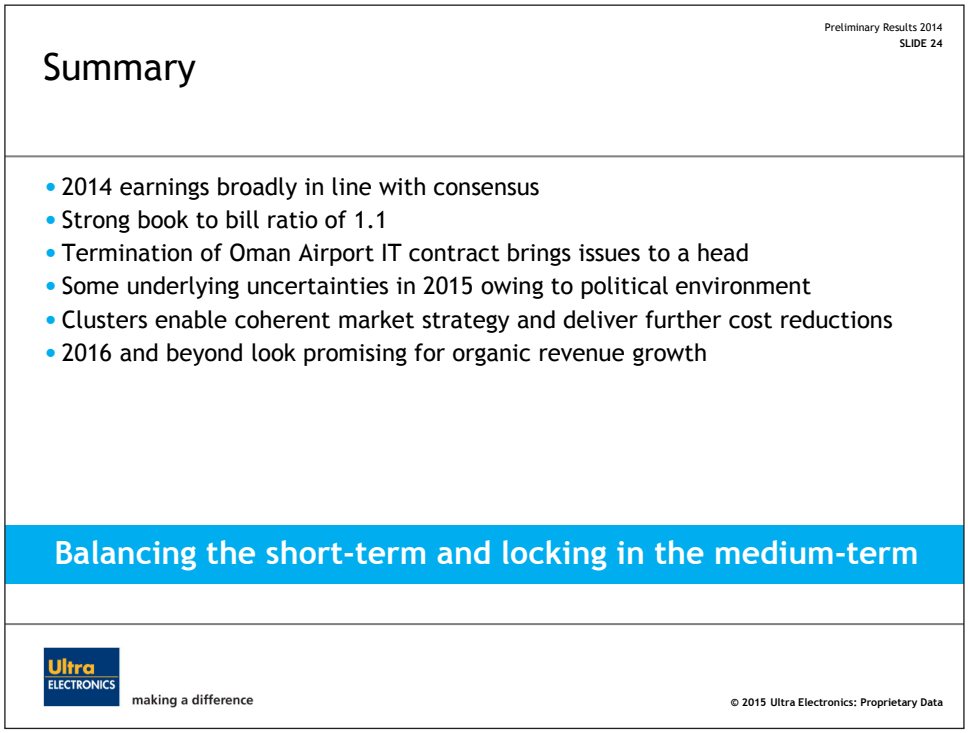
We aim to maintain company funded R&D around 5% of revenue or above. However, you will see from these two charts that the customer funded R&D has been under considerable pressure since 2011 with a drop from $80b at its peak to $64b for 2015. This has made it even more important to maintain the company funded levels to produce the next generation of products and the intrinsic software. This is part of the balancing act that I opened up my presentation with. There is hope that the RDT&E budget will start to grow again as the US DoD has realised that without these funds the defence industry cannot maintain a technical edge over potential threats.

In addition to this investment in organic growth, we continue to be an acquisitive group. The Cluster structure will help to inform and explain the areas for acquisition as well as allow a debate around potential divestments.

We continue to have a good pipleine of potential acquisition targets, although we are unlikely to make an acquisition in the first half of 2015. Our pipeline includes a long list of smaller bolt-on opportunities against and we will continue to assess opportunities against a number of criteria:

- adds to the capabilities that Ultra can provide to existing customers
- provides access to attractive markets for Ultra's existing capabilities and
- fits with Ultra's culture

Just as we have acquired companies that are bolt-in or bolt-on depending on their size we will make larger acquisitions that can also be bolt-in or bolt-on clusters. It is the same successful acquisition strategy except at a higher level.



We've covered a lot in this presentation, 2014 had its difficulties, which were exacerbated by the termination of the Oman Airport IT contract. However as a lead indicator, a book to bill ratio in 2014 of 1.1 bodes well for the future. 2015 is likely to be a perplexing year owing particularly to political battles, but there are still things that we are doing to position ourselves while managing the balancing act I previously referred to. In particular, our cluster strategy furthers our evolutionary path. This together with the market momentum going into 2016 should enable us to return to organic revenue growth. It is not as clean cut as I would like and it continues to be an uncertain time in the Group's journey but we have a plan and the confidence to execute it.

Thank you. We will now take questions.

Note: Appendix slides omitted from this document.

Ultra 2014 Interim Q&A transcript

Q:

First of all thanks for all the disclosure but I still have three questions. The first one is, looking at the cost reduction program what was the run rate – of the £10.5 million that's your targeted run rate for the cost benefit. What was the run rate in '14 and when do you expect to get to that £10.5 million as a run rate? As a subset of that what's the cost of the cost reductions that you anticipate in '15?

Second question, Tactical & Sonar had a very strong second half, now I'm sure some of that was FX turning around and M&A but was there anything non-recurring in that that we need to be aware of when we're doing our 2015 forecast?

Thirdly, and a bit more of a general strategic question, you talked about moving up into tier 2, I'm just wondering if one of the lessons of Oman maybe is do you want to be a large subcontractor? Is the risk-reward actually attractive to where you've always been? Thank you.

A:

Mary Waldner, Ultra

So first, you asked about the cost savings in the period and the run rate. We expect that the £10 million run rate would be achieved by the middle of next year.

Second, I assume you're referring to the Group-wide initiative that we're launching, at this stage it's too early to talk about any costs. Many of the benefits will come from the alignment of our businesses into clusters and the market opportunities that that will bring. The reorganisation itself will not incur significant cost. The Group wide cost initiative, as Rakesh said, is standardisation of systems and processes not centralisation. When we provide more details in June we'll cover the investment case. However our initial analysis reveals significant cost savings are available.

In Tactical & Sonar, the strong second half reflects the acquisitions performing strongly. Also this division particularly benefited from FX. There are no non-recurring items you need to consider.

Rakesh Sharma, Ultra

Okay, on the tier 2 question that is a very good question and I would agree in part. We've learnt not to be a tier 2 integrator in the Middle East. I think we do not have enough business in the Middle East to balance the risk in that region of random decisions being made. It isn't just us that have suffered. Lots of companies in the Middle East are subject to random decisions.

Therefore our strategy going forward is to be a tier 3 supplier in the Middle East, not a tier 2. However, that doesn't mean to say that we don't have successful tier 2 business elsewhere. Our Fatahillah program in Indonesia is going exceptionally well. Tier 2 programs that we have in the US and the UK are also going exceptionally well. It's a case of don't tar everything with the same brush.

Q:

I was trying to work out what the order intake was in Tactical & Sonar because you tell us what the order book is but obviously there's acquisitions and there's stuff moving from one division to another so it looked to me as if that division must have had a very strong book to bill.

A:

Mary Waldner, Ultra

It did, yes.

Q:

Then I wondered following on from that why you have a H2 weighting if you've got strong order cover and you've been having strong order intake? But maybe it's not that division that's H2 weighted. If you could explain for 2015.

A:

Mary Waldner, Ultra

They are linked actually, because the two items that particularly drove the order intake in Tactical & Sonar were the Litening Pod CLS extension and also the first year of the Sonobuoy IDIQ. So if I take the Litening Pod CLS extension for example, that's one of the longer-term contracts that Rakesh talked about as it is executed over 20 years. It's underpinning our future revenues but it doesn't all flow into 2015.

Rakesh Sharma, Ultra

We've strengthened the medium term aspect of our business. When we liquidate the order book

continued on next page

continued from previous page

over the coming years one of the consequences is that we actually have a stronger, as of today, order cover for 2019 than we do for 2017.

The other aspect to that is that if you remember last year 2014, we had a very strong order intake in the first half and a weaker order intake in the second half. So what we'll see is a similar sort of revenue pattern. Also we'll get a strong order intake in the first half this year and a weaker one in the second half because of things like the CR and the budget uncertainties. That's what drives the half one/half two weighting.

Q:

Three questions. Can you just provide a little bit more colour on – it feels like relative to the interims you've become slightly more negative and more cautious on the UK and the US budgets, can you talk about why that is?

Second question is on margins. You are taking costs out but there must be some pricing pressures and you are above your range that you guided in the past, where do you think – actually, when does it start to decline back into the range? Do we expect another year or two of good margins?

The last question. In the slide on the cluster in the markets, and I appreciate we're jumping the gun on the June presentation, but you talk about the Anti-Submarine Warfare, the Under Water Warfare cluster and you talk about growing slower than the market, can you just explain why you think that that's going to have slower growth?

A:

Mary Waldner, Ultra

If we start with the margins you're right, we're slightly higher than our normal range. What we do see as a result of the costs coming out and also the fact that Oman, which had a dilutive effect, will no longer be there. We do expect to be able to stay slightly higher in the short term. However, what we will do, as we've said, is balance investment in R&D as we need to, to renew product cycles with also cost efficiencies and that growth.

Rakesh Sharma, Ultra

On the market, we want to be as transparent as possible. We have a reputation for being honest with you and we wanted to be as transparent as we've always been about what we view as the outcome. The thing is that we had an election in Congress in November of last year and the Republicans took control of the House and the Senate. We believe as a consequence, that there will be a political battle on the budget this year. We're going to get the same level of uncertainty starting the third quarter, resulting in a continuing resolution in the fourth quarter of the calendar year.

The early indication that this battle is going to happen is the continuing fight that the two parties are having over the Department of Homeland Security budget, not for '16 but for '15. They haven't signed off DHS' budget for this year because they're fighting over the immigration content of that budget. So that's an early precursor of what's going to happen with the fight with the Federal budget. What we've done is we've taken account of that uncertainty and the fact that the defence outlays will probably drop as a consequence of those fights.

On the clusters, Anti-Submarine Warfare is just part of the Under Water Warfare cluster. It includes other things as well. Whilst ASW is growing very, very well what we didn't want to do was be overly optimistic. We want to produce a five-year plan that we believe is deliverable. So rather than being optimistic we've taken a prudent approach.

Q:

So three questions really. Airport IT generally, given that Oman was a flagship contract and program, what are the prospects in the near and medium term? Because there used to be quite a long list of potential opportunities, so if you could update us on that please.

Secondly, just some clarification on the Oman story. In terms of the cash impact of what's happened in the near term is it just a £10 million part of the provision that would have a cash impact in the near term for Ultra? You're claiming much more than that and contesting much more than that for the future, which may or may not work out. Can you just clarify that point, please?

Then thirdly, much bigger. A couple of years ago you talked at length about the scale of opportunities getting much bigger for Ultra as the Group has got bigger itself, large multiyear contracts. It feels like you're almost playing that down a bit. I don't know if that's a case of the language or my misinterpretation but can you just talk around that please?

A:

Mary Waldner, Ultra

So on Oman – I mentioned in the presentation, there are two short term impacts that may feature in the first half of 2015 and the first is some potential supplier payments which may go out and the second is other costs relating to short term costs of demobilisation and legal fees. Now we estimate that those could range from £10 million to £20 million, depending on how things progress. But as I said in my presentation, those will be subject to recovery and the timing of that depends, as Rakesh will discuss, on whether we settle amicably or proceed to arbitration.

Rakesh Sharma, Ultra

On the claim aspect of Oman, you're absolutely right, our claims are going to be substantially higher than the provision that we've taken. I can't go into the value of the claims or how it's split obviously for commercial reasons. I'm sure many people are going to be reading our announcement and the Q&As. But the claim will be substantially higher than the provision. My own personal view is that whilst I hope there will be an amicable settlement. I am prepared to go to arbitration. So we're looking at about a two-year process cycle to get that through the court.

In terms of the Airport IT with Oman being the flagship and prospects for other airports, our reputation on Airport IT has not been damaged one iota by what's happened in Oman. The Oman Airport project has a terrible reputation within the industry. Not just the construction industry but also within the Airport IT industry.

All of our customers, we've touched base with our existing customers and with potential customers, both in the Middle East and elsewhere do not view Oman having any effect on our ability to win further airport IT contracts. Also remember, Oman was very, very unusual in the way that it was contracted. All of the other opportunities that we have are all between £5 million and £20 million. They're more of the traditional Airport IT contracts than this as a Master Contractor.

In terms of the bigger contracts, no, it's not. If I've given the impression that we're not interested in bigger contracts anymore that is not what I intended. We are interested in going for bigger contracts and what we're doing with the cluster framework helps us to come together as a set of smaller companies to be able to reach up for those bigger contracts.

In the past when I've showed you that slide of larger contract opportunities I remember it was Ben that asked me which one of those are you going to win, Rakesh, for the next five years. Well, the ones that we needed to deliver the five-year plan we've won. The others that we haven't won – we haven't lost any but they have been delayed because they're large contracts, subject to government changes and government funding patterns.

The UK cyber opportunity for instance is still there. We're still tracking it. The US Government cyber opportunity is still there, we're still tracking it. They're talking about it being released later this year now. It was supposed to have come out two years ago. That's a trait of that particular size of opportunity because the contracts are so large they will ebb and flow. So that's why we never took a huge number of those opportunities into our forecast. We only took a small – less than a handful – because we knew things would change. That doesn't mean we've stopped looking at them. What we've done is put a structure together with clusters to enable us to more effectively compete at that level.

Q:

I think we're going to hack through similar ground. I can't express quite what I feel about what you're saying. I mean where we were tied to major programs like submarines or major deployments we've done just fine and hunky-dory and some of the more cutting edge stuff like cyber seems to be we'll make our minds up. Where they've basically put the money to protect the big programs the little stuff's gone to rats and we've just suffered like everyone else has suffered, from BAE, Lockheed, L-3 and yet we seem to be having some angst about this. It's just gone to rats.

When the budget is properly funded it'll come back but I mean that could be '17 as much as it's going to be '15 or '16. But it's not reason to panic, is it?

A:

Rakesh Sharma, Ultra

Not at all. I hope I didn't give you the impression that I was panicking. In fact, the opposite is true. I actually feel more confident about the medium term growth than I did a year ago. The reason is that when we started looking at the cluster framework and started segmenting and analysing the data that I've shown you, on the medium term growth drivers slide, what that told me is that we've got some of the organic growth in the medium term already baked in. So I find 2015 is a year of treading water because of the political uncertainty.

ISIL hasn't gone away, the Russians haven't given up. In fact the Russians are probably going to drive the UK market into a better place than it is at the moment. With the two Bears that came into UK airspace, I think it was last week. The Russians are saying to NATO "don't forget me, I'm still important". They're going to be probing NATO flanks from now on in. We're back to not quite the Cold War, but we're back to the same sort of tactics as the Cold War. I think the UK is going to have to address this in its defence budget.

So my medium term outlook is actually very positive. I'm very positive about the defence sector. As I've always been. We've never said to you we are going to exit defence. We think it's a good market and we've been strengthening ourselves for when the cycle turns and when the cycle does turn we'll be one of the stronger greyhounds out of the stalls.

Q:

Then the second bit is just on this cluster thing and the point about tier 2. I mean going from tier 3 to tier 2 is always, in my experience, fraught, because you tend to bump into the tier 1s coming down. But there are bits now where we would say we're clearly tier 2 and have been for some years. Perhaps you could say which business it is they are. So the risk of this cluster, tier 2, I mean we're there at probably 30%, 40% of the business I would say.

A:

Rakesh Sharma, Ultra

I don't know what the exact number is, 30%, 40% may sound a bit high. But you're absolutely right. It's been a transition and evolution that we've been making over the last 10 years. So I think probably the first time we moved up to tier 2 was our UK Surface Ship Torpedo Defence program, which was one of the most successful programs I've ever worked on. We did that as a tier 2 supplier. In fact we still continue to do all the logistics support for that program.

We've also done tier 2 for the Air Warfare Defence sonar in Australia and the recent Sonar 2050 Technology Refresh program in the UK. We have been making this change over the last few years.

Within the cluster framework, what we're not saying is every single one of our businesses is going to move up to tier 2. Clearly there are some businesses that are more suited to tier 3 and tier 4 and they will stay at tier 3 and tier 4. There are some businesses that have the skills, the capability that we've invested. in that are capable of moving up to tier 2 and they will represent their cluster at the tier 2 level.

We're also not going to become a pure tier 2 player. Well, we don't run railways so we don't see ourselves as a tier 2 supplier in that sense. We will become a tier 2 supplier where we have strong positions at tier 3 and tier 4. So it's not a whole broad "let's all move up to tier 2", we're going to specifically focus on certain companies that have the capability, the people and the investment in the processes for them to be able to represent the cluster at tier 2.

Q:

The other bit just was the picket fence stuff where we were trying to get the businesses to cooperate together more and more, I mean this goes back years.

A:

Rakesh Sharma, Ultra

Yes.

Q:

But if we didn't have the common systems we can't have actually really taken it all that far. So we now have an opportunity to move it on in a more – sorry, forgive this word – professional manner. Is that right?

A:

Rakesh Sharma, Ultra

It is, but the thing about Ultra that I hope you've all come to appreciate over the years is there's nothing more important than timing and pragmatism. If we had moved to a cluster structure even five years ago it wouldn't have worked. We didn't have the right people in place, we didn't have the right frameworks in place, it's is why we've been working on LEAP, LAUNCH and Collaborative Autonomy. All these things have come together in order for us to now springboard to a cluster framework.

In fact, one of the things that I can tell you is that the cluster framework is not a Head Office diktat to the rest of the companies. During our Business Leaders' Conference in June of last year the business leaders as a collective said "clusters now makes sense because we're tripping over one and other in the marketplace when we're seeing customers. We're not able to work as closely together because we're in different divisions". So it was an outcome from the Business Leaders' Conference that we would move to clusters and put companies in the same cluster where the majority of their revenue was so that we can extract synergy that much better.

Within the current framework it's very difficult, at a Group strategy and divisional strategy level, to have a strategy for Under Water Warfare say or for infrastructure because we have federated businesses that report up to different divisional MDs. So who's responsible within that structure for say the Under Water Warfare strategy? Well, it's a couple of people, maybe three people in the worst case. That means you can't have the authority, responsibility and the accountability all in one place. This violates one of our key success factors.

As the Group has grown and the complexity has grown some people have had the authority, some of them have had the responsibility, and it was uncertain who was accountable. The cluster framework brings these three things together. I can now turn to one divisional MD and say you are accountable for the strategy and the growth of your cluster. You have all the businesses in that cluster reporting to you. It simplifies that whole organisational complexity.

The time is right: now. It wasn't last year, it wasn't five years ago, it's right: now. That's what Ultra does. Ultra evolves at the right time when the circumstances present themselves. We're a very pragmatic company. We don't work on ideologies.

Q:

I've got three questions if I could. The first, just building onto your comment about piecing the bits together – sorry, it's a slight housekeeping one at one level. But your slide 27 shows 64% of sales are sea and I recognise there's other bits of maritime that are going to be buried within your segmentation on slide 21 but it looks to me like maritime plus underwater is 30%. So I'm just wondering where we're missing the other 30% from and if you could help me there?

Secondly, it may be buried in the appendix, Mary, but in the past you've given hedge rates and hedge cover for the next two or three years, could you update us on that. Thirdly, just your caution on US defence and particularly with a Continuing Resolution risk for this financial year, Continuing Resolution is always there, it seems to be the new norm, so why does that lead you to be incrementally more negative than you might have been in the past?

A:

Rakesh Sharma, Ultra

The organic decline that we're talking about is not because of the CR. You're right, on a like-for-like basis compared to last year we had a Continuing Resolution for three months as well, so there

continued on next page

continued from previous page

shouldn't be any decline as a result of that because it's the same. The organic decline is because of the uncertainty of the defence outlays – we're predicting that the defence outlays will be between 4% and 5% down overall for the year and the third quarter of the year will be quite bad for defence outlays. So the organic decline is associated with that.

On the clusters and the sea part of it, if you take a look at slide 18 it isn't just the underwater warfare cluster in that, the maritime cluster is also a part of sea. There's also some nuclear because of the nuclear reactor work that we do for submarines is part of sea as well. When you add all that lot up it comes to the 64% of defence revenue.

Mary Waldner, Ultra

Then on hedging, yes, so we are 100% hedged for 2015 at $1.57. That falls to 80% hedged for 2016 at $1.59 and then we've got 36% in place for 2017 at $1.57. So that's obviously transaction, which is around 10% to 12% of our revenues. Translation will just flow through.

Rakesh Sharma, Ultra

So we're now just hitting an hour and 18 minutes and unless there are really any more burning questions we're going to bring this to an end. I know you've got lots of other announcements and things to get to. We will be touching base with you at some point during the day anyway and we can answer anything more specifically at that point. So thank you very much and we hope you found it informative.

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
information@ultra-electronics.com

Design: **HAT Associates** +44 (0)1242 253112