Ultra Electronics **Annual Report & Accounts 2017**

Focusing on fundamentals…

2017

Ultra ELECTRONICS

Financial highlights

Revenue KPI

£775.4m -1.3%

2016: **£785.8m**

Underlying earnings per share* KPI

116.7p -13.3%

2016: **134.6p**

Statutory basic earnings per share*

66.2p -20.0%

2016: **82.8p**

Dividend per share KPI

49.6p +3.8%

2016: **47.8p**

Underlying profit before tax* KPI

£110.0m -8.4%

2016: **£120.1m**

Underlying operating profit*

£120.1m -8.4%

2016: **£131.1m**

IFRS operating profit

£61.5m -31.5%

2016: **£89.7m**

Group order book

£897.4m +12.3%

2016: **£799.3m**

Dividend

The proposed final dividend is **35.0p**, bringing the total dividend for the year to **49.6p** (2016: 47.8p). This represents an annual increase of **3.8%**, with the dividend being covered **2.35 times** (2016: 2.8 times) by underlying earnings per share. If approved at the Annual General Meeting, the dividend will be paid on 3 May 2018 to shareholders on the register on 6 April 2018.

For more information:
www.ultra-electronics.com/investors/irhome.php

Cautionary statement

This document contains forward-looking statements which 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.

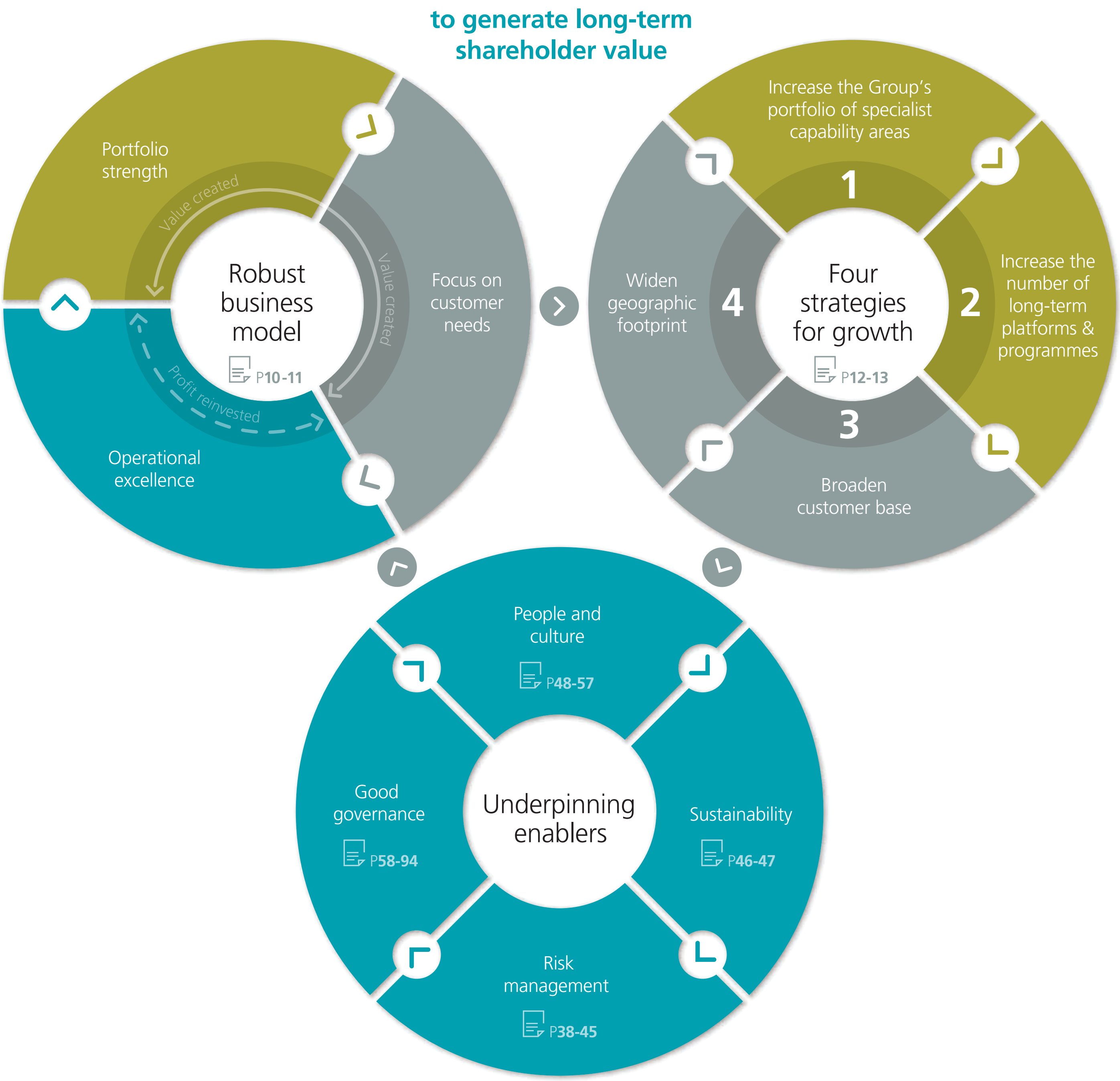
*see footnote on page **150**

What is Ultra?

The Ultra Electronics Group manages a wide range of specialist capabilities, generating highly-differentiated solutions and products in the Defence & Aerospace, Security & Cyber, Transport and Energy markets. We meet customer needs by applying electronic and software technologies in demanding environments and meeting critical requirements.

Ultra's fundamental strategic framework

The Group's framework below is focused on ensuring its prime objective is met:



Operational highlights

Ultra has extensive intellectual property, strong market positions, differentiated technologies and talented people. The Group's core strengths include world-leading positions in many of its specialist capabilities. A number of operational highlights that will underpin the Group's future performance are outlined below.

The award of a government ISTAR* contract to support the provision of advanced surveillance capability valued at £16.6m.

£16m

The supply of the F135 engine's Electrical Ice Protection System (EIPS) for the life of the programme (or a minimum of 30 years) valued at approximately $500m.

$500m

Securing the position on Saab's new Gripen fighter aircraft, with an initial production order valued at £9m, to equip it with Ultra's HiPPAG airborne compressor system solution.

£9m

P24-25
Aerospace & Infrastructure highlights

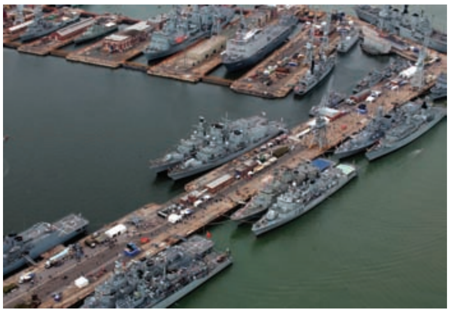
Securing an $8.5m contract with options that could increase the value to $18m for the production of MK 48 Torpedo Array Nose subassemblies.

$8m

*ISTAR: Intelligence, surveillance, target acquisition

The award of a £37m contract for a maritime propulsion system.

£37m



P28-29
Maritime & Land highlights

An $18m contract for a major surveillance and security system and the provision of five years of specialist support over the course of the system's use.

$18m

The production of two variants of the Submarine Countermeasure Acoustic Device (SCAD) valued at $10m.

$10m

The award of a £30m contract to provide 12 ship sets of torpedo defence systems to the Indian Navy.

£30m

P26-27
Communications & Security highlights

How and where Ultra operates

Ultra operates through its three divisions: **Aerospace & Infrastructure**, **Communications & Security** and **Maritime & Land**, delivering cost-effective, specialist capability technologies at the system, sub-system and component levels through eight distinct market-facing segments.

Ultra's place in the market

Defence & Aerospace	**67**
Security & Cyber	**15**
Transport & Energy	**18**

% of Group revenue **by market**

Ultra's extensive portfolio of capabilities serves eight market segments; Aerospace; Infrastructure; Nuclear; Communications; C2ISR+; Maritime; Land and Underwater Warfare. Ultra enjoys long-term positions on many complex platforms owing to its diverse technologies, which are fundamental to the performance, safety and mission success on the platforms in which they are incorporated. The segment structure allows Ultra to exploit the specialist capabilities of its **18 businesses** simultaneously, allowing the businesses to autonomously respond to changing customer demands in an agile manner whilst maintaining the benefits of being part of a larger Group. Additionally, Ultra seeks top-class partners with the ability and specialist capability to offer a more complete solution and seamlessly "leads or follows" as a nonthreatening mid-tier company in order to satisfy customer needs. The Group harnesses both own- and customer-funded research and development, tailoring its solutions to meet changing customer needs and budgets and sustaining its reputation as an innovative supplier of enabling technology.

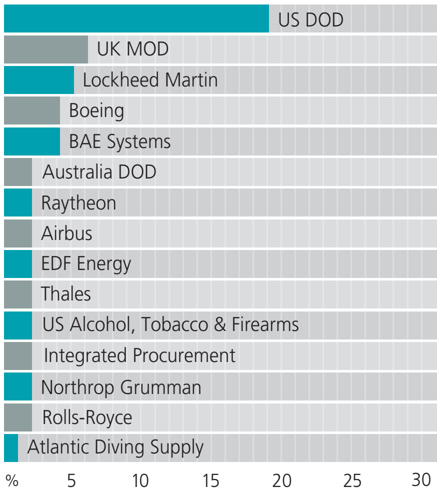
Where Ultra operates

North America	**52**
United Kingdom	**21**
Rest of the world	**17**
Mainland Europe	**10**

% of Group revenue **by region**

Ultra's core markets remain North America, the UK and Australia. These core markets and target regions allow Ultra to access the largest addressable defence and security budgets in the world, positioning for long-term growth through well-considered partnerships and government relationships. The Group has limited exposure to mainland Europe, supplying only technologies that are unavailable from domestic suppliers, for example, sonobuoys. The Group continues to develop strategic positions in the Middle East, India and South Korea, for which there is a strong pipeline of growth opportunities across its eight market-facing segments. Japan is also a region of interest as opportunities emerge following the reinterpretation of Article 9 of its Constitution and the increase in military and natural threats.

Ultra's customers



This market position, together with Ultra's independence, allows the Group to work closely with the world's prime contractors in chosen markets. The chart above shows Ultra's major customers, which includes Tier 1 Primes such as Lockheed Martin, Boeing, BAE Systems and international government procurement offices.

P30-37 Market-facing segments

P10-11 Our business model

+ Command & Control, Intelligence, Surveillance and Reconnaissance

Aerospace & Infrastructure

% of Group revenue

% of Group profit*

Revenue
£203.2m -0.7%
2016: **£204.7m**

Underlying operating profit*
£32.6m +0.6%
2016: **£32.4m**

Order book
£283.2m +5.8%
2016: **£267.8m**

Number of employees
1,244
Managing Director: **Graeme Stacey**

P24-25
Aerospace & Infrastructure highlights

Communications & Security

% of Group revenue

% of Group profit*

Revenue
£242.7m -6.3%
2016: **£259.0m**

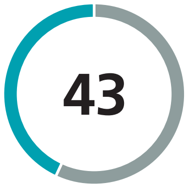
Underlying operating profit*
£28.2m -29.0%
2016: **£39.7m**

Order book
£258.7m +14.0%
2016: **£227.0m**

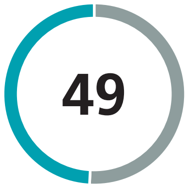
Number of employees
1,295
Managing Director: **Mike Baptist**

P26-27
Communications & Security highlights

Maritime & Land



% of Group revenue



% of Group profit*

Revenue
£329.5m +2.3%
2016: **£322.1m**

Underlying operating profit*
£59.3m +0.5%
2016: **£59.0m**

Order book
£355.5m +16.7%
2016: **£304.5m**

Number of employees
1,633
President: **Bill Terry**

P28-29
Maritime & Land highlights

*see footnote on page **150**

Executive Chairman's review

Focusing on fundamentals

> The Group is well positioned in what we expect to be growth markets with strong niche positions and talented people.

Douglas Caster CBE BSc FIET
Executive Chairman

2017 was a disappointing year for Ultra with the Group's financial performance falling short of expectations and the prior year. In the main this was because expected order intake, from which in-year revenue was planned, was delayed until the second half of the year or beyond. Additionally, in the UK, we experienced a significant downturn of routine, short-term support activity late in the second half year owing to customer funding constraints. When the likely impact of this was announced to the market on 10 November 2017, Ultra's share price declined significantly but has recovered to some extent. Overall, at £901.4 million, Group order intake was good, but it was achieved too late in the year to support the projected 2017 financial performance.

Despite the 8.4% decline, year-on-year, in underlying operating profit, Ultra continues to be a fundamentally sound company with great potential. The Group is well positioned in what we expect to be growth markets with strong niche positions and talented people providing specialised technologies and capabilities that our customers need to support their platforms and programmes. This aligns with Ultra's strategy to generate long-term shareholder value by gaining strong market positions through being a niche supplier of electronic systems, products and services in growing sectors within the defence, aerospace, energy and transportation markets.

Group order book +12.3%

£897.4m (2016: **£799.3m**)

2017	897.4
2016	799.3
2015	753.8
2014	787.3
2013	781.2

Dividend per share +3.8% KPI

49.6p (2016: **47.8**)

2017	49.6
2016	47.8
2015	46.1
2014	44.3
2013	42.2

Underlying earnings per share* -13.3% KPI

116.7p (2016: **134.6p**)

Year	Statutory basic EPS	Underlying EPS
2017	66.2	116.7
2016	82.8	134.6
2015	35.7	123.9
2014	29.8	123.1
2013	54.8	127.1

Just prior to the end of the year, we saw the departure of Rakesh Sharma as Chief Executive. There is no doubt that for the six years of Rakesh's incumbency as Chief Executive, market conditions have been challenging for Ultra. Nevertheless, the continued organic decline over that period combined with the recognition, late in the year, that the 2017 targets were not going to be met caused the Non-Executive Directors to conclude that the Board needed to seek new leadership for Ultra. This decision was made after a period of careful reflection, particularly regarding how the Group's culture had evolved and how that had been a contributing factor to declining performance. The Board's desire to embark on a process of cultural and business renewal as quickly as possible was the reason for implementing the Chief Executive's immediate departure. The Board has embarked on an external search for an industry-leading, high calibre candidate to enable the company to achieve its growth potential. This process is well underway. In the meantime, in view of my previous experience as Ultra's Chief Executive from 2005 to 2011, the Board requested that I should take over as Executive Chairman and lead Ultra again until the successful candidate is available to take over. This is a privilege which I am happy to have.

Cash flow at £116.5 million in the year was good with an underlying profit to cash conversion of 97% and follows the 92% conversion in 2016. This represents a return to a consistent level of cash generation for which Ultra was always noted. The Board is recommending a final dividend of 35.0p per share. At this level, if approved, the dividend is covered 2.35 times by underlying operating profits, which is a lower level of cover than is usual for Ultra. It is the Board's intention therefore that future increases in dividend should not exceed growth in earnings per share so that, over time, dividend cover will be restored to its traditional level of about 2.8 to 3 times. Net debt at the year end was £74.5 million which resulted in a net debt to EBITDA gearing ratio of 0.56 times, well below the banking covenant requirement of less than three times. This low gearing has benefitted from the in-year cash flow as well as the £133.5 million net proceeds, after attributable expenses, of the share placing that we performed in July 2017. The purpose of the share placing was to enable the Group to acquire Sparton Corporation in the United States. Sparton is the co-owner with Ultra of the ERAPSCO joint venture that supplies sonobuoys to the US Navy and the anti-submarine forces of other nations. The fact that ERAPSCO is the sole supplier of all current production sonobuoys types to the US Navy meant that the merger agreement to acquire Sparton had to be reviewed by the United States Department of Justice ('DOJ') under the Hart, Scott Rodino antitrust legislation. Following feedback from meetings with the DOJ, Sparton and Ultra have mutually agreed to terminate the merger as the DOJ advised they would seek to block it (further details on page **19**). It is now the Group's intention to buy back shares in order to return to shareholders the net proceeds of the equity raise.

Statutory basic earnings per share -20.0%

66.2p (2016: **82.8p**)

> Group order intake was good, but it was achieved too late in the year.

*see footnote on page **150**

Executive Chairman's review continued

8 strategic tenets

1. Core competencies
Focus on the Group's core competencies in defence, security, transport and energy and expand into adjacent market sectors of growth

2. Portfolio
Offer a range of products and services including components, sub-systems, systems and through-life management solutions

3. Niche player
Be a niche and market-leading player through technical advantage

4. Growth
Contribute to the organic growth of the Group, as well as identifying well-matched acquisition targets

5. Efficient organisation
Have an efficient organisation with engaged competent people

6. Teaming
Gain competitive advantage by internal and external teaming and honing LEAP* behaviours

7. Excellent supplier
Be an excellent and strategic supplier to our customers

8. Meet our commitments

The immediate priority for the Board is to deliver shareholder value through a renewed focus on organic performance. Improving marketing and sales force effectiveness will be key to this through reinvigorating the innovative culture that has created offerings that were highly-differentiated in the eyes of customers and enabled Ultra to compete successfully. Ultra's eight strategic tenets outlined (left), which have stood the test of time, will be used to drive competitive strategies. Emphasis on the behaviours valued by Ultra that are encapsulated in "LEAP" and "LAUNCH", described on page **50**, will also be an important part of Ultra's cultural renewal.

High-performing organisations are characterised by a culture of openness and learning where differences and diversity are encouraged and respected. Ultra's cultural renewal will embrace these themes as well as improving the way our people interact. It will also extend to strategies to develop Ultra's organisation so that it continues to be fit for purpose as market conditions change. Ultra's management style of collaborative autonomy, where the Group's businesses share technology and team internally, as well as externally, to compete for market opportunities that would have been inaccessible to them individually, will continue to be encouraged. Succession planning to improve the breadth, depth and quality of the bench strength of management below Board level will also be undertaken.

Since my appointment as Executive Chairman I have spoken with a number of Ultra's shareholders from which some consistent themes emerged. Shareholders generally expressed a desire for the Board to create the conditions for delivering long-term value. To this end, the Board intends to increase investment in internally-funded R&D to generate new intellectual property from which competitive offerings will be derived. Business efficiency will also be improved through continued investment in the Group's Shared Services and Standardisation (S3) programme including increased capital expenditure to accelerate renewal of outdated business systems.

> "The Board intends to increase investment in internally funded R&D to generate new intellectual property from which competitive offerings will be derived."

P**58-94**
Good governance

*LEAP: Leadership, Entrepreneurship, Audacity, Paranoia

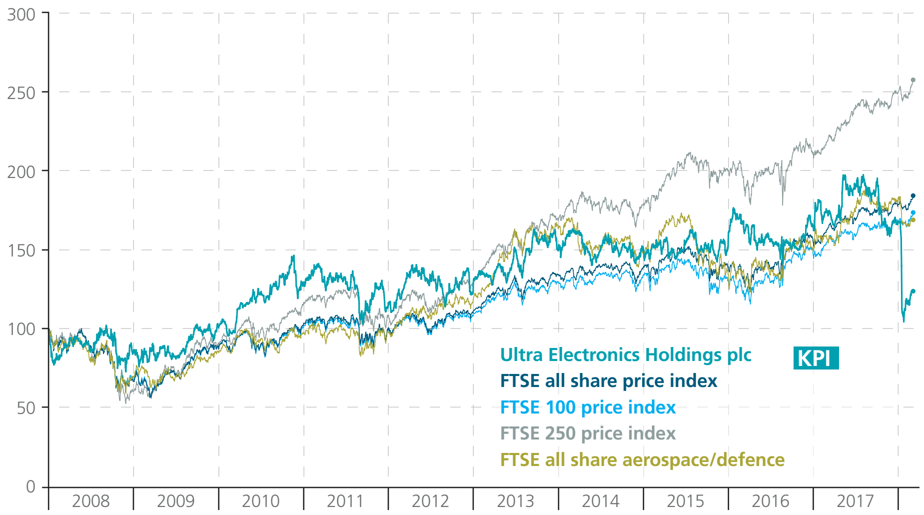
Mark Anderson stepped down as Group Marketing Director and from the Board on 1 June 2017. The Board is pleased to welcome our new Non-Executive Directors, Geeta Gopalan and Victoria Hull. I am confident that Geeta and Victoria will bring diverse experience and thinking to the Board.

On behalf of the whole Board, I send our thanks to Ultra's employees. They consistently show great commitment, fortitude and hard work and this has been particularly so during the challenging time of 2017. With orders arriving so late in the year, they executed 23% of the year's revenue during November and December; a real show of dedication and commitment for which we thank them. The talent and skills of our people combined with the Group's specialised capabilities and technologies are what give Ultra such tremendous potential.

Ultra has extensive intellectual property, strong market positions, differentiated technologies, talented people and a strong balance sheet. The Group's core strengths include world-leading positions in many of its specialist capabilities and a reputation for successful programme execution. It has positions on a broad number of long-term platforms and programmes, significant exposure to the strengthening US defence budget, and to the growing demand for advanced defence technologies. The Group also has good visibility through a strong order book, which excludes contributions from a large volume of IDIQs (US DOD Indefinite Delivery Indefinite Quantity contracts) and other off order book aerospace long-term supply agreements. We have entered 2018 with an order book of £897 million that provides opening order cover against projected revenues for the year of 62% (2017: 56%) which is higher than in recent times. The Board is confident that Ultra has sustainable operating trading momentum as we go into 2018 and beyond.

Douglas Caster
Executive Chairman

Ultra's shareholder returns (pence)



> The Board is confident that Ultra has sustainable operating trading momentum as we go into 2018 and beyond.

Ultra's robust business model

Ultra's business model enables it to achieve its primary objective of generating long-term shareholder value.

Ultra provides the market with **portfolio strength**

Eight distinct and highly-technical market segments

Clearly defined market segments allow Ultra's businesses to combine and provide more complex offerings to customers, leveraging technology from across the full range of the Group's capabilities, rather than only supplying individual products from single businesses operating in siloes. This approach establishes a framework that aligns resources to greater effect across each market-facing segment and utilises the most effective customer relationship. In turn, this supports the development of coherent strategies against particular end markets, based upon collective market research and opportunity capture.

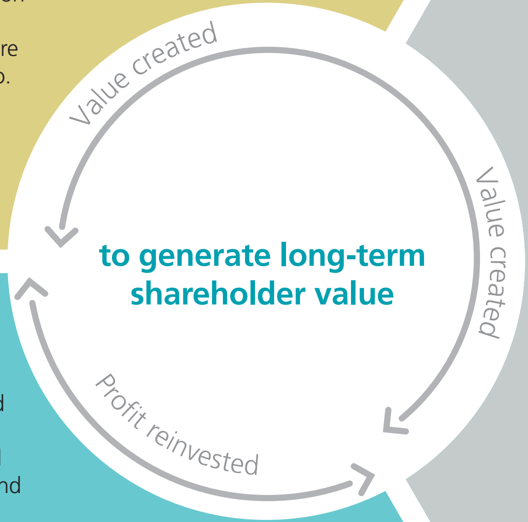
The market segment approach provides the Group with improved analysis at an appropriate level of complexity, thus allowing Ultra to better manage and prioritise the Group's investments, including Research and Development (R&D) alignment and acquisition strategy.

Acquisition to position in growth markets and divestment to maintain focus

Ultra invests in targeted acquisitions to strategically grow and complement its portfolio. The Group invests in acquisitions that develop and apply domain expertise, capabilities and technical synergies in common end markets. The Group will dispose of capabilities that are no longer considered core to the strategic growth plan for the portfolio.

Innovative solutions focused on customer need

Ultra creates value by generating innovative solutions from across its portfolio and by becoming a key partner in its customers' design process ensuring their needs are met. Ultra businesses innovate constantly to create solutions for customers – often through highly specialised technological innovation.



Maintaining Ultra's **operational excellence**

Agility through a devolved organisation

A key differentiator for Ultra is the agility that businesses in the Group exhibit in their customer relationships.

The Board provides leadership and direction in achieving its corporate objective of generating long-term shareholder value. At an operational level, the Executive Team is responsible for running the Group, for the delivery of strategy, for financial performance and for team development.

Ultra's individual businesses have a high degree of operational autonomy, which enables the Group to provide an agile and responsive level of support to customers and partners that is normally associated with a smaller business. The agility of the individual businesses is enhanced by access to wider and complementary technologies and expertise that lie elsewhere in the Group through collaborative autonomy.

Ultra's businesses are focused on helping customers identify their true needs while developing long-term relationships. This enables the Group to be a trusted and strategic supplier to its customers

Ultra's **LAUNCH** is a set of behaviours developed by the Group to facilitate customer engagement and relationship building.

LAUNCH is a way for Ultra's businesses to generate long-term customer relationships which lead to a better pipeline of opportunities and ultimately, enable growth. This approach ensures Ultra understands the real needs of its customers and encourages a long-term strategic relationship where Ultra businesses become part of customers' extended enterprises, to mutual benefit.

P50 More about LAUNCH

BOARD
RESPONSIBLE FOR:
LEADERSHIP – doing the right thing
GROWTH IN SHAREHOLDER VALUE
REVIEWING GROUP STRATEGY
RISK MANAGEMENT
STANDARDS OF ETHICS AND BEHAVIOURS

EXEC TEAM
RESPONSIBLE FOR:
MANAGEMENT – doing things right
DEVELOPING GROUP STRATEGY
FINANCIAL PERFORMANCE
TEAM DEVELOPMENT

18 AUTONOMOUS BUSINESSES
RESPONSIBLE FOR:
MANAGING INDIVIDUAL BUSINESS
DEVELOPING AND IMPLEMENTING COMPETITIVE STRATEGIES
WINNING & EXECUTING BUSINESS
DEVELOPING PEOPLE
WORKING IN PARTNERSHIP

P58-59 Ultra's Board of Directors

Achieving operational efficiency through engaged competent people with domain expertise

Ultra believes that the right people, who embrace and sustain Ultra's culture and who have the domain expertise, are its most important asset in successfully enabling the Group to deliver value to its stakeholders.

P48-57 People and culture

Ultra constantly innovates to meet **customer needs**

Focus on Tiers 2-4
Ultra has no strategic intent to be a **Tier 1**, top-level platform provider. Therefore, the Group is a non-threatening partner to the **Tier 1** prime contractors. As such, **Tier 1** contractors can rely on Ultra to provide the specialist capabilities at which the Group is expert, rather than regarding it as a competitor.

Ultra's specialist capabilities are mainly at **Tiers 3** and **4**, supplying equipment and components to support **Tier 1** and **2** systems and programmes. The Group does undertake **Tier 2** system integration, but does this mainly when integrating its own **Tier 3** offerings where it understands the detailed **Tier 3** interfaces and so is able to manage the risk inherent in system integration activities.

Ultra invested 4% (2016: 4%) of revenue in R&D to develop new offerings in 2017. Its customers invested a further 17% (2016: 14%).

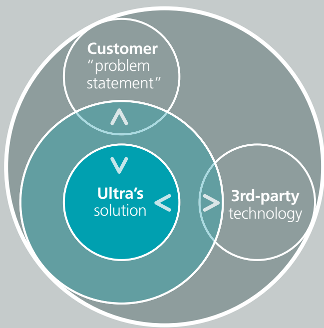
Funded by:

Group	19%
Customer	81%

This R&D spend is focused on enhancing the portfolio of capabilities and programme positions that underpin further growth.

Where the Group has complementary capabilities, it can combine these to offer more comprehensive and innovative solutions. This means that Ultra's products, capabilities and the associated domain expertise uniquely position the Group to be able to meet more complex and demanding system and subsystem requirements.

Form external partnerships to develop the best solutions for customers
Ultra has an established history of partnering and teaming (both internally and externally) in order to offer the best-of-breed technologies that meet its customers' requirements as closely as possible. The Group is agnostic to the source of technology which is required to deliver these solutions. Where proven technology exists outside the Group that meets customers' requirements, Ultra will readily form external teaming partnerships to access it. Ultra sees these teaming arrangements as a source of competitive advantage, allowing it to deliver differentiated solutions that meet customer needs efficiently. By working together, Ultra's businesses are able to win opportunities that would not be possible in isolation.



Ultra is continually evolving its approach in response to:

- changing customer demands
- direction of travel of the markets
- striving to be the first to bring new solutions to market.

In its specialist capability areas, a key differentiator for the Group is its understanding of the:

- customers' domains
- demanding operational environments
- projected capability gaps that customers would like addressed.

In short, Ultra's understanding of customers' needs allows it to develop effective and innovative solutions.

Tier definition

Tier 1. Platform provider
Responsible for being the prime contractor of the platform in question, examples being a naval ship or a fighter aircraft.

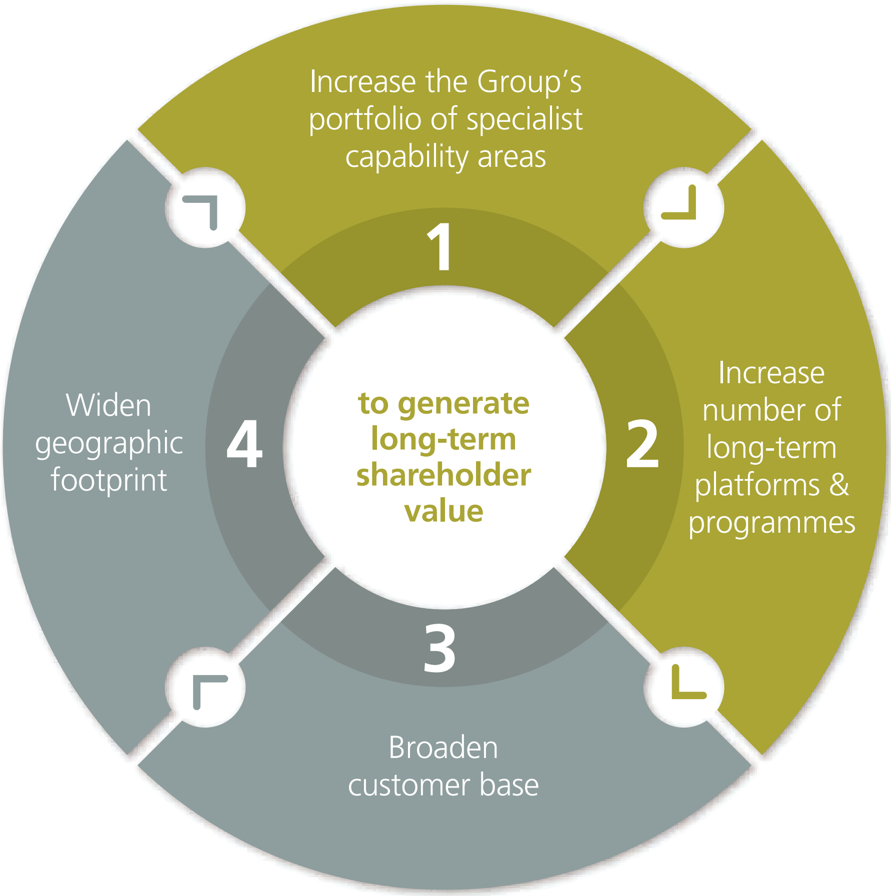
Tier 2. Sub-system integrator
Responsible for integrating equipment or components that will make up a functional element of the platform. Examples of system integration completed by Ultra include integrated sonar systems and wing ice protection systems.

Tier 3. Equipment supplier
Ultra has a large presence at this level of the supply chain, supplying equipment such as data links, cryptographic equipment and sonobuoys.

Tier 4. Component supplier
Ultra also provides a broad range of smaller components for many programmes worldwide, including sensors for measuring the performance of a nuclear reactor and joysticks to control unmanned aerial vehicles (UAVs).

Ultra's four strategies for growth

Ultra's strategy is to generate long-term shareholder value by gaining strong market positions through being a niche supplier of electronic systems, products and services in growing sectors within the Defence & Aerospace, Security & Cyber, Transport and Energy markets.



1. Increase the Group's portfolio of specialist capability areas

- Concentrate on the customers' needs
- Invest in continually improving electronic and software solutions in niche markets
- Focus on developing specialist capabilities with demanding and critical requirements, often for demanding environments.

2. Increase the number of long-term platforms and programmes on which Ultra's specialist capabilities are specified

- Identify new platforms and upgrade programmes to apply Ultra capabilities
- Platform lives are typically 30 to 50 years, which provides a long-term "flywheel" effect
- Enables resilient financial performance despite market fluctuation.

3. Broaden customer base

- Independence allows Ultra portfolio to be sold to a broad range of customers globally
- Supply to different project offices, teams and platform teams within wider customer relationships
- Build on largest customers, including: US DOD, UK MOD, Lockheed Martin, BAE Systems, Boeing and Australian DOD.

4. Widen geographic footprint

- Increased access to two of the largest addressable defence budgets in the world
- Focus on gaining competitive advantage through measured expansion into the Middle East, India and Asia-Pacific.

Examples of how the Group is performing in each strategy:

- NCS successfully conducted the acceptance testing of the innovative reactor and plant protection systems it has developed for leading US technology developer NuScale Power. The UK-developed system will be critical to the operation of NuScale's innovative technology, which will generate clean, reliable, affordable power in both the US and the UK.
- Ultra signed a Memorandum of Understanding with CGN of China that will see both companies co-operate closely to develop next generation instrumentation and control (I&C) systems for civil nuclear power. The I&C systems include reactor protection and control, and will be used in China, the UK and other international markets.

- Expanding its footprint in the US Navy Maritime Patrol and Reconnaissance Aircraft Programme Office, ATS was contracted to support the design, documentation, and development of the distributed data link onboard the MQ-4C Triton Unmanned Aerial System providing line of sight communications through the Joint Tactical Radio System.

- Ultra Electronics' PCS business received an order worth $36m from Pratt & Whitney for equipment used on the F135 engine used in the Lockheed Martin F-35 jet fighter. PCS will supply the engine's Electrical Ice Protection System (EIPS) as part of a long-term partnership with Pratt & Whitney, effective for the life of the programme, or the minimum of 30 years. Based on potential production volumes, in-service spares, repairs and additional through-life support, the agreement is valued at approximately $500m in total.

- Ultra Electronics USSI's joint venture with Sparton Corporation received an IDIQ option exercise valued at $220m, enabling it to extend continuous production for the US Navy. This ensures continuous production and will allow Ultra to deliver seamless service to a major customer in the strategic area of Anti-Submarine Warfare.
- Ultra Electronics PCS secured a position on Saab's new Gripen fighter aircraft, with an initial production order valued at £9m, to equip it with Ultra's HiPPAG airborne compressor system solution.

- Ultra Electronics USSI was successful in expanding its life-safety market sector by integrating its HyperSpike acoustic array technology into life-safety platforms of several primes, including Honeywell and Siemens.

- Ultra EMS broadened its customer base by securing a contract from Turkey's Sedef shipbuilding on the Turkish Navy's Landing Platform Dock vessel.

- Herley was contracted by Boeing for the provision of American subsonic air-launched cruise missile (ALCM) and conventional air-launched cruise missile (CALCM) test equipment micro-electronics.
- Forensic Technology continued to win multiple new contracts for the supply and installation of IBIS systems; including the Philippines National Police and Thailand for the Centre for Forensic Science.

- Ultra's ERAPSCO joint venture with Sparton Electronics also secured its first commercial sale of sonobuoys to support the Indian Navy's P-8i fleet of aircraft with a $10.7m multiyear order for both active and passive sonobuoys.
- Ultra CSS was awarded a contract valued at £10m to support the restoration of the Philippine Navy's Navy Jacinto Class Patrol Vessels, contributing to Ultra's continued expansion into the Asia Pacific region.
- Ultra secured a $1.5m award from EOS Australia for hand controls for integration into Rheinmetall's weapon systems. This strategic award will help position Ultra with the EOS team on Australia's LAND400 programme.

Financial review

The Group continued its focus on managing costs and efficiencies within the businesses, which enabled good operating margins to again be achieved.

Order intake for the year was £901.4m, a 15.8% increase on 2016. At the end of 2017, the order book was 12.3% higher at £897.4m.

Amitabh Sharma BSc FCA
Group Finance Director

Ultra's 2017 results

Revenue

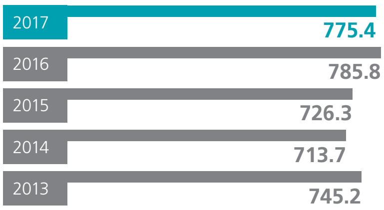
Revenues of £775.4m represented a decrease of 1.3%, or £10.4m, on the prior year (2016: £785.8m). The 2016 revenues included a £13.3m contribution from the ID business, which was disposed of in August 2016. Revenues decreased organically by 3.3% due to a slowdown in UK spending which accelerated during the latter part of the second half and a higher level of engineering activity compared to the prior year, some of which was unexpected due to the additional Surface Electronic Warfare Improvement Programme (SEWIP) module wins. The weakening of Sterling during the year meant there was a positive foreign exchange impact of 3.7% from the translation of overseas revenues. The average US dollar rate in 2017 was $1.29 compared to $1.35 in 2016.

Aerospace & Infrastructure revenues (see pages **24-25**) were broadly flat. The PCS business saw increased revenues through development work on equipment for the Mitsubishi Regional Jet and a ramp up in production activity on certain armoured vehicle programmes, offset by lower license sales compared to 2016. The order book increased compared to the end of 2016 owing to the two significant orders: orders for the US Air Force Joint Strike Fighter electronic control unit, and an initial production order to equip Saab's new Gripen fighter aircraft with Ultra's HiPPAG airborne compressor system solution.

Communications & Security's revenues (see pages **26-27**) in 2016 include a part-year contribution from the ID business of £13.3m, which was disposed of in August 2016. Revenues in the division were impacted by the slowdown in UK spending, with delays to a number of crypto programmes, and by the increase in a number of contracts in the development phase at Herley in the US. Forensic Technology, based in Canada, increased revenues as a result of bullet identification product sales to customers in South East Asia; and TCS, our Montreal-based military radio business, continued to grow in 2017. The order book continued to increase, ending the year at £258.7m (2016: £227.0m). This was due to a good order intake year at Herley, and some notable wins across the division such as: securing a £16.6m programme to support the provision of advanced surveillance capability until 2019, a $16.2m

Revenue -1.3% KPI

£775.4m (2016: **£785.8m**)



Underlying operating profit* -8.4%

£120.1m (2016: **£131.1m**)

Underlying profit before tax* -8.4% KPI

£110.0m (2016: **£120.1m**)

contract awarded by the US Department of the Navy to design, develop, integrate and install a variety of cyber-secure systems for critical infrastructure control and monitoring, and the award of an $18m multi-layered surveillance and security system to a programme for the oil and gas industry.

The Maritime & Land Division revenues (see pages **28-29**) increased, driven by sales of US and international sonobuoys, and there was a positive FX impact. These helped offset the slowdown in UK spending, where our CSS business experienced delays to orders that had been expected in the year. Increased torpedo sales to the US Navy from our Ocean Systems business compensated for strong torpedo countermeasure sales to the Australian Navy by Avalon Systems in 2016. Revenues from the new Indian Navy contract win also contributed this year. The order book grew significantly over last year due to the Indian Navy contract win and the maritime propulsion system order. Ocean Systems also won a number of countermeasures contracts, including a $10m order from the UK MOD. Our US sonobuoy business, USSI, had a strong order intake year, particularly from international customers.

Orders

Order intake for the year was £901.4m, a 15.8% increase over £778.3m achieved in 2016. After adjusting for foreign exchange and disposals, the underlying increase was 12.0%. At the end of 2017 the order book was 12.3% higher at £897.4m (2016: £799.3m). The underlying increase was 16.8%, partially offset by a decrease of 4.5% arising from foreign exchange. Opening order cover for 2018 is 62% (2017: 56%).

Underlying operating profit and margins

Underlying operating profit* was £120.1m (2016: £131.1m), a decrease of 8.4% on the prior year. Foreign exchange increased profit by 0.5%, whilst the disposal of the ID business (2016: operating profit £2.3m) in 2016 resulted in a profit reduction of 1.8%. Profit therefore declined organically by 7.1%. There was a higher proportion of development contracts in the Communications & Security division which required increased investment during the year and this, together with lower sales to the UK and the end of the UK Crypto production contract, contributed to the decreased underlying operating margin of 15.5% (2016: 16.7%).

Aerospace & Infrastructure underlying operating margins* improved to 16.0% (2016: 15.8%). This was helped by the increased revenues from higher margin sales in the period and an improved operational performance at our aerospace business, which benefitted from slightly lower R&D expenditure and efficiencies deriving from S3-related business consolidations and cost reduction initiatives.

The Communications & Security division currently has a greater proportion of production contracts in the early development phase. Consequently, underlying operating margins* reduced to 11.6% compared to 15.3% in 2016. These include the US Navy SEWIP module and an electronic warfare contract for the F-15 aircraft platform, which together required investment in excess of £6m in 2017. The customer-requested pause in a UK Crypto contract also reduced profits in 2017.

Within Maritime & Land, underlying operating margins* remained at a high level, ending the year at 18.0% (2016: 18.3%) owing to the production phase of a number of US sonobuoy contracts.

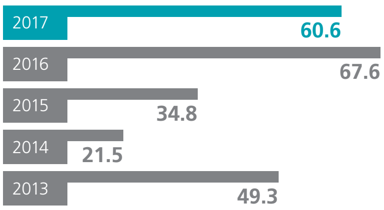
Ultra continued its programme of R&D to position for medium to long-term growth, with total R&D spend in 2017 of £161.1m (2016: £146.9m), the highest it has ever been. This represents a 10% increase and reflects a higher proportion of engineering contracts. The funding required is dependent on the type of engineering contracts awarded; some require Ultra to fund the development phase while others attract customer funding. In 2017, company funded investment was 3.9% of revenue at £29.9m (2016: £34.1m – 4.3%), while customer funding increased to 16.9% of revenue at £131.2m (2016: £112.8m – 14.4%). The Group's three divisions are at different stages of the investment cycle and this mix is reflected in the total figure and will continue to vary as our divisions move through the investment cycle. The Group continues to progress a wide-range of long-term growth opportunities across all eight market segments.

*see footnote on page **150**

Financial review continued

IFRS profit before tax -10.4%

£60.6m (2016: **£67.6m**)



Interest and underlying profit before tax*

Net financing charges* were £10.1m (2016: £11.0m). The decrease reflects the lower debt levels partially offset by higher US interest rates. The interest on bank debt was covered 12 times (2016: 12 times) by underlying operating profit*. The resulting underlying profit before tax* was £110.0m (2016: £120.1m).

IFRS profit before tax

As set out in the table below, Ultra's IFRS profit before tax decreased to £60.6m (2016: £67.6m). The gain on the mark-to-market valuation of our forward foreign exchange contracts and interest rate swap was £12.0m in 2017 (2016: £19.1m loss). This was primarily caused by the significant strengthening of sterling against the US dollar as at 31 December 2017 compared to 31 December 2016.

Acquisition and disposal related costs of £12.8m (2016: £2.2m) include those associated with the proposed Sparton Corporation acquisition and 3 Phoenix staff retention payments which were put in place at the time of acquisition of that business.

There was a £8.0m (2016: nil) charge for legal fees relating to the Ithra (Oman) contract and a £1.6m (2016: nil) impairment of an intangible asset. 2016 benefited from the one-off curtailment gain of £15.5m when the Group's UK defined benefit pension scheme was closed to future accrual on 5 April 2016.

	2017 £m	2016 £m
Underlying profit before tax	**110.0**	120.1
Amortisation of intangibles arising on acquisition	**(28.5)**	(32.7)
Impairment charges	**(1.6)**	-
S3 programme	**(7.8)**	(6.5)
Net interest charge on defined benefit pensions	**(2.7)**	(3.0)
Gain/(loss) on fair value movements on derivatives	**12.0**	(19.1)
Acquisition and disposal related adjustments	**(12.8)**	(2.2)
Oman contract termination related costs	**(8.0)**	-
Unwinding of discount on provisions	**-**	(0.4)
Disposal loss (after intangible and goodwill eliminations)	**-**	(4.1)
Pension scheme curtailment gain	**-**	15.5
Reported IFRS profit before tax	**60.6**	67.6

The £4.1m disposal loss in 2016 represented the legal intercept assets disposed of in December 2016, offset by the gain on the divestment of the ID business.

The Group's S3 programme remains on track. S3 savings of £13.5m (2016: £6.9m) were realised in the period whilst costs on the programme increased to £7.8m (2016: £6.5m). £2.5m of these costs (2016: £2.7m) related to setting up our GBS capabilities in Rochester, New York and Wimborne, Dorset.

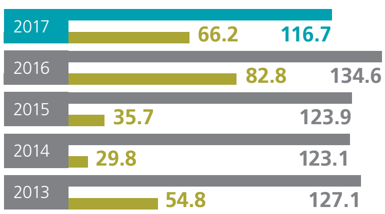
Tax, EPS and dividends

The Group's underlying tax rate* in the year increased to 21.6% (2016: 21.1%) owing to reduced credits for prior year adjustments, offset by a recognition of previously unrecognised deferred tax assets and a reduction in higher overseas taxes. US tax reform will significantly reduce the US tax charge but this benefit will be largely offset by the restriction of tax relief for US interest expenses. The statutory tax rate on IFRS profit before tax was 19.25% (2016: 13.8%). The factors affecting the statutory tax rate are shown in the reconciliation in note 11. We do not anticipate the US tax reforms to have a material effect on the 2018 underlying Group effective tax rate.

Underlying earnings per share decreased to 116.7p (2016: 134.6p). This decrease was in part due to the dilutive impact of the share placing undertaken in July 2017 (see below) which increased the number of shares in issue by 7.05m. Basic earnings per share decreased to 66.2p (2016: 82.8p).

Underlying earnings per share* -13.3% KPI

116.7p (2016: **134.6p**)



Statutory basic earnings per share -20.0%

66.2p (2016: **82.8p**)

*see footnote on page **150**

A final dividend of 35.0p (2016: 33.6p) is proposed. If it is approved at the Annual General Meeting, this will give a full year dividend of 49.6p (2016: 47.8p) and will be covered 2.35 times by underlying earnings per share*

49.6p

A final dividend of 35.0p (2016: 33.6p) is proposed. If it is approved at the Annual General Meeting, this will give a full year dividend of 49.6p (2016: 47.8p) and will be covered 2.35 times by underlying earnings per share*.

Operating cash flow

Cash generated by operating activities was £97.4m (2016: £112.0m). Underlying operating cash flow* was £116.5m (2016: £120.4m) and the ratio of cash to underlying operating profit increased to 97% (2016: 92%). This represents the highest cash conversion percentage achieved since 2011.

Capital expenditure, including on software, increased to £11.2m (2016: £5.4m). Ultra is continuing a programme of IT investment in conjunction with the S3 programme, with two Ultra businesses undertaking IT system ('ERP') implementations over the year and a number of others in their planning phase. The CSS business successfully went live in Q4 and the PCS business achieved its key implementation dates, with its Cheltenham site going live in August and the Greenford site at the beginning of January 2018. The final PCS site will go live in H1 2018. A further five businesses are starting ERP implementations in 2018.

Working capital decreased by £7.0m (2016: increase £11.1m), reflecting an increase in receivables more than offset by an increase in creditors. Inventories increased slightly in the year.

The pension deficit reduction payments in the year on the UK and Canadian schemes were £9.5m (2016: £9.0m), as agreed with the trustees.

Non-operating cash flow

The underlying operating cash flow* of £116.5m (2016: £120.4m) funded the Group's various non-operating items. The main non-operating and non-underlying cash items as set out in note 2 and in the statutory cash flow statement were:

- £133.5m was raised in a July 2017 share placing, together with a further £3.4m in exercised share options over the year. In total, there was a £137.3m inflow from the issue of share capital (2016: £3.0m)
- Dividend payments of £35.0m (2016: £32.6m)
- Tax paid of £10.3m (2016: £9.0m)
- A £9.8m outflow representing Ithra (Oman) related legal fees (2016: £8.2m outflow on calling of a performance bond relating to the same contract)
- £13.0m on acquisition and disposal related costs (2016: £1.7m) which include expenses relating to the proposed Sparton Corporation acquisition and 3 Phoenix staff retention payments which were put in place at the time of acquisition of that business
- £8.9m on the S3 programme (2016: £5.6m).

Consequently, net debt improved to £74.5m (2016: £256.7m).

Return on Invested Capital (ROIC)

ROIC was 17.2% (2016: 20.1%**) and is calculated as underlying operating profit* expressed as a percentage of average invested capital (calculated as an average of the opening and closing balance sheets). Average invested capital is calculated as net assets (after adjusting for exchange rate fluctuations) adjusted for amortisation and impairment charges arising on acquired intangible assets and goodwill, and the add-back of other non-underlying performance items, such as tax, fair value movements on derivatives, the S3 programme, acquisition- and disposal-related costs and the Ithra (Oman) contract, impacting the balance sheet.

" Underlying cash conversion for the year was 97%. This represents the highest cash conversion percentage achieved since 2011. "

* see footnote on page **150**

** The equity placing in July 2017 raised net proceeds of £133.5m; for consistency of comparative, 2016 has been calculated as if the equity proceeds also formed part of 2016 net assets.

Financial review continued

Ultra's net debt at 31 December 2017 was £74.5m (2016: £256.7m) and the total borrowings drawn from the revolving facilities were nil (2016: £87.0m).

£74.5m net debt

Borrowing facilities

The Group's committed banking facilities amount to £466.3m in total, together with a £5.0m and $10.0m overdraft. The Group's revolving credit facility of £300m is denominated in Sterling, US Dollars, Canadian Dollars, Australian Dollars or Euros. This facility was signed in November 2017 and replaces the previous £100m and £200m revolving credit facilities. The facility is provided by a group of six international banks and has a committed maturity of five years to November 2022, and may be extended to a maximum of seven years subject to lender consent. The facility agreement permits an additional £150m 'accordion' which is uncommitted and subject to lender consent and can be used in certain acquisition scenarios.

The Group also holds a $225m term loan, which was established in May 2015. This loan, denominated in US Dollars, was drawn in full in August 2015 to complete the Herley acquisition. $60m is repayable in late 2018 and the loan expires in August 2019. The Group also has loan notes in issue to Pricoa, which totalled $70m at 31 December 2017 (2016: $70m). $10m will be repaid on 14 July 2018 and the remaining $60m will be repaid on 25 January 2019.

As well as being used to fund acquisitions, the financing facilities are also used for other balance sheet and operational needs, including the funding of day-to-day working capital requirements. The US Dollar borrowings also represent natural hedges against assets denominated in that currency.

Ultra's net debt at 31 December 2017 was £74.5m (2016: £256.7m) and the total borrowings drawn from the revolving facilities were nil (2016: £87.0m), giving headroom of £300.0m (2016: £213.0m) in addition to the £5m and $10m overdrafts. The Group held £149.5m (2016: £74.6m) of cash, which was held for working capital purposes and to fund acquisitions.

The Group's balance sheet has strengthened with net debt/EBITDA improving to 0.56 times (2016: 1.76 times), and net interest payable on borrowings was covered around 12x by underlying operating profit*.

The Group's main financial covenants are that the ratio of net consolidated total borrowings/EBITDA is less than three, and that the net interest payable on borrowings is covered at least three times by EBITA.

Interest rate management

Much of the Group's current financing has been taken out to fund acquisitions in North America. To reduce the risks associated with interest rate fluctuations and the associated volatility in reported earnings, Ultra issued a total of $70m of fixed-rate, seven-year loan notes to Pricoa in 2011 and 2012. The amount of fixed-term debt and the associated interest rate policy is kept under regular review. During 2015, interest rate hedging was put in place lasting to mid-2019 to ensure that between 40% and 60% of forecast debt was at a fixed rate of interest at each year end.

Pensions

Ultra offers Company-funded retirement benefits to all employees in its major countries of operation. In the UK, the Ultra Electronics Limited defined benefit scheme was closed to new entrants in 2003 and closed to future benefit accrual in April 2016. All staff who joined Ultra in the UK since the defined benefit scheme was closed to new entrants have been invited to become members of the Ultra Electronics Group Personal Pension Plan and, since April 2011, the Ultra Electronics Group Flexible Retirement Plan. Under the terms of this defined contribution scheme, Company payments are supplemented by contributions from employees.

The Ultra Electronics Limited defined benefit scheme was a contributory scheme in which the Company made the largest element of the payments, which were topped up by employee contributions up until the 2016 closure of the scheme to future accrual. The scheme was actuarially assessed using the projected unit method in 31 December 2017 when the net scheme deficit, calculated in accordance with IAS19, was £67.6m (2016: £92.1m). The present value of the liabilities decreased by £11.1m to £371.3m in 2017 primarily due to changes in actuarial longevity assumptions. There was also a £18.6m increase in scheme assets, mainly driven by increases in investment values in equities and property.

A full actuarial assessment was carried out as of April 2016, the result of which was a funding deficit of £114.4m representing an increase of £14.6m from the previous funding deficit of £99.8m in April 2013. Following the completion of the assessment, Ultra reached an agreement with the pension scheme trustee board to eliminate the deficit through additional deficit payments over the period to March 2025 with £10.0m payable in 2018, £10.5m in 2019 then £11.0m per annum for the remaining period. The next valuation will take place as of April 2019.

The scheme has a statement of investment principles which includes a specific declaration on socially responsible investment. This is delegated to the investment managers. Pension management and governance is undertaken by the pension trustees on behalf of the members. The trustees include both Company-nominated and employee-elected representatives. The scheme investment strategy and the details of the risks to which the scheme is exposed are set out in note 30.

Certain employees at TCS in Canada participate in a defined benefit scheme. This scheme is closed to new employees and had an IAS19 net deficit of £0.1m at the end of the year (2016: £0.6m). Regular payments continue to be made, with both Company and employees making contributions, so as to maintain a satisfactory funding position. The Group's remaining Canadian employees participate in a number of defined contribution pension plans. Certain employees at the Swiss subsidiary of Forensic Technology, Projectina, also participate in a defined benefit pension scheme. The scheme had an IAS19 net deficit of £0.9m at 31 December 2017 (2016: £1.0m).

In the US, Ultra offers a defined contribution 401(k) retirement benefit plan to all full-time employees. Under this plan, Ultra provides participating and contributing employees with matching contributions, subject to plan and US Internal Revenue Service limitations.

Foreign exchange risks

Ultra's results are affected by both the translation and transaction effects of foreign currency movements. By their nature, currency translation risks cannot be mitigated, but the transaction position is actively managed.

*see footnote on page 150

Foreign exchange risks: 100% of expected exposure for 2018 is covered.

100%

The majority of sales made by Ultra's businesses are made in local currency, thus avoiding any transaction risk. However, this risk does arise when businesses make sales and purchases which are denominated in foreign currencies, most often in US dollars. To reduce the potential volatility, Ultra attempts to source in US dollars a high proportion of the products sold in US dollars. For the remaining net expense, the Group's policy is to hedge forward the foreign currency trading exposure in order to increase certainty. The expected flows are reviewed on a regular basis and additional layers of cover are taken out so that, for 2018, 100% of the expected exposure is covered, reducing to 75% of the exposure for 2019 and 22% of the exposure for 2020. Exposure to other currencies is hedged as it arises on specific contracts. In addition, specific foreign exchange forwards are in place with respect to the proposed Sparton acquisition.

IFRS 15

A detailed project has been undertaken to determine the impact of IFRS 15, the new revenue recognition standard. The revenue for the substantial majority of contracts that are currently recognised using contract accounting will continue to be accounted for over the life of the contract, however the method by which performance obligations are determined will change on certain contracts including identification of material rights. A small number of contracts no longer qualify to be contract accounted and revenue will instead be recorded at the point at which control of the goods transfers to the customer. The timing of revenue recognised on the substantial majority of sale-of-goods contracts is not significantly affected with revenue continuing to be recognised as control of goods is passed to the customer.

If IFRS 15 had applied in 2017, revenues would have been £7.1m lower and operating profit would have been £2.4m lower. The net impact to the 1 January 2018 opening balance sheet is a £11.4m reduction in net assets. £10.5m of this is a reduction to 'amounts receivable from contract customers' mainly due to changes in the timing of the revenue recognition on some of our development contracts. The 1 January 2018 opening order book increases by £17.0m to £914.4m.

Sparton

In April 2016, the Board of Sparton Corporation ('Sparton') decided to seek a buyer for the entire Sparton group. Given that decision, Ultra considered the acquisition of Sparton made sound strategic sense and ultimately negotiated a merger agreement with Sparton. On 7 July 2017 Ultra announced its intention to merge its wholly-owned subsidiary with Sparton subject, inter alia, to the approval of the United States Department of Justice ('DOJ') under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ('HSR'). Following recent discussions with the DOJ, and competition concerns raised by it, Ultra and Sparton have mutually agreed to terminate the merger.

The US Navy has indicated that it is now considering ways to increase competition in the sonobuoy procurement process over time, including between Ultra and Sparton. Ultra anticipates that this will take place over a number of years. The DOJ has stated that it intends to take steps to open an antitrust investigation into the ERAPSCO JV and that its approach to the investigation will depend on the US Navy's assessment of increased competition in the sonobuoy procurement process.

In the meantime, Ultra will continue to fulfil its obligations with Sparton under the ERAPSCO JV, which has been supplying sonobuoys to the US Navy under an Indefinite Delivery Indefinite Quantity ('IDIQ') contract since 2014. The current IDIQ period of performance will end in 2020 and the ERAPSCO JV submitted bids in January 2018 for the next two concurrent IDIQ contracts (for Fiscal years 2019-2023). Demand for sonobuoys from the US Navy is growing and sonobuoys continue to be a vital, strategic capability of the utmost importance for the US Navy and the ERAPSCO JV's international customers, which need reliable products and continuity of supply. It is also likely that sonobuoys will become more complex in their design to counter the threats being faced today and in the future.

Ultra has world leading technology and expects to continue to play a significant role in this market. Sonobuoys are complex electro-mechanical devices that are required to deploy and function reliably in harsh maritime operating environments after being launched from ASW platforms. As they are expendable devices, there is considerable focus on delivering the necessary capabilities at the lowest unit cost. Ultra believes that it is pre-eminent in knowing how to build the various sonobuoy products required by the US Navy and its international customers, and how to do so at a low unit cost. Ultra and Sparton, through the ERAPSCO JV, produce tens of thousands of sonobuoys each year and they are two of the very few defence manufacturers of these large volume, high tech products. This has required a culture of working together with the cooperation of the US Navy to value engineer sonobuoy designs. In the future, the US Navy is likely to choose for any new devices to be supplied by more than just the ERAPSCO partners. Nevertheless, Ultra believes that a considerable period of time will be needed by any new entrants to design and produce sonobuoys to meet the rigorous performance standards of the customer.

In anticipation of the acquisition of Sparton, in July 2017 the Group completed a placing of new ordinary shares representing approximately 9.9% of Ultra's existing issued share capital, raising net proceeds of approximately £134m to part fund the acquisition. The Group remains highly cash generative with good balance sheet strength and the Group remains comfortable with debt levels of approximately 1.5x net debt to EBITDA. The Group therefore intends to undertake, over time, a share buy-back through on-market purchases in order to return the net proceeds of the earlier equity issue to its shareholders. The existing buy-back authority from the 2017 AGM allows for up to 7,047,169 shares to be bought back. Additional authority will be sought at the 2018 AGM. Any shares bought back are expected to be cancelled.

Amitabh Sharma
Group Finance Director

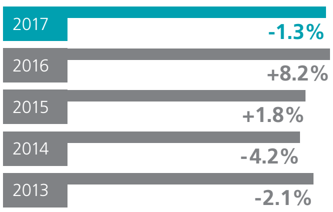
KPIs charting growth

The indicators shown below have been identified by the Board as giving the best overall indication of the Group's long-term success in improving its FTSE ranking by outperforming the market.

Revenue growth

Description
Growth in total Group revenue compared to the prior year, providing a quantified indication of the rate at which the Group's business activity is expanding.

-1.3%

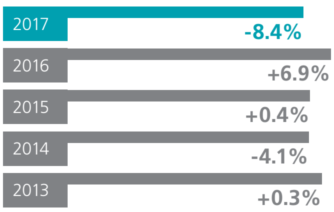


Comment
Revenues decreased by 1.3% or £10.4m to £775.4m. There was a 3.7% benefit from the positive impact on translating overseas revenues, offset by an organic decline of 3.3% and the 1.7% impact of the disposal of the ID business.

Underlying profit before tax*

Description
Growth in Group underlying profit before tax* compared to the prior year.

-8.4%

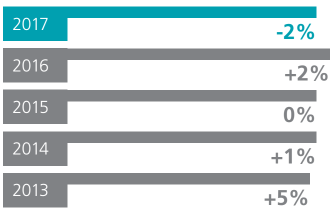


Comment
Underlying profit before tax* was £110.0m (2016: £120.1m). The underlying operating margin* was 15.5% (2016: 16.7%). The decline in underlying profit before tax* followed the disposal of the ID business in August 2016, a higher proportion of development contracts in the Communications & Security division which required increased investment during the year, lower sales to the UK, and the end of the UK Crypto production contract.

Underlying earnings per share*

Description
Underlying earnings per share* calculated over a rolling three-year period.

-2%

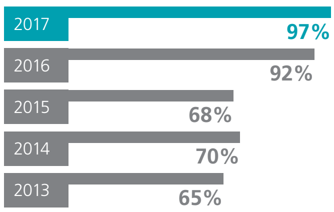


Comment
Underlying earnings per share* decreased to 116.7p (2016: 134.6p). This decrease was in part due to the dilutive impact of the 9.9% share placing undertaken in July 2017 to part-fund the proposed Sparton acquisition. On a pro-forma basis, eliminating the impact of the July 2017 share placing, the decline would have been 0.2%. A final dividend of 35.0p (2016: 33.6p) is proposed. If it is approved at the Annual General Meeting, this will give a full year dividend of 49.6p (2016: 47.8p) and will be covered 2.35 times by underlying earnings per share*.

Operating cash conversion

Description
Net cash from operating activities and dividends from associates, less net capital expenditure, R&D, LTIP share purchases and excluding the cash outflows from the S3 programme, acquisition and disposal related payments and Oman related costs, expressed as a percentage of underlying operating profit*. Operating cash conversion* is a simple yet reliable measure of cash generation, which represents the major element of the Group's short-term incentive bonus scheme.

97%



Comment
Underlying operating cash flow* was £116.5m (2016: £120.4m) and the ratio of cash to underlying operating profit increased to 97% (2016: 92%). This represents the highest cash inflow and cash conversion percentage achieved since 2011.

*see footnote on page 150

Non-financial KPIs

Total shareholder return*

Description
Annual total shareholder return (capital growth plus dividends paid, assuming dividends reinvested) over a rolling five year period.

-2.0%

2017	-2.0%
2016	+8.0%
2015	+6.0%
2014	+8.0%
2013	+14.0%

Comment
Annual total shareholder return over the five year period from 2013 to 2017 is -2.0%.

Health and safety

Description
The number of externally reportable accidents per 100 employees.

0.7

2017	0.7
2016	0.7
2015	0.5
2014	0.4
2013	0.7

Comment
The number of externally reportable accidents remained constant in 2017. Ultra continues its efforts to drive a health and safety aware culture.

YOURviews employee engagement survey

Description
Ultra's internal employee satisfaction survey, YOURviews, provides an employee engagement rating for each individual business within Ultra and is completed every one to two years. Answers to various questions are combined to give the overall employee engagement scores.

82%

2017	82%
2016	82%
2015	82%
2014	81%
2013	81%

Comment
The level of employee engagement has remained stable during a year of change and business consolidations. Each business develops its own action plan, which is focused on employee engagement, taking into account internal and external benchmarks.

Additional non-financial performance indicators
Ultra's four strategies for growth are described on pages **12** and **13** of this report. Performance indicators relating to the Group's success in these four dimensions are shown on those pages. The Group's people are its most important asset. Performance indicators that relate to the recruitment, retention and development of Ultra's staff are included on pages **51-53** of this report.

Standardisation & Shared Services (S3)

The Standardisation & Shared Services programme (S3) was established in 2015 with the goal of delivering £20m in enduring cost savings by 2019. The programme ensures that it does not detract from a business's autonomy in its market place or restrict its ability to deliver its in-year budget.

S3 has identified areas to improve business efficiency and is managing the implementation of changes as individual projects.

The eight illustrated workstreams have become functions of Ultra's Global Business Services (GBS). Two GBS shared service centres opened in Wimborne, Dorset in June 2016 and in Rochester, New York in December 2017. The S3 programme management office drives the portfolio of projects that deliver business efficiencies and realise the savings that have been targeted. In 2017 £13.5m of enduring cost savings were made.

Global Business Services

UK GBS is operational for Property Management, Indirect Sourcing, Payroll, Accounts Payable and Facilities Management services. In the US, GBS has begun to deliver Payroll and Sourcing services.

Continuous improvement techniques are in place within GBS to develop the services offered. Working in partnership, businesses are recognising the value that comes from collaboration, sharing best practices and challenging historical norms. The GBS team has developed a set of values to underpin its culture of supporting the businesses to achieve its shared target. These values are shown below.

Empower & Develop

Continuing to create opportunities to grow and develop talent across the Group. Facilitating the bringing together of great minds, recognising and rewarding the value of problem solving together.

Stronger Together

Supporting Ultra businesses to focus on customers, continually sharing ideas and knowledge at every level and across every area the businesses are touched.

"Working in partnership, businesses are recognising the value that comes from collaboration, sharing best practices and challenging historical norms."

Innovative & Trusted Service

Enabling the future growth of Ultra Electronics. Proactively looking to improve, innovate and surpass expectations. Placing value in the mutual respect and trust of Ultra's stakeholders.

Integral Partner

Recognising the value that comes from working together, learning about, and sharing best practice, challenging the norm, determining the best outcomes, and taking ownership.

01.

Property
During 2017, through proactive portfolio management, Ultra's property footprint reduced by a further 5%, a total of 164,626ft^2. A further 89,048ft^2 reduction has been identified for 2018, through a combination of exiting, subleasing and general consolidation of the estate. This represents a further 2% reduction in Ultra's property footprint. Through a central database of all property leases, GBS has the visibility to assess Group-wide future property requirements. When S3 completes, the Group expects to have achieved a total reduction in its property estate of 13%.

02.

Indirect Sourcing
Indirect Procurement savings were achieved in 2017. By implementing a common indirect procurement system across the UK businesses, the Purchase-to-Pay process and expenses reporting have been standardised.

With total visibility of all indirect expenditure, GBS is now able to negotiate improved pricing and supplier terms by consolidating Ultra's buying power, and offer a standard service level to all employees for the reimbursement of business expenditure. In 2017, the GBS sourcing team has worked with business representatives to deliver savings of over £100k through the consolidation of UK mobile telephony and savings of over 30% with a leading freight provider.

In the US, implementation of Ultra's indirect procurement system began in the latter part of 2017 and will complete in 2018. This project will see the creation of a North American Indirect Procurement function, performing a mirror role to its peer organisation in the UK.

03.

Direct Sourcing
Each business is accountable for identifying and delivering its own savings plans and participates in a regional Procurement Council. These forums provide visibility of opportunities to consolidate spending across the Group and allow businesses to decide which initiatives to join depending on their business plans and customer or regulatory constraints.

Procurement Councils track and report savings, share best practices and target the optimisation of Ultra's supply chain.

04.

HR
Since May 2017, GBS has offered a centralised Payroll service to all UK businesses, the transition to which completes in 2018. In the US, all employees are paid through GBS where processes and procedures in the administration of US payroll and benefits are well advanced.

A review of how Ultra recruits has reduced the number of UK suppliers from 80 to a preferred supplier list of 10. GBS now offers UK businesses a consistent recruitment service and leveraging the commercial scale of the Group.

A project is taking place in 2018 to move US recruitment to GBS to deliver productivity efficiencies via standardised and centralised processes and shared resources.

05.

ERP
The Group is implementing an ERP strategy, which will migrate businesses towards standard technologies and processes. In the last twelve months, two businesses (PCS and CSS) have transitioned to a standard platform and are realising the benefits of optimised operational processes, simpler cost and project reporting and lower IT support costs.

Over the next 18 months and beyond, ERP implementations will continue across the Group, rolling out a standard technology and process suite.

06.

Finance
The implementation of a Target Operating Model for the finance function across the Group has commenced, with focus on leveraging the shared services capabilities possessed both in the UK and the US by implementing standard processes and removing duplicated efforts. For example, the UK Payroll consolidation will result in a single process which will remove activity in each of the six UK operating businesses.

In addition to consolidating buying power, the standardised Purchase-to-Payable System implemented across 2016 and 2017 will support the delivery of streamlined finance processes.

During 2018, the roll out of the Target Operating Model will continue both through the on-going implementation of the ERP strategy and the continuing transfer of certain finance activities into GBS.

07.

Facilities Management
The first shared service to go live in the UK was Facilities Management, in early 2017. The service delivers all site maintenance & repair services and meets the Health, Safety & Environmental management needs of all businesses. A Service Desk for the Facilities Management function is accessible across the UK via a web-based portal and allows for standardised reporting to the businesses, providing an electronic, auditable data trail.

Divisional Managing Director's review

Aerospace & Infrastructure

Aerospace & Infrastructure revenues were broadly flat. The Precision Control Systems business saw increased revenues through development work on equipment for the Mitsubishi Regional Jet and a ramp up in production activity on certain armoured vehicle programmes, offset by lower license sales compared to 2016, and lower demand for industrial products elsewhere in the division.

The division's underlying operating margins* improved to 16.0% (2016: 15.8%). This was helped by the increased revenues from higher margin sales in the period and an improved operational performance at Ultra's aerospace business, which benefitted from slightly lower R&D expenditure as a number of large programmes approached production. Underlying operating margins* also benefitted from S3 related business consolidations and cost reduction initiatives.

The division's order book increased by 5.8% to £283.2m (2016: £267.8m) owing in part to the orders noted below.

Features of activities in the period that will underpin the division's future performance include:

- Orders for the electronic control unit which manages the US Air Force Joint Strike Fighter aircraft engine's Electrical Ice Protection System amounting to $36m
- Securing the position on Saab's new Gripen fighter aircraft, with an initial production order valued at £9m, to equip it with Ultra's HiPPAG airborne compressor system solution
- Partnering with NuScale Power in the US to submit the first-ever Small Modular Reactor design certification application to the US Nuclear Regulatory Commission.

The division's order book increased by 5.8% to £283.2m.

Businesses within this division

- Airport Systems
- Nuclear Sensors & Process Instrumentation
- Nuclear Control Systems
- Precision Control Systems

Graeme Stacey
Divisional Managing Director,
Aerospace & Infrastructure

Graeme has been a Divisional Managing Director since 2010, operating across the defence, aerospace, transport and energy sectors. He was, for seven years, Managing Director of Ultra's Airport Systems business and prior to that a software engineer and project manager from 1994 to 2003. Graeme has developed growth strategies to access new markets in China, the Middle East and Africa and has led the continued growth of Ultra's market share in the transport and energy sectors.

This division is responsible for the following segments:

Aerospace Infrastructure Nuclear

Revenue by segment

Aerospace	17
Infrastructure	4
Nuclear	8

% of Group revenue

Revenue
£203.2m -0.7%

Underlying operating profit*
£32.6m +0.6%

Order book
£283.2m +5.8%

Number of employees
1,244

Strategy in action

PCS received an order worth over $36 million for equipment used on the US Air Force Joint Strike Fighter Aircraft F135 engine. This order was issued under an existing partnership with Pratt & Whitney which sees PCS provide support for the F135 for the life of the programme, or a minimum of 30 years. Based upon the potential production volumes, in-service spares, repairs and additional through-life support, the agreement is valued at approximately $500 million. This significant order underpins Ultra's established long-term relationship with Pratt & Whitney and the value of Ultra's solutions which will be provided over the life of the programme.

P12-13
Ultra's strategies for growth

*see footnote on page **150**

Divisional Managing Director's review

Communications & Security

Communications & Security's 2016 results include a part-year contribution from the ID business, which was disposed of in August 2016. Revenues in the division were impacted by the slowdown in UK spending, with delays to a number of crypto programmes, and by the increase in a number of contracts in the development phase at Herley in the US. Forensic Technology, based in Canada, increased revenues as a result of bullet identification product sales to customers in South East Asia; and TCS, Ultra's Montreal-based military radio business, continued to grow in 2017.

The Communications & Security division currently has a greater proportion of contracts in the early development phase. Consequently, underlying operating margins* reduced to 11.6% compared to 15.3% in 2016. These include the US Navy Surface Electronic Warfare Improvement Programme and an Electronic Warfare contract for the F-15 aircraft platform, which together required investment in excess of £6m in 2017, some of which was unexpected due to the additional SEWIP module wins. The customer-requested pause in a UK Crypto contract also reduced profits in 2017. 2018 margins are expected to be higher than achieved this year.

The division's order book continued to increase, ending the year at £258.7m.

Features of activities in the period that will underpin the division's future performance include:

- The securing of a £16.6m programme to support the provision of advanced surveillance capability until 2019
- A $16.2m contract awarded by the US Department of the Navy to design, develop, integrate and install a variety of cyber-secure systems for critical infrastructure control and monitoring
- The award of an $18m multi-layered surveillance and security system for the oil and gas industry.

Businesses within this division

- 3eTI
- Advanced Tactical Systems
- Communication & Integrated Systems
- Forensic Technology
- Herley
- TCS

Mike Baptist
Divisional Managing Director,
Communications & Security

Mike Baptist brings a wealth of systems engineering and business acumen developed within defence, security and aerospace. He has a track record of major programme delivery, team development and business growth, always seeking to innovate so as to deliver solutions to customers. Mike joined Ultra in 1989 and was appointed Divisional Managing Director of the Communications & Security division in August 2014.

This division is responsible for the following segments:

Communications

C2ISR+

Revenue by segment

Communications	**16**
C2ISR	**19**

% of Group revenue

Revenue

£242.7m **-6.3%****

Underlying operating profit*

£28.2m **-29.0%*****

Order book

£258.7m **+14.0%**

Number of employees

1,295

The division's order book continued to increase, ending the year at £258.7m.

Strategy in action

In 2017 Ultra Electronics' Communication & Integrated Systems (CIS) business was awarded a government ISTAR contract to support the provision of advanced surveillance capability, worth £16.6m over a 26-month period, along with the provision of specialist support over the course of the system's use. Working closely with all stakeholders involved, Ultra played a significant role in understanding the end user's requirements and the industrial supply chain needed to deliver them. Ultra's strong partnership behaviours with the customer, prime OEMs and the broader supply chain were a key factor in the achievement of this contract win.

1 2

P12-13
Ultra's strategies for growth.

+ Command & Control, Intelligence, Surveillance and Reconnaissance

* see footnote on page **150**

** -1.2% compared to 2016 revenue of £245.7m when excluding ID

*** -24.6% compared to 2016 underlying operating profit of £37.4m when excluding ID

Divisional President's review
Maritime & Land

Revenues increased in the Maritime & Land division, driven by higher sales of US and international sonobuoys, and there was a positive FX impact. These helped offset the slowdown in UK spending, where the Command & Sonar Systems business experienced delays to orders that had been expected in the year. Increased torpedo sales to the US Navy from Ultra's Ocean Systems business compensated for strong torpedo countermeasure sales to the Australian Navy by Avalon Systems in 2016. Revenues from the new Indian Navy contract win also contributed this year.

The order book grew significantly over the previous year owing to an Indian Navy contract win and a maritime propulsion system order. Ocean Systems also won a number of countermeasure contracts, including a $10m order from the UK MOD. Ultra's US sonobuoy business, USSI, had a strong order intake year, particularly from international customers.

Within Maritime & Land, underlying operating margins* remained at a high level, ending the year at 18.0% (2016: 18.3%), largely owing to the production phase of a number of US sonobuoy contracts.

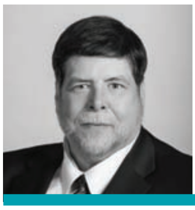
Features of the division's performance in the year that will underpin future performance include:

- A £30m contact in partnership with Mahindra for the supply of the first batch of Surface Ship Torpedo Defence Systems to the Indian Navy
- A £37m programme for the final development and production of a maritime propulsion system
- An initial $8.5m contract for the production of MK48 Torpedo Nose Array subassemblies with options to extend the contract for a further three years that could increase the value of the contract to $18m.

Businesses within this division

- Avalon Systems
- Command & Sonar Systems
- EMS Development Corporation
- Flightline Systems
- Maritime Systems
- Ocean Systems
- PMES
- USSI

Underlying operating margins* remained at a high level, ending the year at 18.0%.



Bill Terry
Divisional President,
Maritime & Land

Bill Terry brings a system oriented perspective combined with strong business acumen, with over 30 years of professional experience predominantly in the maritime domain. Bill joined Ultra in 2011 as Vice President of Engineering before becoming President of Ocean Systems in 2012. In 2015, Bill was appointed President of the Maritime & Land division.

This division is responsible for the following segments:

Underwater Warfare | Maritime | Land

Revenue by segment

43

% of Group revenue

Underwater warfare	25
Maritime	8
Land	3

Revenue
£329.5m +2.3%

Underlying operating profit*
£59.3m +0.5%

Order book
£355.5m +16.7%

Number of employees
1,633

Strategy in action

In October 2017, Ocean Systems was awarded an initial $8.5m contract from Northrop Grumman for the production of MK 48 Torpedo Array Nose subassemblies.

Under this new contract, Ultra will provide Nose Array subassemblies which will ultimately increase the US Navy's inventory of MK 48 torpedoes. The MK 48 is used by all classes of US Navy submarines as their primary anti-submarine warfare and anti-surface warfare weapon. There is a potential for production orders from the US Navy of more than 180 MK 48 Array Nose Assemblies to be delivered over the next three years.

This award reinforces Ultra's position as a leading supplier of MK 48 Nose Array subassemblies and underpins Ultra as a leader in the Undersea Defensive Warfare environment, through the provision of highly complex acoustic products and capabilities to both the US Navy and international customers.

P12-13
Ultra's strategies for growth.

*see footnote on page **150**

Market-facing segments
Aerospace

Manufacturers and operators across both the civil and military aerospace sectors are driving to reduce acquisition and operating costs for aircraft and helicopters. Ultra's innovative solutions, which increase efficiency, improve reliability and increase aircraft availability, are well positioned to support these goals.

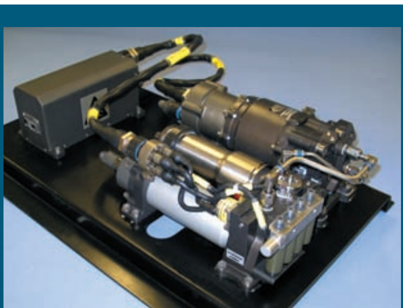
Revenue by segment
Aerospace

% of Group revenue

Ultra's portfolio strength

Ultra's CORE capabilities include:

- Ice protection and detection
- Pneumatic systems and solutions
- Position sensing and control
- Active noise and vibration control
- Health and Usage Monitoring (HUMS)
- Ground handling equipment
- Pilot controls
- Data and power transfer
- Fuel system solutions.



Strategy in action

In 2017 Ultra secured several major contracts for its HiPPAG stores ejection systems. To further augment these systems, Ultra has created an innovative design for high pressure hoses. These hoses allow the carriage of high pressure gas whilst maintaining the ability to flex. This allows the hoses to work across a moving joint, such as a bomb-bay door, without reliability issues. This, coupled with the latest design of HiPPAG, which is able to provide seeker-head cooling and pneumatic stores ejection from the same unit, positions Ultra to provide high-pressure gas solutions for the future stores-management requirements of advanced combat aircraft.

2

Market overview

Commercial aerospace is growing: major manufacturers forecast the need for between 35,000 and 42,000 jet airliners over the next 20 years and order backlogs currently exceed 14,000 aircraft. This growth in platform numbers is driven by the demand for new aircraft in developing regions, while the more established markets require new aircraft to replace ageing fleets as well as to capture greater efficiencies in fuel, emissions and system reliability.

Rising global tensions are leading to an increasing demand for defence and military products. South Korea, Japan, Qatar, the United Arab Emirates (UAE), Saudi Arabia and India have already started to increase budgets for the purchase and development of next generation military equipment.

These acquisitions and developments, along with the ramp-up of the existing major military aircraft programmes, and increased spending in the US, are resulting in growth in this sector.

Market outlook

In the civil aerospace market, a forecast need for over 8,000 wide-body aircraft by 2036 will continue to provide significant revenues for the supply chain. In the wide-body market, dominated by Airbus and Boeing, Ultra has a number of positions on the Boeing 787, Airbus A350 and the A330neo.

The single aisle market is forecast to require nearly 30,000 aircraft by 2036. With new entrants from China, Russia and Canada to compete with the established Airbus and Boeing offerings, it is expected that the market will become increasingly competitive.

Ultra's positions on the Japanese Mitsubishi Regional Jet and the new Chinese MA700 regional turboprop, along with significant value on the Bombardier Q400 aircraft, give good access to the regional aircraft market.

The business aircraft market is set to return to growth in 2018 and will be sustained over the foreseeable future. Ultra has secured positions on business jet platforms, including the Cessna Citation Jets, the Cessna Citation Longitude, and the Gulfstream G500, G600 and G650.

The large helicopter market is dependent on oil and gas rig servicing businesses and is currently impacted by the low price of oil. These businesses are looking to minimise the through-life costs of their helicopters and Ultra's new Health and Usage Monitoring System (HUMS) specifically targets these requirements.

In the military aerospace sector, the fixed-wing combat aircraft market will be dominated for the next 20 years by the increasing build rate and entry-into-service of the F-35 Joint Strike Fighter and its F135 engine. Ultra provides significant content to this aircraft/engine combination including precision pneumatics (HiPPAG) for weapons ejection and the engine inlet ice protection system controller.

Many nations, including Japan, Turkey and India, are now seeking to develop their own aircraft. Ultra has secured several positions on India's FCA indigenous combat aircraft and will continue to seek opportunities in these emerging markets.

In the military transport and special missions aircraft market, Ultra has secured positions on the Embraer KC-390 and on the Airbus A400M, as well as on the smaller Airbus CN235. This market is stable and relatively uncompetitive.

The UAV market remains a crowded sector with many platforms vying for position. Ultra remains interested in the UAV sector, and is focusing its efforts on the larger, more strategic platforms.

Market-facing segments
Infrastructure

Ultra is a trusted international provider and integrator of critical systems and software needed to operate and secure transport and energy infrastructure.

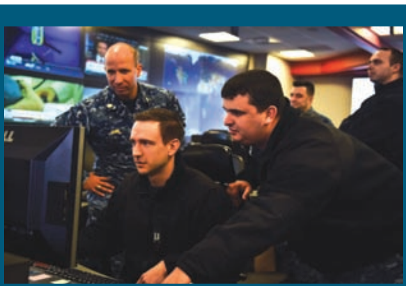
Revenue by segment
Infrastructure

% of Group revenue

Ultra's portfolio strength

Ultra's CORE capabilities include:

- Broad suite of integrated infrastructure offerings spanning airports, rail and energy
- Secure localised network communications for measurement and control
- Protection of critical energy and transport information systems
- Power management and control
- Compact power solutions
- Flexible delivery models; outstanding service reputation
- Integration and domain expertise at both technological and programme level.



Strategy in action

Ultra Electronics' 3eTI continues to deliver security solutions that mitigate both physical and cyber threats, as reiterated by the 2017 award of a US $16.2m modification to a previously awarded cost-plus-fixed-fee contract by the US Department of the Navy. The contract extends Ultra Electronics' services providing solutions to cyber-secure critical Navy infrastructure. These solutions include the cyber hardening of various industrial control systems and electronic security systems in mission essential environments.

1 2

Market overview

Air and rail transportation remains an area of strong investment worldwide. The increase in global air traffic is driving investment in airport infrastructure, although competition in this sector is increasing. Globally, rail infrastructure is also growing rapidly as a key commercial and national enabler in both established and emerging economies. In established economies, infrastructure investment is focused on upgrading existing capabilities and driving economic recovery. In emerging economies, such investment is being used to secure growth and build national capacity. Increasing global demand for energy has led to increased investment in power generation, power distribution, secure power management and the renewables markets. Energy dominates the global trend in smart infrastructure, with Smart Grid and secure energy management lying at the heart of Smart Cities and Critical National Infrastructure. Whilst global infrastructure demand is largely being driven by growing populations in developing countries, at least 50% of the global market for smart solutions lies in Europe and the US.

Market outlook

In the airport sector, the market is still driven by accommodating passenger growth and aircraft deliveries planned for the next ten years. This is achieved by building capacity in North America and emerging countries such as South America and Asia.

Passenger and baggage solutions continue to be commoditised, while secure information systems provide higher returns in opportunities such as situational awareness and data integration.

Ultra will continue to focus upon market intimacy, customer relationships and solutions that deliver value to airports over individual products.

The rail transit power conversion and control market is also anticipated to see significant growth. The commencement of UK Network Rail's Control Period 6 in 2019 and continued investment in inner city tram and metro systems both in the UK and overseas bodes well for Ultra's trackside direct current & alternating current capabilities. However, with the exception of the rail control sector and the drive towards smart digital solutions, the market is becoming increasingly price-sensitive. In the power management and renewables sector, the growing need for compact, power-dense solutions plays to Ultra's capabilities with power resilience, energy storage and fast switching all being key drivers for growth. The secure energy management sector is forecast to see substantial investment, particularly in areas related to secure monitoring, analysis and control. The emergent Smart Grid market relies on the ability to securely identify each connected device. Ultra has now introduced the cyber-hardened critical infrastructure management system that is used to improve site management and performance. Opportunities in the Smart Grid market are likely to remain fragmented until the appropriate regulatory frameworks are established. However, Ultra's broader secure communication and data portfolio places it in a strong position with the Group able to offer the highest level of assurance that can be gained for the storage of unique digital keys and identifiers of devices.

Market-facing segments
Nuclear

Through its global experience with Original Equipment Manufacturers, the domain knowledge of its Suitably Qualified and Experienced Personnel, and its diverse portfolio of qualified safety systems and sensors, Ultra is well-positioned to support the growing market in the licensing, construction and safe operation of reactors and associated research and full cycle markets via a full "defence in depth" approach.

Revenue by segment
Nuclear

% of Group revenue

Ultra's portfolio strength

Ultra's CORE capabilities include:

- Extensive pool of Suitably Qualified Experienced Personnel (SQEP)
- Nuclear safety system expertise
- Qualified reactor instrumentation and control
- Radiation detection sensors
- Nuclear energy management systems
- Nuclear operational support
- Nuclear rod control for submarines.

Strategy in action

In 2017, NSPI was awarded a high priority contract for one of Bechtel's US sites which included designing and delivering a first-of-a-kind sensor for a specialised process control system. Ultra's NCS and NSPI businesses have been working with Bechtel over a number of years for similar projects and see future opportunities with them in the nuclear and other energy markets.

Market overview

There were over 445 commercial nuclear power reactors operating in 29 countries worldwide at the end of 2017, providing over 11% of the world's electricity as continuous, reliable, base-load power and they remain an important part of the low carbon energy mix. In addition, 56 countries operate around 240 civil research reactors, with many of these in developing countries. Globally, there were 61 new reactors under construction. Many of the new builds are being developed within emerging economies and in those countries where there is substantial state backing. However, the emphasis in established Western markets has largely shifted to a shorter-term focus on safety system upgrades, life extensions, emergency management and plant sustainment programmes. In addition to this, the UK is proceeding with a new commercial model it has pioneered in support of new nuclear build ambitions. The nuclear market is generally very conservative and supported through large multinational organisations; however, there remain several complex niches served by smaller specialist companies. It is a highly regulated market, with high barriers to entry, and as such is dominated by a number of well-established global players. The qualification of sensors and products across multiple standards and platforms is extremely expensive and offers further barriers to entry once established.

Market outlook

Although the nuclear market is a long-cycle one, the outlook is positive. Much of the current global fleet of plants will need life extensions and upgrades. These plants are largely older analogue Instrumentation and Control (I&C) designs, with the biggest market by far being the US. The new build, digital I&C market, currently dominated by China, India and Russia, is of a similar magnitude. Ultra has invested significantly in new facilities for the testing, development and manufacture of sensors. This has shown its value through further contract wins with EDF for the provision of specialist sensors and, with the Strategic Partnership announcement with NuScale, to develop a suite of reactor and plant I&C systems for their Small Modular Reactor (SMR). The Group currently provides equipment to over 190 reactors across 17 countries, plus another 28 reactors under construction. Ultra is uniquely qualified on eight new types of plants (as well as many legacy plants), meaning that it is well positioned for the future. Growth in the nuclear emergency management market continues and is prompted by the Fukushima accident, which caused a global reassessment of post-accident response and support needs. The decommissioning and clean-up of legacy reactors and fuel cycle plants, which utilises qualified instrumentation and radiation sensors, is also expected to see further growth. Ultra's experience with global standards and various platforms positions the Group well for these new opportunities.

1

Market-facing segments

Communications

Ultra is well-positioned as one of the most trusted and respected providers of specialised secure communication capabilities in the world offering advanced, interoperable solutions that are scalable and low-risk.

Revenue by segment
Communications

% of Group revenue

Ultra's portfolio strength

Ultra's CORE capabilities include:

- Encryption and key management solutions
- Data link systems
- High-performance, high-reliability radio and wireless systems
- Secure voice, video and data communication platforms
- Secure wireless mesh networking
- Fixed, mobile and transportable satellite earth stations
- Identification and autonomous guidance products
- Airborne communication exchange
- Personal protective gear communications
- Acoustic hailing devices
- "Through the earth" communications.

Strategy in action

Ultra's Multi-Data Link Management System (MDLMS) is a real-time tactical data link interoperability system capable of operating in a stand-alone or integrated maritime environment. ATS was awarded a contract to deliver the MDLMS to three destroyers for the Republic of Korea Navy. ATS's offering provides the ability to communicate tactical information over a secure, jam-resistant data link using the latest Link 16 radio terminals. This key, regional, strategic win enables ATS to be well positioned to provide more systems in the next class of Korean destroyer planned in 2019.

Market overview

The communications market is broad and spans: airborne, air-to-ground, ground-based, underwater, and ship-borne communications, each encompassing a wide and diverse range of requirements and capabilities. There is continued demand for increased bandwidth and broader connectivity, coupled with a need for multi-platform and multi-user interoperability within both the military and security sectors.

Security is a driving factor across networked communications and is especially important whilst nations seek to modernise their systems using a combination of commercial and bespoke solutions.

The ability to deliver security across real-time voice and data with ad-hoc mesh capabilities has become essential. This is driving investment in a market where proven designs, which can be integrated with existing equipment and are secured from threat actors yet interoperable with allies, are preferred.

Market outlook

The increased transfer of data and its translation into useable information continues to envelop all aspects of military, security and commercial operations. The secure provision of data that is available where and when it is required, in a useable format, continues to push the boundaries of technology. Ultra's communications portfolio supports this need through a multitude of capabilities: satellite systems, data link systems, encryption solutions, radio communication systems and specialist niche systems.

Software-defined solutions such as the Ultra ORION family of radio systems can provide at-the-quick-halt and on-the-move communications across multiple military echelons. Being based on a software-defined radio platform allows the Ultra ORION to maximise flexibility to support various missions while reducing training costs and supporting logistics.

Similarly, in the data link communications market, in which Ultra's position remains strong, its wide range of advanced air and ground solutions answer the growing demand for secure tactical and full-motion video links.

Securing communications has become a necessity and Ultra's ability to understand how technology can best support this market means the use of technical skills and products from link to Internet Protocol (IP)-based cryptographic solutions will continue to grow. Following the market shift to develop new electronic encryption key distribution and management systems, Ultra has a unique position with proven solutions for both commercial and US and UK government requirements.

The 'Internet of Things' (IoT) continues to expand the amount of networked devices and, as we control more of the physical world with IT, the merge between cyber and physical threats will continue to emphasise the need for resilient solutions that securely connect and communicate across them. Ultra's proven certified security portfolio is well placed to deliver cyber defence across all communication domains.

The trend towards greater connectivity and networking continues to persist, driving significant further investment in military, security, critical national infrastructure and commercial communications.

3 4

Market-facing segments
C2ISR

As a trusted supplier of innovative surveillance and security solutions to government and commercial customers, Ultra is well positioned to exploit this growing market.

Revenue by segment
C2ISR

% of Group revenue

Ultra's portfolio strength

Ultra's CORE capabilities include:

- Surveillance solutions for critical national infrastructure, coastal and border security needs
- Covert surveillance solutions
- Command and Control systems (C2)
- Airborne surveillance and targeting
- Electronic Warfare (EW) solutions, EW simulators and radar test systems
- Document examination systems
- Ballistics and crime scene analysis.

Strategy in action

ATS was contracted to provide the Programme Executive Officer of the US Land Systems Marine Corps with its Virtual Air Defense System Integrator (vADSI). These systems will provide the Marine Corps with the ability to process tactical data while automatically correlated with air and ground targets, thus enabling enhanced decision making at tactical operations and intelligence centres. ATS has worked closely to ensure that the Air Defence C2 requirements have been met through both reliable and technical solutions and an understanding of the importance and complex needs of tactical air defence.

Market overview

As interconnected, networked data is continuing to be collected from a burgeoning amount of sensory equipment, the necessity to receive, understand, filter and transmit this data into timely, useable information is paramount to government, security and critical national infrastructure operations.

Within defence C2ISR remains a priority capability within global budgets due, primarily, to the increased importance and investment in modern warfare systems. The application of C2ISR solutions across a variety of platforms as the principal mechanism for early or urgent delivery of military effect continues to drive the demand for intelligence, surveillance, target acquisition and reconnaissance (ISTAR).

The increased capability, and resulting data, offered by sensor and communications solutions means that the ability to collect data is close to ubiquitous, so the market increasingly shows a need to be able to manage and represent this data in a meaningful way as information.

Alongside operational defence needs, global security threats and the interconnectivity of networked physical and IT devices increases the importance of C2ISR in the wider border security and critical national infrastructure (CNI) protection markets.

Interoperability, mobility and a single integrated useable picture can deliver timely situational awareness that makes a real difference to combating threats and saving lives.

Market outlook

The increased transfer of data and its translation into useable information continues to envelop all aspects of military, security and commercial operations. The secure provision of data that is available where and when it is required, in a useable format, continues to push the boundaries of technology. Ultra's C2ISR portfolio supports this need through a multitude of capabilities for both military and civil applications, providing the accurate and timely exchange of voice, video and data to military, government, law enforcement agencies, industry and commercial customers in support of the planning and execution of complex and critical operations at all levels of the command structure.

The ability to fuse or correlate data streams into a single real-time integrated picture that can be disseminated to the lowest level will drive growth in real-time ISTAR solutions (for both manned and unmanned platforms) and the connectivity between assets in the battlespace.

Ultra's leading data fusion, situational awareness and visualisation systems will continue to play well to this growing need.

Cyber Electromagnetic Activities (CEMA) is growing the need to be able to understand and accommodate both radio and IP data into single operational views. Ultra's portfolio spans the development of sensors, communication solutions, and data management techniques that use proven software and artificial intelligence (AI) solutions.

People and data will continue to move throughout the world. Whether following the economic and political boundaries or cutting across them using interconnected networks, the need to enforce the law and mitigate illegal activities will continue to grow. Ultra's ability to understand this ever-changing data-driven world helps it to provide solutions that meet the growing needs of government, critical national infrastructure and commercial customers.

Market-facing segments
Underwater warfare

Ultra is renowned for its world-leading domain knowledge, acoustic technical expertise and ability to provide leading technology in underwater warfare performance through rapidly delivered, modular, affordable and reliable solutions.

Revenue by segment
Underwater warfare

% of Group revenue

Ultra's portfolio strength

Ultra's CORE capabilities include:

- Expert knowledge of acoustic system performance in the maritime domain
- Design and manufacture of air deployable sonobuoys
- Sonar transducer and towed array design and manufacture
- Design and manufacture of acoustic countermeasure for torpedo defence
- Sonar processing, display and decision aids
- Recognised integrator of complex sonar systems both towed and hull-mounted.

Strategy in action

Ultra has a long history of providing sonobuoys designed to be deployed from large manned aircraft and helicopters. In 2017, Ultra began development of a new class of miniature active and passive sonobuoys. In parallel, work commenced with Marshall Aerospace and Defence to develop a lightweight 'pod' that could not only carry the miniaturised sonobuoys, but also the radios and processor required to capture, analyse, and transmit underwater target data to a command and control centre. Ultra officially launched its miniature sonobuoy and pod system for UAVs in September 2017 and has received widespread interest. Development continues as flight trials have commenced with several major UAV primes to help develop a concept of operations for this new capability.

Market overview

Western nations' traditional adversaries, Russia and China, have made rapid and large scale submarine investment a cornerstone of their strategy to project power. Numerous smaller nations are also rapidly procuring submarines in an effort to cost-effectively protect their national interests. This growth in submarine capability is no longer offset by what was once western underwater warfare technological superiority and investment in anti-submarine warfare (ASW) has become a top priority for many nations.

The underwater battlespace is complex and the never ending improvements in stealth and the increased submerged endurance of the modern submarine has been a catalyst for the development and procurement of a new generation of airborne ASW sensors, warship and submarine sonar systems and advanced torpedoes to detect, track and defeat these underwater antagonists. More emphasis is being placed on countermeasure systems that can be used to jam or decoy incoming torpedoes as a last layer of defence for both ships and submarines.

Underwater warfare is a key market for Ultra. Ultra continues to invest substantially in ASW technology and is already recognised as the world's pre-eminent supplier of expendable sonobuoys and torpedo countermeasures.

Market outlook

The end of the land-based conflicts in Iraq and Afghanistan coupled with an aggressive push by Russia and China to extend their naval spheres of influence has signalled a renewed focus on naval recapitalisation. It is expected that the underwater warfare market will continue to grow significantly over the next decade, driven by a strong demand for new ASW-oriented surface combatants globally. Nations are increasingly spending on on-board complex electronics and off-board sensor systems compared to the previous generations of vessels.

US defence spending continues to dominate the military marketplace and ASW and submarines remain areas of preferential spend with increased budget allocation. The US continues to build two Virginia Class SSNs per year and has taken delivery of more than 50 P-8A maritime patrol aircraft to the US Navy as well as awarding contracts to upgrade both light and heavyweight torpedoes. Ultra is a major sonobuoy supplier with annual revenues exceeding £100m and a forecast steady growth rate of 2 to 3% as new platforms become operational.

Elsewhere, several countries have embarked on a major recapitalisation of their ASW frigates. In all, western navies will start construction of more than 30 warships over the next decade and all will be assembled with a significant emphasis on ASW. In the addressable Asia-Pacific market, spend related to ASW systems, including towed torpedo defence solutions, is projected to increase from an estimated £400m in 2018 to over £0.5bn in 2022. India alone intends to award at least two major ASW-related programmes totalling in excess of £100m over the next three years.

Ultra continues to invest in new ASW technology to meet the market needs. Research and development is underway on new active and passive transducers, thin-line towed arrays, miniature sonobuoys and launch mechanisms, enhanced countermeasures, and improved target detection and tracking algorithms.

Market-facing segments
Maritime

Combining its expertise in power electronics and open architecture design, Ultra provides innovative, scalable, and affordable solutions to meet customer needs in signature management, power-dense motors and electronics, Electro-Optic (EO) tracking systems, surface search radars and command, control and navigations systems for maritime platforms.

Revenue by segment
Maritime

% of Group revenue

Ultra's portfolio strength

Ultra's CORE capabilities include:

- Magnetic and electric signature management for naval vessels worldwide
- Specialist power dense motors and drives
- Power conversion and control management
- Nuclear rod control
- Stable positioning for precise EO tracking on moving platforms
- Customised command, control and navigation systems for small ships
- Next Generation Surface Search Radar (NGSSR).

Strategy in action

In 2017, Ultra received a contract to use High Temperature Superconducting (HTSC) technology in support of the US Navy's Unmanned Influence Sweep System (UISS), a mine countermeasure system designed for use against magnetic and acoustic mines. Ultra continues to differentiate itself from its competitors through the exploitation of HTSC technology and is adapting HTSC for use in shore-based deperming facilities. These installations are used to reduce the permanent magnetic field properties of warships and submarines and the use of HTSC technology greatly reduces shore-based power requirements. Furthermore, the lightweight cabling enables the ship or submarine to be prepared for deperming much more quickly; thereby increasing platform operational availability.

Market overview

World tensions continue to grow in the maritime domain, as Russia, China, North Korea and Iran are all challenging the established sea lanes through their desire to employ a naval presence to control strategic areas of the world's oceans. This has sparked increased naval spending in the procurement of new platforms and the extensive modernisation and re-armament of existing warships. The UK, Australia, and Canada have recently adopted national shipbuilding strategies with a view to stimulate long-term new ship construction to meet evolving threats. In the US, the Trump administration has made a 355 ship navy an election promise and requirements have been established for a new frigate with specific focus on increased lethality and survivability.

Submarine production has increased around the globe. Australia has recently awarded a contract to build new conventional submarines and the US and the UK have both commenced construction of their new strategic deterrent submarine fleets. In other parts of the world the requirement for increased maritime capability is clear, but fiscal constraints are driving the desire for life extensions to existing platforms through cost-effective capability upgrades. Consequently, the demand for system/sensor upgrades and technology insertion programmes on existing vessels is growing, particularly for navies in emerging nations. There is ongoing pressure to establish an indigenous capability as part of any new production or modernisation programme. Hence, technology transfer is becoming an increasingly important factor to win work in the export market.

Market outlook

The Maritime segment is a growing market where Ultra has developed and maintains certain highly differentiated technologies that support niche applications. In the UK, Ultra continues to provide in service support to the Type-45 destroyers and Type-23 frigates. The US Navy has several active warship production programmes in its quest to reach a 355 ship Navy and Ultra is well-positioned on a number of these programmes, including Flight III of the Arleigh Burke guided missile destroyers (DDG-51) and replenishment naval vessels (T-AOX). With the requirement definition of the US Navy's Future Frigate just being completed, Ultra is well-positioned to supply a myriad of unique power and signature management equipment to this new warship class. The US Navy has been funding Ultra to develop the next generation of surface ship radar for a number of years. The recent spate of at sea collisions involving US warships has been an impetus to accelerate the technology development and introduce an enhanced surface search radar capability into service as soon as possible.

Elsewhere, Ultra is beginning the transition from the design and qualification of new development technologies into the production phase on a number of significant programmes such as the Virginia Class Submarine (VCS), where long-term production is well funded, and the new Columbia Class SSBN, which is projected to provide 12 new hulls beginning in 2021.

Ultra has followed up on its success in the Indonesian Navy's Fatahillah modernisation programme by winning a number of international tenders in Turkey, the Philippines, Australia and Canada to support both new construction and updates to existing platforms, underpinning the continuing demand for warship system and sensor upgrades and this plays well to Ultra's strength of being able to partner with local industries to provide cost effective and differentiated naval solutions that meet the customers' needs.

Market-facing segments
Land

Ultra has specialised in-depth knowledge and experience of implementing Land Open Systems Architecture which define the integration of power, data and video for vehicles, soldiers and bases.

Revenue by segment
Land

% of Group revenue

Ultra's portfolio strength

Ultra's CORE capabilities include:

- Vehicle systems
- Soldier systems
- Power systems
- Information systems
- Control systems
- Mission systems
- Electronic architectures
- Operating base solutions.

Strategy in action

In September 2017, Ultra launched the innovative UltraLYNX soldier-worn electronics system. Through in-depth knowledge of the UK Generic Soldier Architecture (GSA) standards, and by listening carefully to customers worldwide, Ultra has developed a standard, capable and flexible smart hub and integrated connector system which can be readily and quickly customised to individual customer requirements.

The unique "smart hub" approach that Ultra has taken with UltraLYNX has resulted in intense interest from customers worldwide, including ongoing evaluations by the British and US Army, US Marine Corps and British and US Special Forces. Police and Fire Services are also customising and evaluating UltraLYNX for their specific use cases.

Market overview

Mounting instability and unpredictability in the Philippines, Ukraine, North Korea, and Syria are driving market demand for armoured vehicles. Growing demand from western nations is underpinned by the increased US defence spending in conjunction with the call for NATO members to increase their defence spending.

The rising likelihood of state-on-state warfare has generated requirements for lighter tanks, equipped with sophisticated weapon systems so as to achieve increased lethality. There is an increased demand for armoured personnel carriers, mine-resistant ambush protected (MRAP) vehicles and unmanned ground vehicles, all with increased lethality, survivability, interoperability and reliability. Improved communications, situational awareness and vehicle information integration are all prominent requirements for interoperability for both new and back-fitted vehicles.

The concept of the dismounted soldier as an effective electronics and weapons platform is now widely accepted. Requirements have been developed in several countries to maximise dismounted situational awareness and associated lethality. Ultra is also involved in initiatives to improve soldier-machine interfaces both when within the vehicle, as well as when dismounted and remote from the vehicle.

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Market outlook

For military vehicles, Ultra has the full range of skills and a proven track record, to act either as an integrator of Vehicle Electronics Architecture (VEA), or as an electronics sub-system supplier to vehicle Primes. Ultra has a wide product range of VEA subsystems and is actively addressing the growing worldwide market for high technology vehicle electronics for existing vehicle upgrades and new vehicles.

As part of the "Army 2020 Refine" programme, the British Army is currently undertaking work on many of its vehicles, all within the next five-year period. This includes upgrades and extension programmes on existing platforms such as the Warrior Capability Sustainment Programme (WCSP) and the development and delivery of new vehicles such as the Ajax development programme. Ultra has positioned itself on both platforms and is actively pursuing positions on new vehicles in other high-growth markets including Turkey, Saudi Arabia, UAE, India, Poland, Ukraine and Australia.

The US military vehicle market continues to be large with wide ranging requirements including upgrades to the mature Abrams Tank and Bradley vehicles, as well as new research and development programmes such as the Armored Reconnaissance Vehicle (ARV), Mobile Protected Firepower (MPF), Next Generation Combat Vehicle (NGCV) and Maneuver Robotics and Autonomous Systems (MRAS). Ultra is pursuing niche positions on all of these platforms.

2017 Principal risks and uncertainties

Analysing and managing uncertainty

Effective risk management is a fundamental aspect of Ultra Electronics' operating, financial and governance activities. The Group continually analyses the risks it faces and assesses the effectiveness of its response to these risks within the control environment. This means that Ultra is able to give early consideration to emerging risks and this helps it to deliver on its commitments, improve long-term performance and enhance its reputation in the market.

Profitable growth cannot be achieved without some degree of considered risk and the Group's objective to generate long-term shareholder value is reflected in Ultra's appetite for risk. Ultra's principal risks reflect the high priority it places on compliance with all legislative and regulatory requirements and the maintenance of high ethical standards across the Group, its supply chain and in its dealings with its customers. The Group's strategies for growth centre on delivering change programmes that support the agility of Ultra's businesses, encouraging an entrepreneurial culture of innovation in its people by having a diverse range of skills and capabilities amongst the Group's employees. Ultra has a low-risk appetite in situations where its culture, reputation or financial standing may be adversely affected. However, the Group does consider taking higher risks where the opportunity is seen to outweigh the potential negatives, provided appropriate levels of mitigating controls are in place. Where safety may be compromised, Ultra has zero tolerance to risk.

Risk management and internal control
The Board has overall responsibility for establishing, monitoring and maintaining an effective system of risk management, governance and internal controls. The Board reviews risk as part of its annual strategy review process and risk management is a regular feature on Board meeting agendas. This provides the Board with an appreciation of the key risks within the business and oversight of how they are being managed. The responsibility for risk oversight is principally delegated to the Audit Committee with the ongoing review and challenge of risk management information provided by the Executive Team.

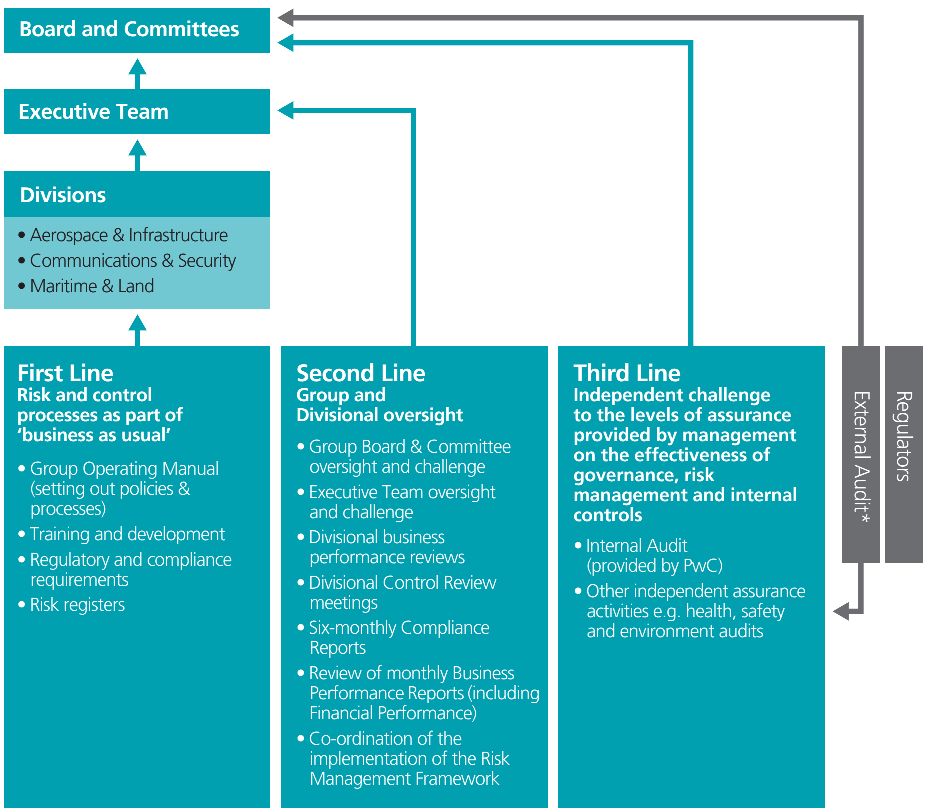
Risk management
The approach to risk management across the Group is to focus on the early identification of key risks thereby reducing the likelihood of the risk occurring and mitigating the effect of any potential impacts. Over the past year, Ultra has continued to develop the role of Risk Champions at all levels of the business so that it has early visibility of any emerging risks across different market segments and business units. The work of the Risk Champions is supported by the following enhancements which have commenced or been implemented during this reporting period:

- An in-house Group Risk and Compliance Manager was appointed to provide ongoing development and coordination of the risk management framework and to consolidate, challenge and report on all risk management information. Risk is a standing agenda item at the Audit Committee, and the culture of openness is enabling emerging risks to be highlighted at Board level
- Deep dive reviews were undertaken in respect of information security, pensions and delivering change. They included a robust review of existing controls, comparison to industry benchmarks, consideration of any changes in internal and external factors and the organisation's response to these changes. The output of the reviews was an evaluation of the mitigation measures, reassessment of the risk and its impact on the organisation's strategic objectives
- A watching brief is being maintained in respect of the economic and political uncertainties in Ultra's key markets so that it responds effectively to the new realities if there are potential impacts to business
- The risk appetite metrics were reviewed and updated to reflect measures that provide the organisation with a clear view on how much risk it is exposed to so that risks are taken strategically
- An assessment of the Group's aggregate risks was undertaken by the Board.

The risk management focus in 2018 will be on:

- Embedding the Risk Management Framework at business level to ensure consistency in the reporting and escalation of risk across the Group and to further embed a risk culture
- Conducting deep dive reviews of principal risks on a rolling basis.

The risk management process



*provided by Deloitte

2017 principal risks and uncertainties

Risk Management Framework

The Risk Management Framework governs the approach Ultra takes to managing risk effectively. The cultures and behaviours inherent within Ultra (see pages **48-53**) ensure risk consideration and commitment to proactively managing risk is embedded into the way it operates.

The Group's risk management process is set out in the Risk Management Framework and facilitates the achievement of the following objectives:

- Identification, measurement, control and reporting of risk that can undermine the business model, future performance, solvency or liquidity of the Group
- Allocation of resources for the management of principal and emerging risks
- Assurance from management that a particular risk is owned by the individual best positioned to control/mitigate that risk
- Driving business improvements and provision of enhanced intelligence for key decision making
- Support and development of Ultra's reputation as a well governed and trusted organisation.

The key components of the Risk Management Framework are:

Oversight structure and accountability

The risk management oversight structure has been developed using the principles of the 'three lines of defence', which ensures risk is considered from both a top down and a bottom up perspective, with risk information captured at strategic, divisional and individual business levels.

Process

The risk management process is focused on risk identification (using cause and effect analysis), inherent (pre controls) and residual (post controls) assessment, control identification and the development and implementation of further mitigation strategies.

Escalation, monitoring and reporting

Changes to risk exposure are notified through the governance structure as required. Risk leads are identified for all risks and they have responsibility for the ongoing monitoring of the effectiveness of current controls and the progress against the implementation of further mitigating actions. The risk reporting flow is based on a combination of annual, bi-annual, quarterly and monthly reporting to the Board, Audit Committee, Executive Team and divisional/individual businesses' management teams.

Risk management in operation

Cyber Security

Globally, the scale and pace of cyber security incidents has seen a dramatic rise in 2017 with a significant increase in ransomware attacks against organisations and institutions. In addition, the introduction of the General Data Protection Regulation (GDPR) in May 2018 will increase the impact resulting from a cyber breach of personal information. To ensure that Ultra's response to the risk is adequate, internal and external factors that could make the Group vulnerable, including why it may be targeted and how a successful attack might impact the Group, were considered.

Understanding Exposure and Controls

The deep dive review focused on understanding the type of data Ultra manages, and why and where it holds the data. The focus was not just within the organisation but also across suppliers, cloud service and critical data feeds. Ultra also commissioned an independent review of the effectiveness of its controls in relation to the level of threat that it faces and its alignment with industry practice.

Incident Preparedness

The review of preparedness to deal with incidents considered the Group's flexibility and responsiveness as well as dwell time for malware containment. External training was provided to the senior management team focusing on the key vision for the business and its strategic goals together with blockers which had the potential to slow progress.

Overall risk exposure

Following the Cyber Security independent review and deep dive, the overall severity of the risk remains unchanged.

Delivering Change

Ultra Electronics is making significant investments in new infrastructure to replace legacy systems and standardise indirect procurement activities. Other change initiatives include the consolidation of some of Ultra's business units. Given the perceived impressions that major change projects are overly ambitious on their costs, time to complete and achievable benefits, a deep dive was conducted on this risk and S3 was used as the basis for the case study.

Understanding controls and validating benefits

- S3 is an initiative set up to seek to identify costs savings across Ultra from standardising various back office functions, improving the buying power of the Group whilst maintaining the autonomy and agility of the Ultra businesses
- The deep dive review focused on the challenges and areas of concern related to the scale and complexity of the change initiative, the Group's ability to realise the expected benefits as well as its resilience and readiness in maintaining 'business as usual' during the transformation phase
- In addition to the deep dive, the effectiveness of existing controls was reviewed and independent external assessment of the business benefits and robustness of the governance process was undertaken. This included feedback focus groups, Executive Team governance over major change programmes and the auditable and consistent realisation of benefits
- Improvements were recommended for extending good practice on controls and processes across major change programmes. Business benefits realised to date were independently verified and recommendations on improving the collation and communication of business benefits were agreed.

Overall risk exposure

Following the deep dive review, it was agreed that the overall severity of the risk following the deep dive remains unchanged as S3 initiatives are being delivered and business consolidations take effect.

Principal risks

Following the November profit warning, the Board and Executive Team have implemented enhanced controls and procedures in certain specific areas, including strategic planning and forecasting. In addition, oversight and management of risk has been further strengthened with the appointment of an in-house Group Risk & Compliance Manager. The process of setting up a Risk Committee (as a formal sub-committee of the Executive Team), is underway and will be chaired by the Executive Team. The Group's robust response to the events in 2017 means that the principal risks and uncertainties which potentially materially impact the Group's performance have not changed significantly from those set out in the Group's 2016 Annual Report & Accounts. Each principal risk continues to have an Executive Team risk lead allocated to it.

In the year, the Board considered the impact of political and economic uncertainties in its major markets and the potential risks and opportunities these may have for the Group. These include: emerging risks and opportunities arising as a result of the UK's decision to leave the EU; challenges to some of the long-standing political and economic conventions in the USA; and geopolitical tensions and concerns in the former Soviet Union, on the Korean Peninsula and elsewhere. A working group which reports into the Executive Team has been set up to monitor the development of these external factors in relation to Ultra's principal risks. At present, the Group's risk exposure remains largely unchanged by these factors.

The Group's principal risks are set out below and on the following pages with details of their potential impacts, examples of the current controls and mitigation actions taken to manage the risk and an indication of whether the risk exposure is increasing, decreasing or largely unchanged.

No.	Principal risk	Trend
Risk 1.	Growth	→
Risk 2.	Delivering change	→
Risk 3.	People & culture	→
Risk 4.	Information management & security	→
Risk 5.	Supply chain	→
Risk 6.	Governance & internal controls	→
Risk 7.	Pensions	↓
Risk 8.	Legislation/regulation	↑
Risk 9.	Health, safety & environment	→

Risk 1. Growth

Trend: No significant change

Changes during 2017

Although the defence market has been challenging in recent years, there are strong indications of a return to growth, particularly in the US, as indicated by the Group's strong order book going into 2018. Political and economic circumstances in some of the Group's key markets mean that it is cautiously optimistic about any return to organic growth. The Company's focus in the year continued to be on its market-facing segment strategies, improving its planning for future political and economic developments in its key markets, and exploiting the anticipated market upturn.

Description

Ultra's strategic objective for year on year growth requires: the ability to respond to changing market dynamics; the capacity to win new business and deliver successfully against contracted customer requirements; the development of highly differentiated solutions to address customer needs; and the ability to select, execute and integrate acquisitions effectively.

P10-13
Ultra's business model and strategies for growth

Potential impact of failure:

- Poor investment decisions leading to inadequate returns
- Reduced business opportunity and loss of reputation, customers, market share, revenue and profit
- Specialist capabilities eroded through commoditisation
- Reduction in anticipated acquisition value through overpayment, non-delivery of synergies and/or economies of scale and senior management focus diverted away from delivering "business as usual".

Mitigations (examples):

- The Group is offsetting challenges in the UK defence market by expanding in targeted overseas regions that exhibit long term growth characteristics
- The market-facing segments enable Ultra to remain competitive and use the capabilities of its businesses to deliver enhanced solutions more effectively to its customers
- Improving the capacity and capability of the Group's sales and marketing teams using the LAUNCH approach and providing training
- Establishment and implementation of rigorous gate reviews of risk appetite for major opportunities so that acceptable margin levels and risk tolerances are maintained
- The Board conducts a rigorous review of acquisition opportunities including commissioning third party market reports and due diligence. Post-acquisition reviews are performed on all acquisitions comprising integration effectiveness, operational performance compared to expectation and lessons learned
- A working group reporting to the Executive Team has been established to evaluate the impact of recent geo-political events on Ultra.

2017 principal risks and uncertainties

Risk 2. Delivering change

Trend: No significant change

Changes during 2017

The scale and complexity of change has increased as S3 initiatives and business consolidations take effect. S3 has adopted a multi-faceted and proactive communication strategy and recruited specialist skills to augment Group talent in key roles.

Description

Effective delivery of major change programmes with minimal effect on business as usual is a key component of Ultra's continual drive for operational improvement.

P22-23
Strategy for standardisation and shared services (S3)

Potential impact of failure:

- Expected benefits of change not realised
- Significant increase in change programme costs
- Senior management distraction from business as usual
- Reduction in employee morale
- Disruption of business performance.

Mitigations (examples):

- An Executive Team sponsor is allocated to all major change programmes which are also monitored on a monthly basis by the Board
- Recommendations arising from the deep dive review and external review conducted in 2017 are being considered for implementation
- An S3 steering committee, chaired by the Group Finance Director, meets monthly to track progress against the plan
- An S3 Communications Manager has been recruited with responsibility for implementing the communications strategy approved by the S3 steering committee.

Risk 3. People and culture

Trend: No significant change

Changes during 2017

Ultra's culture and how it is reflected across its businesses has been the subject of discussion at both the Board and Executive levels, especially in the last quarter of 2017. Talent and succession planning remained a focus for the Executive Team in 2017 and remains on the Board's agenda as an area of focus in 2018.

Description

Preserving Ultra's culture (underpinned by its behaviours of LEAP: leadership, entrepreneurship, audacity and paranoia) and attracting, developing and retaining the right people who have the domain expertise and who embrace Ultra's culture is critical to the Group's strategic objectives.

P46-57
Sustainability, people and culture

P48-53
Developing Ultra's people

Potential impact of failure:

- Not recruiting and retaining the right employees in the right roles would result in Ultra being unable to fulfil its contractual obligations and would lead to operational inefficiencies and loss of productivity
- Staff morale could be impaired resulting in a rise in employee-related issues (e.g. grievances and sickness)
- Failure to maintain a strong ethical culture would increase the Group's exposure to legal and regulatory breaches.

Mitigations (examples):

- Ultra continues to engage in a number of initiatives with local schools, colleges and universities to gain access to the best people for its apprenticeship and graduate recruitment programmes. This enables Ultra to grow a broad range of skills and capabilities and to remain successful at innovating to meet customers' needs
- Ultra's people and their development are fundamental to Group success. Employee development needs form part of performance and development reviews and are aligned to employees' specific needs
- Employee engagement and morale is measured through YOURviews surveys. The leadership teams in the businesses use the survey to address any areas of concern so that Ultra's people remain engaged and committed
- Talent and succession planning has been, and will continue to be, a focus for the Board
- The annual Organisation, Succession & Development Plan (OSDP) results in high-potential employees being identified and their development monitored.

Principal risks continued

Risk 4. Information management and security

Trend: No significant change

Changes during 2017

The CORVID Protect and Ultra approach to security provides a high level of assurance. The global increase in the incidence and sophistication of cyber security crime means this risk continues to be a priority for the Company. As such, this risk was the subject of a deep dive review in 2017.

Description

The incidence and sophistication of cyber security crime continues to rise. The effective management and protection of information and Ultra's IT systems is necessary to prevent the loss of data and the disruption of operations.

P39
Cyber security case study

Potential impact of failure:

- Reduced product differentiation caused by loss of intellectual property
- Reputational damage to Ultra as a highly regarded provider of secure data systems
- Loss of business opportunity with removal of government approval to work on classified programmes
- Disruption of business activity as systems are cleansed and restored.

Mitigations (examples):

- The Group's information security is provided through its continued investment in Ultra's Cyber Protection Group (part of CORVID Protect). It provides Group-wide monitoring, incident response and continued enhancement of Ultra's IT systems and processes
- The Board is kept updated on how CORVID Protect secures Ultra's network, including protecting Ultra from phishing attacks
- The Group's Information Security Policy is being updated to reflect GDPR
- Recommendations arising from the deep dive review have been implemented
- Intellectual property is addressed in the bid and contract management process and protected through information security
- Security clearance processes are in place for all employees
- Established physical security processes are implemented at all sites.

Risk 5. Supply chain

Trend: No significant change

Changes during 2017

The level of risk remains unchanged in the year.

Description

The Group relies upon suppliers and subcontractors to deliver upon its customer commitments. Ultra's supply chain needs to be efficient to maintain margins and to be compliant with legislation.

The Group's manufacturing facilities are exposed to natural catastrophe risks and the Group is exposed to social, economic, regulatory and political conditions in the countries in which it operates.

P46-47
Sustainability

P22-23
Standardisation and Shared Services (S3)

Potential impact of failure:

- Failure to deliver against customer commitments
- Reduced profit margins and increased contractual disputes and litigation
- Loss of reputation and investor confidence.

Mitigations (examples):

- Using the visibility created by S3 deliverables to consolidate the supply chain and to leverage the commercial scale of the Group
- Building ongoing partnerships with strategic suppliers and managing major supplier risks and issues (including single source arrangements) through the bid management and contract management policies
- Establishment of regional procurement councils to target the optimisation of Ultra's supply chain for Direct Procurement
- The Board's commitment to compliance with the Modern Slavery Act 2015 is contained in the Anti-Slavery and Human Trafficking Statement (**www.ultra-electronics.com/investors/anti-slavery-and-human-trafficking-policy.aspx**)
- Business continuity and disaster recovery plans are in place
- The Group has business interruption, property damage, professional indemnity and product liability insurance.

2017 principal risks and uncertainties

Risk 6. Governance and internal controls

Trend: No significant change

Changes during 2017

Ultra does not consider that the level of risk has changed in the year even though the role of Chairman and Chief Executive is being performed by the Group's Executive Chairman until a new Chief Executive is appointed. This is due to the effectiveness of existing controls, ongoing mitigations and the broader perspective provided by the appointment of two new Non-Executive Directors in 2017.

Description

Maintaining corporate governance standards as well as an effective risk management and internal control system is critical to supporting the delivery of the Group's strategy.

P**61** and **68**
Governance and accountability

Potential impact of failure:

- Significant financial loss (e.g. fraud, theft, material errors)
- Loss of reputation and investor confidence
- Loss of business opportunity with removal of government approval to work on classified programmes.

Mitigations (examples):

- The Group Operating Manual (GOM) and Risk Management Framework provides clear instructions on the Group's internal governance and controls
- The businesses provide year end disclosures on the effectiveness of their accounting and internal control systems
- Internal Audit conducts an audit of the Group's internal control system
- The terms of reference for the Board and committees are reviewed and updated annually.

Risk 7. Pensions

Trend: Decreased risk

Changes during 2017

Following the closure of the pension scheme to future accrual in 2016, the pension scheme has increased the hedging of its liabilities. This risk has therefore reduced.

Description

The Group's UK defined benefit pension scheme needs to be managed to ensure it does not become a serious liability for the Group. There are a number of factors including investment returns, long-term interest rate and price inflation expectations, and anticipated members' longevity that can increase the liabilities of the scheme.

P**18**
The Group's UK defined benefit pension scheme

Potential impact of failure:

- Any increase in the deficit may require additional cash contributions and thereby reduce the available cash for the Group.

Mitigations (examples):

- Annual accounting and triennial pension valuations are in place and any issues that may arise are highlighted to the Board
- The pension scheme deficit decreased during 2017 due to improved asset performance and following the closure of the Group's UK defined benefit pension scheme to future accrual in 2016
- The Pension Trustees and the Company actively consider pension risk reduction activities such as liability matching, dynamic de-risking, pension increase exchange and retirement transfer options
- The Pension Trustees and the Company agreed to increased hedging of the scheme's liabilities
- The Board undertakes regular Pension Strategy Reviews
- Recommendations arising from the deep dive review conducted in 2017 have been implemented.

Principal risks continued

Risk 8. Legislation/regulation

Trend: Increased risk

Changes during 2017

The Company continues to take compliance very seriously and the Board and Executive Team strive to reinforce an ethical culture. For example, the Group provided additional targeted training to certain groups of employees on anti-bribery and managing agents. Ultra is proactively working towards GDPR compliance and has employed legal advisers to help with achieving compliance in this and other legislative and regulatory changes. The overall level of risk may increase due to various changes in legislation and regulation.

Description

The Group operates in a highly regulated environment across many jurisdictions and is subject to regulatory and legislative requirements. There is a risk that the Group may not always be in complete compliance with laws, regulations or permits.

Export restrictions could become more arduous and factors outside of Ultra's control could result in the Group being unable to obtain or maintain necessary export licences.

P73-77
Audit Committee Report

P55
Ultra's approach to ethics

Potential impact of failure:

- Failure to comply with legislation and regulations could result in fines and penalties and/or the debarment of the Group from government contracts
- Reduced access to export markets could have a material adverse effect on the Group's future revenue and profit
- Loss of reputation and investor confidence.

Mitigations (examples):

- The Group Operating Manual is well established and policies and procedures are regularly updated to reflect changing legislative and regulatory requirements
- Regular compliance training is undertaken as part of Ultra's commitment to an ethical culture and individual businesses provide compliance statements as part of monthly business performance reporting
- The Ethics Overview Committee provides independent advice and scrutiny of Ultra's business activity. It provides assurance to the Board that the Group's undertakings are transparent and conducted ethically within the legislative environment
- Employees have access to a Group-wide confidential hotline to report anonymously any concerns they may have about possible improprieties and other compliance issues
- The Board receives regular updates and presentations on the Company's legal and regulatory requirements
- A project has been established to evaluate the impact of the GDPR and to ensure that Ultra is compliant with the regulation
- External advice has been sought on the impact of recent changes to the US tax regime on Ultra.

2017 principal risks and uncertainties

Risk 9. Health, safety and environment (HS&E)

Trend: No significant change

Changes during 2017

Ultra has strong HS&E processes and procedures. The Board has zero appetite for HS&E reportable incidents. The number of lost time accidents per 100,000 hours reduced in 2017 and the reportable/recordable accident rate per employee remained unchanged.

Description

Ensuring high standards of health and safety of employees and visitors and maintaining commitment to minimise the environmental impact of activities is of paramount importance to the Company.

P56-57
Ultra's approach to HS&E

Potential impact of failure:

- Incidents may occur which could result in harm to employees and visitors, the temporary shutdown of facilities or other business disruption
- The Group may be exposed to regulatory action and financial loss
- Loss of reputation and investor confidence.

Mitigations (examples):

- The Board has zero appetite for HS&E risk and the Group's leadership is committed to ensuring that this remains a top priority. Any material incidents are reported to the Board along with a correction or mitigation plan
- Near miss reporting has been introduced in order for Ultra to be proactive in identifying and taking action on early warning indicators to prevent serious injury or fatality
- The Board undertakes an annual review of HS&E and the Executive Team reviews HS&E on a quarterly basis. Each business conducts an annual HS&E self-assessment in addition to a biannual external audit.

Statement of going concern

Ultra's net debt at 31 December 2017 was £74.5m. The Group's committed banking facilities amount to £466.3m in total, together with a £5.0m and $10.0m overdraft. The Group's revolving credit facility of £300m is denominated in Sterling, US Dollars, Canadian Dollars, Australian Dollars or Euros. This facility was signed in November 2017, and replaces the previous £100m and £200m revolving credit facilities. The facility is provided by a group of six international banks and has a committed maturity of five years to November 2022, and may be extended to a maximum of seven years subject to lender consent. The facility agreement permits an additional £150m 'accordion' which is uncommitted and subject to lender consent and can be used in certain acquisition scenarios.

The Group also holds a $225m term loan which was established in May 2015. This loan, denominated in US Dollars, was drawn in full in August 2015 to complete the Herley acquisition. $60m is repayable in late 2018 and the loan expires in August 2019. The Group also has loan notes in issue to Pricoa which totalled $70m at 31 December 2017 (2016: $70m). $10m will be repaid on 14 July 2018 and the remaining $60m will be repaid on 25 January 2019. As well as being used to fund acquisitions, the financing facilities are also used for other balance sheet and operational needs, including the funding of day-to-day working capital requirements. The US Dollar borrowings also represent natural hedges against assets denominated in that currency. Details of how Ultra manages its liquidity risk can be found in note 22 – Financial Instruments and Financial Risk Management.

Though global macro-economic conditions remain uncertain, and there continues to be uncertainty over the future landscape due to Brexit, the long-term nature of Ultra's business and its positioning in attractive sectors of its markets particularly in defence and aerospace which are long-term in nature, taken together with the Group's forward order book, provide a satisfactory level of confidence in respect of trading in the year to come.

The Directors have a reasonable expectation that the Group has adequate resources for a period of at least 12 months from the date of approval of the financial statements and have therefore assessed that the going concern basis of accounting is appropriate in preparing the financial statements and that there are no material uncertainties to disclose.

Long-term viability statement

In accordance with provision C.2.2 of the 2014 revision of the Code, the Directors have assessed the viability of the Company over a longer period than the 12 months required by the going concern basis of accounting. The Board conducted this review for a period of three years to December 2020, to coincide with its review of the Group's financial budgets and medium-term forecasts from its Strategic Plan. The level of certainty is lower in later years due to the inherent uncertainties in forecasting future performance. The Strategic Plan is underpinned by the regular Executive Team reviews of business unit performance, market opportunities and associated risks. The assessment has taken into account the Group's current position and the potential impact of the principal risks documented in the Strategic Report. Based on this assessment, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the period to December 2020. In making this statement, the Directors have considered the resilience of the Group, taking account of its current position, the principal risks facing the business in severe but reasonable scenarios and the effectiveness of any mitigating actions. This assessment has considered the potential impacts of these risks on the business model, future performance, solvency and liquidity of the Group over the period. Specific scenarios modelled (i) the impact of a 10% year-on year organic revenue and underlying operating profit* decline during each of the three years covered by the assessment period and with operating cash conversion each year of 70%, and (ii) the impact of no organic revenue or underlying operating profit* growth during the three years covered by the assessment period and with operating cash conversion each year of 50%. In each scenario the Group remains well within its permitted financial covenants. The Directors have determined that the three-year period to December 2020 is an appropriate period to provide its viability statement. In making their assessment, the Directors have taken account of the Group's robust balance sheet, its financial covenant headroom, its ability to raise new finance in different financial market conditions and its key potential mitigating action of restricting dividend payments.

This conclusion is based on a review of the resources available to the Group, taking into account of the Group's financial projections together with available cash and committed borrowings, financial covenants and material uncertainties. In reaching this conclusion, the Board has considered the magnitude of potential impacts resulting from uncertain future events or changes in conditions, the likelihood of their occurrence and the likely effectiveness of mitigating actions that the Directors would consider undertaking.

Sustainability
Making a difference

Ultra recognises that the success and sustainability of the business is enhanced by positive relationships built with stakeholders and continues to focus on value creation for all: shareholders, customers, employees, local communities and suppliers.

In the community:
Ultra's businesses continue to be active in their local communities, building positive links by engaging with local people and local issues. Many businesses form relationships with educational establishments in the surrounding communities offering work placements and visits to businesses as part of school, college and university courses, as well as providing interview practice, support for lessons, careers events and school science fairs. In the UK, Ultra is involved in nationwide initiatives on STEM* education and also offers Arkwright scholarships: a scholarship that sponsors A-level students looking to pursue a career in engineering. Ensuring a long-term supply of talent to the business is essential and Ultra commits itself to developing its future talent pipeline in schools and higher education institutions.

Fundraising and volunteer work in the local community and at a national level is something the Group is keen to encourage. It actively supports employees who undertake voluntary activities. Some noteworthy examples in 2017 include:

- CIS continues to operate its "CIS in the community" policy which provides time and matches funding for employees' charitable activities
- ATS received the Distinguished Partnership Award from the Del Valle Independent School District for the fourth consecutive year for outstanding contributions throughout the year to its neighbouring Smith Elementary School
- TCS and École de technologie supérieure were awarded the 2017 prize for "Technology Partnership" from ADRIQ (Association des directeurs de recherché industrielle du Quebec).

P51-52
Securing the Talent pipeline

*STEM: Science, Technology, Engineering and Mathematics

Shareholders:
The Group's primary objective is to deliver long-term shareholder value.

Customers:
Ultra aims to be an excellent strategic supplier to its customers. To enable this, Ultra's businesses are focused on helping customers identify their true needs whilst developing long-term relationships based on performance excellence and meeting commitments. Ultra's businesses aim to build long-term, mutually beneficial relationships with their customers and to become part of the customers' extended enterprise. Examples from 2017 that highlight Ultra's commitment to its broad customer base are:

- Herley was presented with both the "Raising the Bar" and "Return to Green" coins by Lockheed Martin. This was for its outstanding performance in support of the Fleet Ballistic Missile programme and for dedication and outstanding support, respectively
- 43 employees from NCS were invited to spend the day at the Tank Museum and received thanks from EDF for their work on the first Ultra-manufactured Neutron Flux Detector
- Airport Systems was awarded IT Company of the Year by BUILD magazine.

Employees:
Ultra believes that the right people are its most important asset; the capabilities of its employees allow the Group to innovate continually and meet customer needs. Ultra has a solid commitment to developing people and securing the talent pipeline, details of which can be found in the section "Developing Ultra's people". The Group believes that, to ensure its continuing growth and success, these initiatives for talent development and employee retention are crucial. However, ultimate responsibility for individual talent development and employee retention resides within each of Ultra's businesses, a number of which have launched unique initiatives to ensure continuing employee development and engagement. Examples include:

- Employees from NCS participated in a 'Productivity through People' workshop which aims to increase productivity through empowerment of the workforce
- Command & Sonar Systems launched a "Make it Happen" management development programme aimed at developing managers in readiness for promotion
- 3eTI implemented the "Walk the Wall" exercise, enabling the Senior Management Team to meet and discuss each employee's overall performance and goals. 3eTI has also introduced quarterly recognition awards for employees nominated by their peers or managers for going "above and beyond".

The environment:
Ultra is committed to implementing and applying effective measures to minimise the environmental impact of its activities. All businesses are audited at least biennially.

Ultra continues its commitment to investing in manufacturing facilities to offer increased efficiencies and reduce energy consumption, while improving productivity across the Company. The Group also looks to its suppliers to reduce their environmental impact.

Initiatives that have taken place within the Group include:

- Avalon installed solar panels on its facilities in an initiative to reduce energy consumption requirements
- 3eTI, NSPI and the Ocean Systems Braintree facility scored 100% in their Environmental Audit
- USSI was registered as a Conditionally Exempt Waste Generator, which no longer requires waste reporting, due to efforts in reducing landfill waste.

Suppliers:
Ultra views its suppliers as an extension of the Ultra enterprise, as many businesses rely on these suppliers for delivery of their products and services. These are safety or performance critical in their end markets so working together is crucial. Partnership with suppliers and customers generates innovative and differentiated solutions which are at the core of Ultra's business model. Many Ultra businesses work with their suppliers to enable them to operate more efficiently.

> The Group believes that, to ensure its continuing growth and success, its initiatives for talent development and employee retention are crucial.

P04 Ultra's customers

P48-53 Ultra's people

P57 The environment

Our people and culture
Developing Ultra's people

Ultra would not be able to deliver value to customers without the innovative and entrepreneurial spirit of its people.

> Taking over the position as Towed Array Project Manager has been my biggest challenge to date...

The right people

Ultra believes that having the right people is the Group's most important asset. Across the Group, it is recognised that Ultra is successful in innovating to meet customers' needs due to the broad range of skills and capabilities of its employees. Therefore, people and their development are fundamental to the Group as it strives to achieve an efficient organisation with engaged and committed people.

Domain expertise

Ultra recognises that one of its commitments to customers is to ensure that the Group's domain expertise is maintained. This is achieved by ensuring that employees maintain their continuing professional development and close links with customers and end-users of Ultra's products.

The key factors in delivering innovative solutions to meet customers' needs are Ultra's deep understanding of its specialist capability areas combined with knowledge of the users' environments. The Group ensures that it has the right people to work with customers to support their needs by understanding their problems and creating winning solutions.

How Ultra manages its people

Ultra continues to value the autonomy of its businesses and believes a high degree of operational autonomy enables businesses to focus on delivering agile and responsive solutions to its customers.

The Managing Directors and Presidents of Ultra's individual businesses and their management teams are given as much authority and responsibility as possible. This allows these teams to maintain the agility and sharp focus that is typical of smaller owner-managed businesses.

> Ultra actively invests in and supports the training and development of its employees.

People in action

Sarah-Lynn MacKenzie joined Ultra as a Graduate Mechanical Engineer in 2014. Over the last three years, Sarah-Lynn has been involved in increasingly complex design work and is now Towed Array Project Manager at Maritime Systems.

What is your role within Ultra?

Within my role as Towed Array Project Manager, I manage the scheduling of towed array builds in order to meet external deadlines. To do this I interface with the production team to ensure efficiency and teamwork, with the Senior Management Team to provide various forecasts and updates, and with the customer to provide status reports and array ship dates.

How has your role evolved during your time with Ultra?

I started at Ultra three and a half years ago as a Graduate Mechanical Engineer using software to analyse the acoustic abilities of our new projectors. As I became more familiar with the towed array technology at Ultra, I migrated into a mechanical design role. This role grew to the point where I was also creating numerous design documents for internal and external use that used cross-discipline knowledge to capture electrical, mechanical, and acoustic design. From there I was recently promoted to my current position as Towed Array Project Manager.

What have you enjoyed most about your role?

I have enjoyed being exposed to various fields of work within Ultra. This exposure has allowed me to grow within the company in a self-directed manner based on my interests. Taking over the position as Towed Array Project Manager has been my biggest challenge to date, but has also been the work from which I have derived the most satisfaction.

Developing Ultra's people continued

Ultra is committed to securing the talent pipeline and developing people to ensure the continued growth and success of the Group. Resetting the Group's focus on its people ensures that the right people are in the right roles, with the right skills at the right time. Furthermore, businesses are responsible for and are encouraged to develop their teams and individuals continuously, which will enable people to grow with the business.

What people mean to Ultra
Ultra's aim of delivering an efficient organisation, with engaged and steadfast people to meet the Group's business commitments, is a fundamental goal that all managers work towards and is a measure of their success. The broad range of skills and capabilities of Ultra's employees support the Group's success in innovating to meet customer needs. The quality of Ultra's leadership teams is constantly reviewed and improved as this is essential to the continuing growth and success of the Group.

Culture
The Group believes that its culture is what drives Ultra's success and that this includes aspects such as values, role models, processes and the behaviours of its employees. Ultra recognises that maintaining a strong culture is essential. The Group's culture, values and behaviours are shaped by the guiding principles, in particular the call for "an efficient organisation with engaged and committed people". To achieve this, Ultra has identified four cultural behaviours of its people that are highly valued and encouraged. These are: Leadership, Entrepreneurship, Audacity and Paranoia. Together, they are known within the Group as **LEAP**.

LEAP

Leadership
Good leadership is essential to Ultra and a number of models of leadership are incorporated in the development and training programmes that are delivered around the Group.

Entrepreneurship
Being entrepreneurial is a behaviour which underpins the Group's strategy. All Ultra businesses seek to provide customers with solutions which are different from, and better than, those of our competitors. Ultra's entrepreneurial culture seeks to maximise the capability to generate exceptional ideas and the business skills needed to bring them successfully to market.

Audacity
Audacious thinking is the difference between incremental improvement and business transformation. It takes the idea of innovation, one of Ultra's core values, and invites employees to think about issues in ways which are unconstrained by existing norms, making use of creative approaches in every aspect of the Group's business.

Paranoia
Paranoia, in the business sense, is a concern and fear about competitors and what they may do. It also relates to concerns and fears about things which can go wrong internally. For Ultra, paranoia is important in focusing its people on maximising their knowledge of the competitive landscape, by constantly asking questions of the Group's individual businesses, customers, teaming partners and suppliers.

Growth through engagement
LAUNCH is a set of behaviours which the Group has developed to facilitate customer engagement and relationship building.

This approach ensures Ultra understands the real needs of its customers. In addition, **LAUNCH** is a way for Ultra's businesses to generate long-term customer relationships, which leads to a better pipeline of opportunities and enables growth. **LAUNCH** is aligned with the Group's approach to systems engineering and project management.

LAUNCH

- **L** Listen to customers
- **A** Ask the right questions
- **U** Understand what their "pain" is
- **N** identify the customers' Needs and get their agreement
- **C** Create a relationship, opportunity and solution
- **H** Holistic. Examine the bigger picture; how can Ultra maximise the scope and value of the opportunity?

Sustainability, people and culture

Securing the talent pipeline

Ultra has been committed to developing people ever since it was formed in 1993. There are a number of programmes which help the Group to attract the best people, as well as encouraging students to develop careers in engineering or business.

Schools

Ultra businesses engage with schools in the local community, building relationships with schools and colleges through various means. These include offering work experience, longer work placements or internships, visits as part of AS-level courses, interview practice sessions, careers events, and Ultra employees supporting both lessons and after school clubs. Examples include:

- Ultra became an Official Supporter of the "Race for The Line" Classroom Project and National Competition, an initiative set up by The Learning Partnership (TLP) which enables teachers to introduce STEM* classroom projects for students in years 8 and 9, exploring concepts such as aerodynamics, Newton's Law of Motion, maths and physics
- Command & Sonar Systems continues to participate in the STEM* Ambassador Scheme, with six ambassadors currently in place and a further nine undergoing registration
- NCS began a five-year sponsorship of St Bees Primary School in Cumbria as part of the British Energy Coast league initiative.

Ultra's continued focus remains on engineering but extends to include other STEM* subjects, as well as finance and commercial disciplines. The Group also sponsors students through their A Levels via the Arkwright Scholarship. This provides students with support and mentoring during their studies and has led to more students electing to undertake STEM* degree courses. Ultra is recognised as a major sponsor of the scheme and currently has eight scholars.

Apprenticeships

Many Ultra businesses have well-established and successful apprenticeship programmes, which have also historically provided the Group with engineering leaders. The Group runs apprenticeship schemes at most of its UK businesses and currently has 45 apprentices in training in the UK.

There have been a number of notable successes:

- CIS has developed a relationship with SEPnet** and currently sponsors two eight-week summer placements for undergraduates, alongside one internally-funded placement
- PCS gave a presentation on apprenticeships to the Bournside School. A current apprentice, previous apprentice and an HR representative presented
- Apprentices at NCS were awarded at the 2017 National Skills Academy for Nuclear 'UK Nuclear Skills Awards', winning the Manufacturing Apprentice of the Year and the SME Apprentice of the Year awards.

UK data	Total 2017	Total 2016
Apprentices	**45**	42
University placement students	**7**	7
Sponsored university students	**1**	3
Arkwright scholars	**11**	11

US data	2017	2016
Undergraduate interns	**21**	16
New graduates	**6**	5
Employees working on graduate-level degrees	**15**	14

Canada data	2017	2016
Undergraduate interns	**16**	0
New graduates	**1**	5
Employees working on graduate-level degrees	**1**	1

Ultra actively invests in and supports the training and development of its employees.

* STEM: Science, Technology, Engineering and Mathematics
** SEPnet: South East Physics Network

Developing Ultra's people continued

Ultra actively engages with lecturers and faculties during degree courses as part of the excellent links the Group maintains with universities around the world.

Securing the talent pipeline (continued)

Universities and colleges

In addition to traditional career fairs, Ultra actively engages with lecturers and faculties during degree courses as part of the excellent links the Group maintains with universities around the world. This provides Ultra with access to leading research and enables the Group to form relationships with students well before graduation. The Group benefits from working with universities as it can collaborate on innovation and recruit students who can make a difference. Ultra is currently sponsoring 12 university students and also provides a number of work placements as part of degree courses (28 in the UK and US in the last year).

Ultra businesses provide opportunities for students to work on real projects via work placements, co-operative programmes and internship schemes; all internships are paid for, to promote access to all. The Group also works with SEPnet to provide summer work placements to students to help advance and sustain physics as a strategically important subject for the UK economy.

Success stories

- CIS works closely with Uxbridge College, who supports its apprentice programme, and during 2017 provided four lecturers with work experience placements, enabling them to update their skills and knowledge of the workplace
- Flightline has a continued technical collaboration with a professor at the Massachusetts Institute of Technology (MIT)
- NCS became a member of the Southampton University Industrial Board and sponsored its 'Electronics and Computer Science Society'. It also delivered presentations to the Society and held a Graduate Interview Day on campus
- In July 2017, PCS hosted students and lecturers from Embry Riddle Aeronautical University in Florida for the second year running.

Institutions

Ultra's UK businesses are members of Engineering UK and other bodies that research and develop new ways to attract people into engineering careers, as well as helping to forecast future trends in the sector. Ultra businesses worldwide have a variety of links with their local business forums and chambers of commerce members, helping to encourage STEM* activities.

* STEM: Science, Technology, Engineering and Mathematics

Sustainability, people and culture

Training and development

Ultra actively invests in and supports the training and development of its employees. As a Group, Ultra has invested in its Learning Academy, an online portal, which is available to all of the Group's businesses to support training. Individually, each business is responsible for identifying the training needs of its employees and managing its own training budget. Employee performance and development reviews are held at least annually and are used to identify the development needs of individuals.

Many of the courses in the Learning Academy are tailored to the specific requirements of Ultra, and the trainers have an intimate knowledge of how the Group operates across all of its businesses. These training events include programmes on leadership and management, along with workshops on Ultra's successful competitive strategy, strategic selling, programme management and systems engineering. Specific training programmes are also provided for individuals as necessary.

To give students access to real-life current work challenges, and to enable Ultra employees to develop their management and leadership skills, there are opportunities to participate in national schemes such as the Engineering Education Scheme (run by the Engineering Development Trust) and competitions promoting STEM* careers. Ultra's businesses have also developed corporate partnerships with engineering institutions, including the Royal Academy of Engineering and the Institution of Engineering and Technology, in order to support and encourage employees to pursue professional recognition (in the form of CEng, IEng or EngTech status) for both their current and previous work and academic achievements.

2017 saw a renewed focus on high-potential development across Ultra. Two examples are programmes introduced at Command & Sonar Systems and Precision Control Systems. Attendees progress through the programme developing their leadership skills while working on projects focused on real business issues. Through attending these programmes, participants have not only enhanced their skills but have progressed in their careers within Ultra.

Succession planning and retention

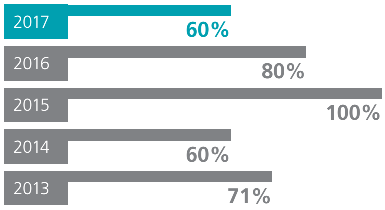
Each of Ultra's businesses prepares an annual "Organisation, Succession & Development Plan" to ensure that Ultra has the right people in the right place. The plan assesses individuals' performance in their current role and their potential to perform larger roles in the short or longer term.

Assessments are recorded in Ultra's Talent & Succession system and give a performance versus potential rating for each employee. The system is used by businesses to ensure a supply of suitable talent is available when required and recognises that any role within Ultra may become more challenging as the business grows. The performance categories consist of "exceeds", "meets", "partially meets" or "does not meet" the required performance level. Equal attention is given to enhancing the performance and retention of those who meet and exceed standard performance levels and to addressing the challenges of the people who fall into the "partially meets" or "does not meet" categories. Where an individual is not meeting the standard performance level, it often means that they need to be placed in a role more suited to their talents in which they can start to exceed the required standard.

The Group is able to create its next generation of business leaders, through developing and retaining those employees identified as having high potential who will be able to take up the challenge of continuing the growth of Ultra. The Group has a high retention rate among those individuals in the businesses' senior management teams who continually meet or exceed expectations in terms of their performance, or who are high-potential and still developing in their new role.

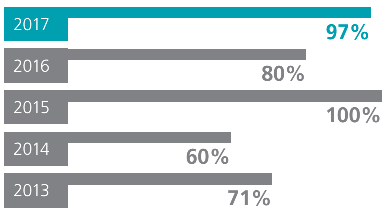
Ultra has been able to appoint a high proportion of its leaders at Board, divisional and business levels through internal promotion. This is because the succession planning element of the process aims to ensure that there are always suitable successors for all management team roles across each business and for other senior-level roles.

Internal appointments at Executive Team, divisional and MD/President level (%)



As well as the people listed as successors, each business also identifies people with high potential. The combined list represents Ultra's "high-potential" talent pool and is used regularly to find the right people to fill internal vacancies via the Group's Talent & Succession system. Ultra businesses attend graduate and undergraduate fairs, utilising current graduates as the Group's ambassadors. Attendance has seen applications for graduate schemes increase, and this in turn helps to ensure that there is a future supply of engineers for the Group.

Retention of "high-performers"



Our people and culture

Corporate and social responsibility

Ultra recognises its commitments and its reputation for meeting them, believing that a successful and sustainable business is built on more than just financial results.

Ultra is committed to maintaining high standards of business ethics as part of being a responsible business. The Group endeavours to uphold the rights of its employees as well as creating an honest and transparent business both internally and externally. The Group's corporate responsibility initiatives are focused on the following key areas:

Human rights

Ultra's Board requires that the Group should, at all times, be a responsible corporate citizen and, as such, the Group complies with all applicable legislation in the countries in which it operates. Ultra recognises and respects the rights of its employees, stakeholders and the communities in which it operates. As such, Ultra adheres to all relevant government guidelines, designed to ensure that its products are not incorporated into weapons or other equipment used for the purposes of terrorism, internal repression or the abuse of human rights. Key statements and policies can be found on the Ultra website.

Ethical business conduct

Ultra is committed to ethical business conduct.

Meeting legal and ethical standards

Ultra requires all employees, businesses and third parties who act on Ultra's behalf to comply with the applicable laws and regulations of the countries in which it does business.

Ultra is committed to operating in accordance with all legislative requirements, including those pertaining to anti-corruption and bribery practices, with competition and antitrust laws and relevant national export control regulations.

Ultra has a corporate ethics code, which encompasses a gifts and hospitality policy. All Ultra businesses are required to report on compliance with the corporate ethics code monthly and the Board reviews compliance with the code twice a year.

Ultra's ethics code can be found within Ultra's Policy Statement on Ethics and Business Conduct along with its policies on anti-corruption and anti-bribery, competition compliance and gifts and corporate hospitality. All of these policies can be found on the Group website:

https://www.ultra-electronics.com/about-us/corporate-responsibility.aspx

Providing guidance and training to employees

The Group continues to promote and strengthen its policies, processes and training to ensure that employees have the clear guidance they need in identifying and managing ethical matters.

Ultra uses EthicsPoint in all of its businesses. EthicsPoint is a Group-wide independent, confidential web- and telephone-based hotline, which enables all employees to report concerns anonymously about possible improprieties and other compliance issues. All reports registered through EthicsPoint are reviewed and responded to in a timely and appropriate manner. The responsibility for handling reports rests with Ultra's Senior Independent Non-Executive Director (with the exception of US security-related issues which are routed to the Chairman of the Security Committee of either Ultra's Special Security Agreement company or Ultra's Proxy Board company, as appropriate). No retaliatory action is taken against employees for making reports in good faith through EthicsPoint. Any employee found to be in breach of the Policy statement on Ethics and Business Conduct is subject to appropriate disciplinary action.

Independent ethics overview committee

The Ethics Overview Committee was formed to provide independent advice and scrutiny in relation to Ultra's business activity, giving assurance that the Group's current and planned undertakings are conducted in a manner consistent with the legislative environment and are transparent. The Committee comprises six permanent members, three of whom, including the Chairman, are independent.

To maintain the highest degree of impartiality, the independent members of the Committee are self-electing with the appointment of the Chairman exclusively within the remit of the independent members. The Committee meets quarterly and provides assurance that Ultra's business is being conducted in line with the Group's policies, processes and any relevant legislation. This is ascertained through discussions with senior managers, receiving reports and visiting Ultra's businesses. During these reviews, the Committee undertakes a formal review of business activities and the independent members provide advice and guidance on the appropriateness of target markets and customers and on potential teaming partners. The Committee also considers the reports that come through EthicsPoint.

Diversity and inclusion

These values are embedded into the organisation to ensure that each business is truly representative of the environment in which it operates. It is essential to the Group that all employees feel fairly treated and are not discriminated against in any way. To enable this, Ultra complies with all applicable employment rights and legislation in the countries in which it operates. In addition, the Group is strongly committed to maintaining a work environment which provides equal opportunities for all employees, regardless of age, disability, gender re-assignment, marriage or civil partnership, pregnancy or maternity, race, religion or belief, sex or sexual orientation.

Ultra uses rigorous recruiting practices to ensure the best candidate is selected, based on objective requirements and assessments. Ultra monitors gender and age diversity.

Corporate and social responsibility continued

Disabled employees

It is the policy of the Group that the training, career development and promotion of disabled people should, as far as possible, be identical to that of other employees. Applications for employment by disabled people are always fully considered, bearing in mind the aptitude of the applicant concerned. In the event of a member of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and that appropriate training is arranged.

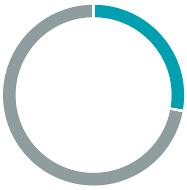
Health and safety

The health, safety and well-being of the Group's employees and visitors is of the upmost importance to Ultra. A healthy, committed and engaged workforce, working in a safe environment, is necessary to achieve superior business results. The businesses manage a wide range of safety risks, from office and manufacturing risks to providing services at customer sites, including military bases and platforms. The Group is committed to upholding and improving health and safety across the Group and engages in continuous safety improvement activities.

The safety of the products and services provided to users and customers is a key priority to Ultra. Each business ensures the appropriate legal and ethical levels of safety are met across a product's life cycle, with particular emphasis on the manufacturing, in-service and disposal phases.

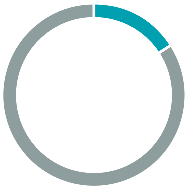
All operating businesses are required to have a written health and safety policy, which is to be upheld at all times. Within each business, Managing Directors and Presidents are responsible for health and safety and for providing adequate resources to meet the requirements of the health and safety policy. Independent external audits, which take place biennially, assess compliance. Overall health and safety responsibility at Board level resides with the Executive Chairman.

Each business is required to submit an annual report on health and safety performance. The Board receives an annual report which summarises the health and safety performance of the Group.



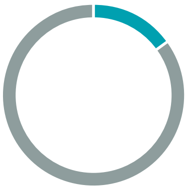
Board of Directors

Female	29%
Male	71%



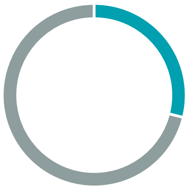
Senior management

Female	16%
Male	84%



Executive Team

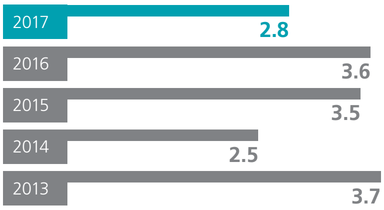
Female	15%
Male	85%



All employees

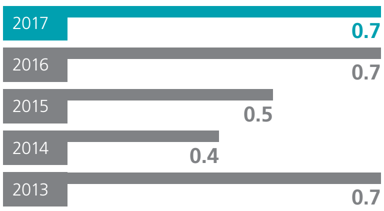
Female	29%
Male	71%

Figure 1
Lost time accidents per 1,000 employees



Ultra reports a lost time accident rate (being an accident resulting in half a day or more off work) per 1,000 employees, see **Figure 1** and externally reportable accidents per 100 employees, see **Figure 2**. This reflects the non-financial Health and Safety KPI on page **21**.

Figure 2
Externally reportable accidents per 100 employees



Sustainability, people and culture

Figure 3
Packaging waste (t/£m sales) in UK businesses

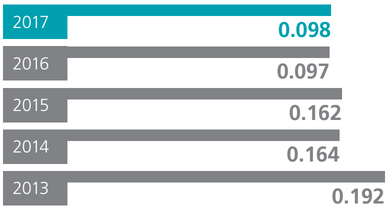


Figure 4a
Total CRC emissions (per 1,000 CO_2 tonnes)

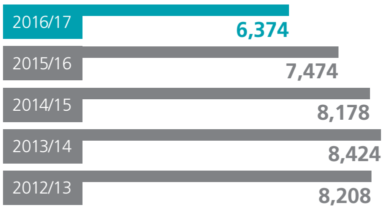
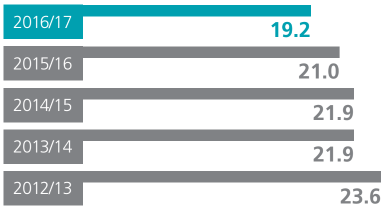


Figure 4b
Total CRC emissions (t/£m) in UK businesses



Environment

Ultra is committed to putting effective measures in place to minimise the environmental impact of its activities. This is important both for its employees and the communities in which it operates, as it will help to secure the long-term future of the Group. These measures include the operational business environment and the products and services that the Group provides.

Products

Environmental considerations are taken into account throughout a product's life cycle, from concept through to disposal; each individual business ensures its practices and processes consider this. Businesses work with their suppliers to reduce the impact of their products and to maximise the use of acceptable components.

Ultra ensures the full co-operation of all employees to minimise environmental impact and maximise the conservation of materials.

Implementation

The Executive Chairman is the main Board member with overall environmental responsibility and the Managing Directors and Presidents of the operating businesses are responsible for the implementation of the environmental policy.

Ultra's formal environmental policy addresses compliance with environmental legislation, conformity with standards for air, waste disposal and noise, the economical use of materials and the establishment of appropriate environmental performance standards. Progress is monitored through annual reporting and a biennial external audit process, which took place in 2017. Where appropriate, individual businesses have ISO14001 accreditation.

Each site plans and manages compliance with environmental requirements and the processes for the storage, handling and disposal of hazardous or pollutant materials are reviewed on a continuous basis. Ultra caused no contamination of land in 2017, continuing the excellent track record of the previous five years.

There were no environmental incidents reported in the year.

Ultra measures and reports on its packaging waste annually and this is shown in **Figure 3**. In the UK, businesses are encouraged and incentivised to reduce the net amount of waste they produce.

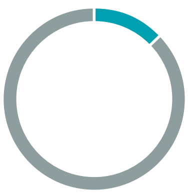
The Group continues to address energy conservation and emissions. Energy consumption is measured annually and the data compared with previous years.

As part of the Carbon Reduction Commitment (CRC) programme, Ultra, in the UK, is registered with the Environment Agency. The Group's compliance emissions reported for 2016/17 were 6,374t CO_2, a 14.7% reduction over 2015/2016. Historical performance data is shown in **Figures 4a** and **4b**.

Greenhouse gas emissions

Ultra is committed to the systematic reduction of greenhouse gas emissions. In compliance with the 2013 Greenhouse Gas Emissions Regulations, Ultra collects and consolidates information on carbon dioxide (CO_2) emissions from across its portfolio of 18 businesses; 2013 was the first year this was undertaken and serves as the baseline year.

Total tonnes of CO_2 emitted by all Ultra businesses



Total tCO_2 (scope 1)	13%
Total tCO_2 (scope 2)	87%

Ultra's Greenhouse gas emissions – tonnes of CO_2 (tCO_2)

Total tCO_2 emitted by all Ultra businesses	**17,415**
Total tCO_2 from Ultra's business activities (scope 1)	**2,285**
Total tCO_2 purchased by Ultra (scope 2)	**15,130**
Ultra's annual emissions shown as tCO_2 per £m of revenue	**22.46**

Methodology

In 2017, each UK business reported on the appropriate greenhouse gas metrics. These metrics were aggregated to produce the figures reported above to which standard DEFRA conversion factors were applied.

Energy Savings Opportunity Scheme

The Energy Savings Opportunity Scheme (ESOS) is a relatively new piece of legislation introduced by the UK Government that applies to Ultra. The scheme is run by an Environment Agency (such as CRC) and its focus is to reduce the demand for energy. Ultra has successfully demonstrated compliance with the requirements using ESOS-compliant energy audits and notified its compliance to the Environment Agency in January 2016. The opportunities for energy savings identified during the ESOS assessment will be addressed as part of the S3 programme.

Additional environmental initiatives

All businesses are audited biennially. In the US in 2017, EMS, 3eTI, Flightline and NSPI all achieved 100% in the audit. Additionally in the UK, NCS, CSS, PMES and PCS all maintained the ISO 14001 environmental standard.

Anant Prakash
General Counsel & Company Secretary

Board of Directors

Douglas Caster CBE BSc FIET
Executive Chairman

Time with Ultra: **29 years 2 months**

Time in position: **6 years 8 months***

Douglas is a highly experienced engineer and manager of electronics businesses. He has a long track record of delivering growth both organically and through effective acquisitions, achieving superior financial performance in the companies he has led.

Douglas started his career as an electronics design engineer with the Racal Electronics Group in 1975, before moving to Schlumberger in 1986 and then to Dowty as Engineering Director of Sonar & Communication Systems in 1988. In 1992, he became Managing Director of that business and, after participating in the management buy-out which formed Ultra Electronics, joined the Board in October 1993. In April 2000, he was promoted to the position of Managing Director of Ultra's Information & Power Systems division. In April 2004, he was appointed Chief Operating Officer and became Chief Executive in April 2005. He was appointed deputy Chairman in April 2010, became Chairman of Ultra in April 2011 and Executive Chairman in November 2017.

Douglas is a Non-Executive Director of Morgan Advanced Materials plc and was appointed Chairman of Metalysis Limited in January 2015.

Amitabh Sharma BSc FCA
Group Finance Director

Time with Ultra: **2 years**

Time in position: **1 year 8 months**

Amitabh is a highly experienced financial professional, having held senior finance positions at listed and private companies. He has extensive industry experience as well as an excellent track record of delivery across different sectors. Amitabh was previously Group Financial Controller at Ultra from 1999 to 2005. He was Group Finance Director at Gibbs and Dandy plc (now Gibbs and Dandy Ltd) and a Divisional Finance Director at Saint Gobain. He has been an audit manager with KPMG in London and qualified as a Chartered Accountant in 1993.

Amitabh joined Ultra in January 2016 and became Group Finance Director with effect from May 2016, when he was appointed to the Board.

Martin Broadhurst OBE MA C.Dir FIoD FRAeS
Non-Executive Director

Time in position: **5 years 5 months**

Martin has a wealth of valuable experience in the defence and aerospace markets, having run a large engineering organisation within the sector for fifteen years. He has demonstrable expertise and skill in growing international business and in expanding capabilities. Martin joined Marshall Aerospace as a management trainee in 1975 and, following a number of roles with the company, including Production Director and Director of Programmes, was appointed as Chief Executive in February 1996.

During his time as Chief Executive, he served on the Group Holdings Board and was Chairman of a number of subsidiary companies. Martin is a Non-Executive Director of the Centre for Engineering Excellence and a trustee of the Royal Aeronautical Society. He was appointed to the Board in July 2012.

Geeta Gopalan
Non-Executive Director

Time in position: **8 months**

Geeta brings to the Ultra Board a wide range of knowledge and experience from a long career in the financial services sector. She has worked in commercial and retail banking as well as social investment and community development in the third sector.

Geeta holds Non-Executive Directorships with UK retail bank Virgin Money Holdings plc and Virgin Money Bank, and Wizink Bank S.A (a Spanish digital bank). Geeta is also a Non-Executive Member and Vice-Chair of the England Committee of the Big Lottery Fund, a non-departmental public body. As an executive, she has a long career including Chairman Europe for Monitise Plc, and Director of Payments Services at HBOS. Geeta spent 16 years working for Citigroup during which time she was a Managing Director for UK Retail Bank and Business Development Head of EMEA. She has experience coaching and mentoring as well as in-depth knowledge of the digital economy, mobile and internet spaces and the social sector. Geeta joined the Ultra Board in April 2017.

*2 months as Executive Chairman.

Executive Director
Non-Executive Director
General Counsel & Company Secretary
Audit Committee member
Remuneration Committee member
Nomination Committee member

John Hirst CBE BA DSc FCA MCT CCMI
Non-Executive Director

Time in position: **3 years**

John is a highly experienced leader of large global organisations, in both the private and public sectors. He has a wealth of knowledge and expertise which he brings to Ultra's Board. John was Chief Executive of the Met Office, a post he held from 2005 to 2014. Prior to this, John was CEO of Premier Farnell and prior to that, he spent 19 years with ICI plc, during which time he was Chief Executive of two of ICI's Global businesses, ICI Performance Chemicals and ICI Autocolor, and was Group Treasurer. He was awarded a CBE in the 2014 New Year's Honours List for his national and international services to Meteorology. He is a Fellow of the Institute of Chartered Accountants, a Member of the Association of Corporate Treasurers and a companion of the Chartered British Institute of Management. John is a Non-Executive Director of Marsh UK, Jelf plc, SME Insurance Services, Anglian Water, IMIS Global Ltd, Hammerson plc Pension Fund, ORSUS Medical Ltd and White Square Chemical Inc. John was appointed to the Board in January 2015.

Victoria Hull LLB
Non-Executive Director

Time in position: **8 months**

Victoria joins the Ultra Board with a wealth of experience across a diverse range of sectors from her extensive legal and Board career. She is a highly experienced Board member and Board advisor being a former Executive Director and General Counsel of Invensys plc and Telewest Communications plc. She has considerable international and domestic experience of legal, commercial and governance matters having worked in global and domestic companies. Victoria has always operated at an Executive Committee or Board level and joined the Ultra Board in April 2017.

Sir Robert Walmsley KCB FREng
Non-Executive Director

Time in position: **8 years 11 months**

Sir Robert brings to Ultra's Board solid experience in the defence, security, transport and energy sectors. He has a deep knowledge of Ultra's main geographic markets and substantial experience of government procurement. Sir Robert was Chief of Defence Procurement at the UK Ministry of Defence (MOD), a post which he held from 1996 until his retirement from public service in 2003.

Prior to his MOD appointment, Sir Robert had a distinguished career in the Royal Navy, where he rose to the rank of Vice Admiral in 1994 and served for two years as Controller of the Navy. Sir Robert is a Non-Executive Director of Cohort plc. He was appointed to the Board in January 2009.

Anant Prakash BA
General Counsel & Company Secretary

Time with Ultra: **Appointed January 2018**

Anant is the Group's General Counsel & Company Secretary. He brings to the role over eight years of legal and commercial experience, acquired working on a broad range of corporate, commercial and M&A matters at Slaughter and May. Anant provides advice and support to the Board and its Committees, and maintains the Group's relationships with its external law firms. He was appointed Company Secretary in January 2018.

NOTE: All details correct as at 31 December 2017

Executive Chairman's Governance Statement

> The Board believes that Ultra's culture of accountability and responsibility is an essential factor in the Group's development.
>
> **Douglas Caster**, Executive Chairman

Dear Shareholder,

2017 was a year of significant organisational change and market challenges for Ultra. In my statement to the 2016 Corporate Governance Report, I emphasised that strong corporate governance is fundamental to Ultra's success: in such times of significant change, the importance of good corporate governance, underpinned by a sound ethical culture, is brought into sharp focus. We continue to believe that good corporate governance is fundamental to Ultra's success. Our approach is to ensure that good practices and procedures are embedded into Ultra's businesses, so that we can deliver on our stated corporate objective of generating shareholder value.

I am pleased to present Ultra's 2017 Corporate Governance Report, which provides an insight into how the Board led Ultra in navigating often difficult and complex issues over the past year, with a renewed focus on discharging our corporate governance duties and applying the principles of the UK Corporate Governance Code.

Board changes and succession planning

It is vital for the Board to have the right balance of skills, knowledge and experience to ensure effective leadership, and to provide a robust challenge to the Executive Team. There were a number of changes to the Board announced during the year, further details of which you will find in the Nominations Committee Report on pages **71-72**.

In April 2017, we welcomed Geeta Gopalan and Victoria Hull as Non-Executive Directors. Mark Anderson (Group Marketing Director) left Ultra on 31 October 2017. Rakesh Sharma stepped down as Chief Executive and from the Board on 10 November 2017, and I assumed the role of Executive Chairman on the same date (see page **7** for further details). One of my main tasks, as Chairman of the Nominations Committee, is to find a new Chief Executive and the search process is well underway. Sir Robert Walmsley, whose term as a Non-Executive Director was due to expire in April 2018, was asked by the Board to remain for a further year as Senior Independent Director to provide continuity and leadership.

The structure, size and composition of the Board was a point of focus in 2017, and will continue to be kept under review in the year ahead to ensure we maintain a broad and complementary range of skills, personalities and competencies on the Board.

Culture

The Board and senior management play a key role in establishing, shaping and embedding the culture, values and ethics of the Company. We are taking important steps in defining the culture and behaviours that we believe we need to deliver on our promises.

The Board's programme of Non-Executive Director site visits continued in 2017. This provides an opportunity for the Directors to satisfy themselves that the culture, values and ethics, which must be set from the top, are reflected in the business at all levels.

The Board believes that Ultra's culture of accountability and responsibility is an essential factor in the Group's development. The Board is conscious of the need to ensure that Ultra's culture of accountability and responsibility is maintained throughout the implementation of the S3 Programme (details of which are on pages **22-23**) and the continued progress of the introduction of the new ERP System. "People and culture" is considered by us to be one of the Group's principal risks (as further described on pages **40-45**), and has been the subject of discussion at both the Board level and at the Executive level, especially in the last quarter of 2017.

As a result of these discussions, we are in the process of setting up a Risk Committee (as a formal sub-committee of the Executive Team), which will be chaired by the Executive Chairman. "People and culture", along with other key business risks, will be monitored closely by the Risk Committee.

We know that we still have further to go, but we believe that Ultra's open and diverse culture has been, and will continue to be, the foundation for its future as a resilient and sustainable business.

Corporate governance reforms – looking ahead

We note with interest the Government's response to the BEIS green paper on corporate governance reforms, and the FRC consultation on fundamental changes to the UK Corporate Governance Code. In anticipation of the reforms that will take effect in the year ahead, we will continue to consider our level of engagement with key stakeholders (and especially employees), promote diversity across the workforce and the Executive Team, and monitor and assess Ultra's culture so that behaviour throughout the business is aligned with its values and strategic goals.

Despite the challenges it has faced in the past year, we believe that Ultra's strategy, reinforced by its culture of accountability and responsibility and a robust governance framework, ensures that it remains a resilient and sustainable business. We look forward, with renewed spirit, to the year ahead.

Douglas Caster CBE
Executive Chairman
5 March 2018

> The Board and senior management play a key role in establishing, shaping and embedding the culture, values and ethics of the Company.

Corporate Governance Report

Compliance statement
With Rakesh Sharma's resignation as Chief Executive on 10 November 2017, and Douglas Caster exercising the role of Executive Chairman from the same date, the Board does not comply with A.2.1 of the UK Corporate Governance Code currently in effect (the Code), which states that the roles of Chairman and Chief Executive should not be exercised by the same individual. The Board's decision to make these directorate changes followed a period of reflection by the Non-Executive Directors on the future leadership of Ultra, and its conclusion that Douglas Caster was ideally qualified to lead the Group until a successor could be appointed. Although there were potential internal candidates that could have allowed immediate succession, the Board thought it important to embark on a search process to benchmark those internal candidates against other best-in-class industry leaders and ensure that the best possible person is appointed. Ultra's search is now well underway, and the Board is confident that it will be compliant with A.2.1 of the Code in the near future.

On 10 November 2017, the Board also asked Sir Robert Walmsley, whose term as a Non-Executive Director was due to expire in April 2018, to remain on the Board for a further year as Senior Independent Director. This extension means that Sir Robert will have served on the Board for more than nine years from the date of his first election, and would therefore not be considered independent for the purposes of B.1.1 of the Code. The Board acknowledges this, but considers Sir Robert's experience, skills and knowledge invaluable in providing Non-Executive continuity and leadership during this time of significant change.

Throughout the financial year ended 31 December 2017, the Board considers that it, and the Company, has complied with the other provisions set out in the Code. The Code is issued by the Financial Reporting Council and is publicly available on their website (**www.frc.org.uk**). Summarised below and explained in detail throughout this report, we have described how we have applied the main principles of the Code.

Leadership

The Board provides leadership to the Group and rigorously challenges strategy, performance, responsibility and accountability to ensure that the right decisions are made in the right way and in consideration of the long-term success of the Group.

Read more about the Board's leadership on pages **62-65**.

Effectiveness

Directors are appointed on merit, following a rigorous and transparent process. The Board evaluates the balance of skills, experience, knowledge and independence of the Directors through an externally facilitated evaluation process and ensures that all new Directors undertake an induction programme.

Read more about the Board's effectiveness on pages **66-67**.

Accountability

Effective risk management is fundamental to achieving the Company's objectives. Decisions are based on the Board's appetite for risk.

Read more about the Board's accountability on page **68**.

Relations with shareholders

We maintain strong relations with shareholders through events and consultations.

Read more about shareholder relations on pages **68-69**.

Remuneration

Executive Directors' remuneration is designed to promote the long-term success of the Company. The Board ensures performance-related elements are transparent, stretching and rigorously applied.

Read more about the Company's remuneration on pages **78-91**.

Role of the Board
The role of the Board is to provide effective leadership and direction in delivering the key corporate objective of generating shareholder value. The Executive Directors set the Group strategy, which is subject to challenge by the Board before final agreement. The Board ensures that adequate controls are in place, including calibrating risk appetite and maintaining oversight of Ultra's risk management processes. The Board also receives and reviews regular Compliance Reports. The Board encourages the Group's businesses to behave ethically and properly at all times and engenders a culture of fairness to customers, suppliers and employees. It is the function of the Group's management, through the Executive Chairman and his Executive Team, to run the operations of the Group.

In addition to the nine scheduled Board meetings, the Board held a number of unscheduled Board meetings in the year to, amongst other things, review progress and next steps on the proposed Sparton acquisition, to evaluate potential directorate changes, and to release a trading statement ahead of its year end on 31 December 2017. Following such reviews, the Board implemented the directorate changes (see pages **7** and **9** for further details), and released a trading statement (both on 10 November 2017).

A summary of how the Board spent its time in 2017 is set out on pages **62-63**. The full range of Board responsibilities are detailed in the document entitled "Terms of Reference for Main Board", which is available from the Investors' section of the Group's website (**www.ultra-electronics.com/investors**).

Corporate Governance Report continued

Leadership

How the Board spent its time in 2017

Group strategy	
Review the Group's strategies for growth and the market segment strategies. Monitor the performance of the Group against these strategies.	In addition to the scheduled and unscheduled Board meetings held in the year, a full-day Board strategy session was held on 1 August 2017, which focused on the divisional and market segments strategies. Presentations were given by the Executive Team and Segment leads and discussions were held on significant matters identified in respect of each of the segment areas. After Douglas Caster had assumed the role of Executive Chairman of the Group on 10 November 2017, he undertook a full set of strategic and budget reviews with each of the Ultra businesses, reporting his findings back to the Board. This continued monitoring and oversight of the Ultra businesses provided the Board with a valuable insight into the financial health of the Group as a whole, thereby enabling it to evaluate the performance of the Group against its named strategy for facilitating organic growth.

Financial reporting and controls	
Agree the final budget. Review the financial results and forecasts, reports on performance against budget, Shareholder engagement and analysis, and treasury and tax activities. Set the dividend.	• At each scheduled Board meeting, the Board received a: – Chief Executive/Executive Chairman's Report, which covers the Group's operational performance and particular performance issues in each division; and – Group Finance Director's Report which covers financial forecasts for the half year and full year and reviews of financial performance, banking covenants and analysts' views of the Group, major shareholdings and major share buyers and sellers. • As part of its annual work plan, the Board approved the annual and interim financial statements and accompanying regulatory announcements, reviewed and approved the annual budget and approved the Group's dividend policy, payment of the interim dividend and the recommendation of the final dividend. • The Board reviewed reports from the Board's Committees, including recommendations from the Audit Committee in respect of: the effectiveness of the Company's risk management and internal control statement; the adoption of the going concern statement; the long-term viability statement; impairment; and the reappointment of the External Auditor. • The Board approved the Group tax and treasury strategy, with country-by-country tax filings being made for the first time over the past year.

Market analysis and major bids	
Receive market reports. Review major bid wins and losses and significant current and future bids.	• At each scheduled Board meeting, the Board received a Group Marketing Director/Corporate Marketing Director's Report providing a brief on market developments, order intake and bids (including information in respect of missed bids). Improvements were made to this report in the year to improve order pipeline visibility. • A significant amount of time was spent by the Board in discussing and evaluating the proposed acquisition of Sparton Corporation and the associated placing of new ordinary shares to part-fund the acquisition (see page **19** for further details of the proposed Sparton acquisition), including compliance- and governance-related issues such as the necessity of maintaining insider lists and ensuring compliance with the Market Abuse Regulation.

Group risk framework and management **Set the Group's risk appetite and monitor the Group's significant risks.**	• The Board (either by itself or through the Audit Committee) conducted an annual refresh of the Group risk register (including risk appetite), and reviewed the Group's principal risks to determine the nature and extent of the risks it is willing to take and to review the management of those risks. • A "deep dive" review of the cyber security risks facing Ultra, and the Group's ability to mitigate such risks, was conducted. • The Board continued to consider the potential impact of political developments (including Brexit) on the Group. • The Board received a health, safety and environment report summarising the position across the Group and considered reports on externally reportable health and safety incidents and evaluated the adequacy of the correction and mitigation plans. • The Board approved the Group's insurance programme.
People, Board effectiveness and succession planning **Receive reports on changes in senior management. Review Board succession planning and undertake an annual Board evaluation.**	• At each scheduled Board meeting, the Board received an update on changes in senior management. • The Board took part in an annual Board evaluation (see page **67** for further information on this).
Significant transactions, matters and expenditure **Consider, review and approve significant transactions, matters and major capital investment projects and bids. Monitor significant litigation/disputes.**	• At each scheduled Board meeting, the Board received project reports on major contracts and programmes (including the S3 and ERP Programmes) and evaluated acquisition opportunities. • The risk profile of major projects, focusing on the proposed Sparton Corporation acquisition, was considered and strategies to mitigate surrounding risks were evaluated. • Quarterly reports on the Ultra Electronics Herley integration plan were considered. • The Board received regular briefings on the arbitration between Ultra Electronics in Collaboration with Oman Investment Corporation LLC (Under Liquidation) and the Government of the Sultanate of Oman represented by the Ministry of Transport and Communications in relation to the termination of the Oman Airport IT contract in 2015, and, based on the information it received, the Board determined to cease funding of the arbitration in November 2017.
Corporate governance and legal/regulatory compliance **Review and approve the annual report and accounts. Receive reports from each Committee and on legal and regulatory developments. Review Group policies.**	• Biannually, the Board reviews the Compliance Reports prepared by Divisional Managing Directors (MDs) and Presidents which summarise the compliance matters in the Business Performance Reports submitted each month by the Business MDs and Presidents (see page **94**). • The Board considered and approved Group policies, including Ultra's dividend policy and professional advice policy. • The Board reviewed the annual corporate governance update prepared by the General Counsel & Company Secretary, and approved recommended associated actions. • The Board considered, evaluated and approved actions in respect of material upcoming legal and regulatory updates, including the EU General Data Protection Regulation (GDPR), gender pay gap reporting and US tax reforms. • The Board undertook corporate governance compliance training, covering topics including Directors' duties, compliance with certain relevant aspects of MIFID II, and significant transactions. • The Board reviewed reports on the Group's offset policy.

Corporate Governance Report continued

Leadership

Board priorities for 2018

- Conclude the search for, and appoint, a new Chief Executive
- Establish and fully embed an Executive Risk Committee chaired by the Executive Chairman.
- Monitor implementation of the Group's strategies for growth
- Support further development of talent and succession planning across the Group with particular focus on the sales and marketing, project management and commercial functions
- Continue to develop and maintain best practice standards in corporate governance and compliance with legislation – the Board will oversee the Group's compliance with the GDPR, gender pay gap reporting, payment practices reporting, and any changes following on from the Government's response to the BEIS green paper on corporate governance reforms.

How Ultra's governance supports the delivery of its strategy

Good governance is crucial to ensuring that Ultra is well managed and can deliver its strategy.

The Board

Executive Chairman: Douglas Caster; Senior Independent Director: Sir Robert Walmsley.

All the Directors are collectively responsible for the success of Ultra. In addition, the Non-Executive Directors are responsible for exercising independent and objective judgement and for scrutinising and challenging management.

The Board is responsible for approving strategy and policies, for oversight of risk and corporate governance, and for ensuring expected returns on investment are made from leveraging portfolio strength. The Board is accountable to shareholders for the proper conduct of the business and for Ultra's long-term success; it represents the interests of all stakeholders.

Members of the Board and their biographies are shown on pages **58** and **59**.

The Board has delegated certain key responsibilities to the Nomination Committee (see page **71**), to the Audit Committee (see page **73**) and to the Remuneration Committee (see page **78**). The Committees make recommendations to the Board for approval. However, ultimate responsibility lies with the Board.

The responsibilities of each Committee are in line with the recommendations of the Code and the detailed terms of reference of each Committee, which are reviewed annually by the relevant Committee and approved by the Board, are available from the Investors' section of the Group's website (**www.ultra-electronics.com/investors**).

Executive Chairman: Douglas Caster

The Executive Team comprises:
Executive Chairman; Group Finance Director; Corporate Marketing Director; Chief Operating Officer; General Counsel & Company Secretary and Divisional Managing Directors/Presidents.

The Executive Team is the body through which the Executive Chairman exercises the authority delegated to him by the Board. It considers major business issues, makes recommendations to the Executive Chairman and typically reviews those matters which are to be submitted to the Board for its consideration. The Executive Chairman is responsible for establishing the Executive Team and chairing the Executive Team meetings.

Ultra is committed to ethical business conduct. In this regard, the Group has the benefit of an independent Ethics Overview Committee. The Group has issued a Policy Statement on Ethics and Business Conduct (available from the Corporate Responsibility section of the Group's website: **www.ultra-electronics.com**).

Ethics Overview Committee

Three independent members:
David Shattock (Chairman); Martin Bell; and Major General (retired) Tim Cross

Three Ultra members:
Executive Chairman; General Counsel & Company Secretary; and Divisional Managing Director Communications & Security

Further details about the Ethics Overview Committee are given on page **55**.

Board meetings
Financial results for each operating business, Division and the Group are presented at every scheduled Board meeting. Comprehensive briefing papers are circulated to the Directors in advance of each Board meeting to enable an informed debate to take place. Acquisition opportunities are presented to the Board by the appropriate Divisional Managing Director/President and/or the M&A Director. This enables a full discussion of the merits and risks of any acquisition proposal to take place at an early stage. The Executive Chairman and Group Finance Director explain the significance of any major impacts on the Group's financial performance and draw the Board's attention to any significant trends or deviations from budget revealed by monthly forecasts of future performance.

Other significant matters that require formal Board approval, which are routinely presented by the appropriate business include major bids, updates on key strategic initiatives, tax strategies and major capital and private venture development expenditure proposals.

When a scheduled Board meeting is not held in the month, the Directors receive a summary financial report for the Group comprising consolidated financial information and business financial information, summary financial reports from each of the businesses, forecast for the half and full year, and a shareholder analysis summary report on Ultra.

The Executive Team as a whole meets the Board annually to present the proposed Strategic Plan for the next five years. This is then debated with the Directors, changes are agreed and a final plan is approved. During 2017, the Board visited two operating businesses in the UK. Martin Broadhurst individually undertook site visits of some of Ultra's North American Businesses and provided a report of his findings to the Board. Such visits provide a useful cultural barometer and enable the Board to see the Group's capabilities first-hand and to engage with colleagues formally and informally.

At scheduled Board meetings, the Board receives presentations by Ultra's businesses detailing recent performance, key opportunities (including in respect of specific bids or programmes) and future forecasts. This gives the Non-Executive Directors a good, practical insight into the operating businesses.

Product demonstrations and site tours take place, giving the Non-Executive Directors a good practical insight into operating businesses. They also conduct individual visits to operating businesses.

Meeting attendance 2017
The table below shows attendance by Directors at Board and Committee meetings. To the extent that Directors were unable to attend meetings, because unscheduled meetings were called at short notice or because of prior commitments, they received and read papers for consideration at the relevant meeting, relayed their comments in advance and, where necessary, followed up with the Chairman on the decisions made.

	Board		Audit Committee		Remuneration Committee		Nomination Committee	
	Actual (inclusive of unscheduled Board meetings)	Maximum possible (inclusive of unscheduled Board meetings)	Actual	Maximum possible	Actual	Maximum possible	Actual	Maximum possible
Executive Chairman								
Douglas Caster	18	18	-	-	-	-	5	5
Chief Executive								
Rakesh Sharma [1]	16	16	-	-	-	-	-	-
Executive Directors								
Mark Anderson [1,2]	6	7	-	-	-	-	-	-
Amitabh Sharma [2]	17	18	-	-	-	-	-	-
Non-Executive Directors								
Martin Broadhurst [2]	18	18	5	5	5	5	5	5
Geeta Gopalan [1,3]	12	12	3	3	2	3	4	4
John Hirst [2]	17	18	5	5	5	5	5	5
Victoria Hull [2]	11	12	3	3	2	2	4	4
Sir Robert Walmsley [2]	17	18	5	5	2	5	5	5

[1] Geeta Gopalan attended all Board meetings after her appointment and Mark Anderson and Rakesh Sharma ceased to attend Board meetings following their departure.
[2] Mark Anderson and John Hirst were each unable to attend one Board meeting and Victoria Hull, Martin Broadhurst, Amitabh Sharma and Sir Robert Walmsley were each unable to attend one unscheduled Board meeting.
[3] Geeta Gopalan was unable to attend one Remuneration Committee meeting.

Corporate Governance Report continued

Effectiveness

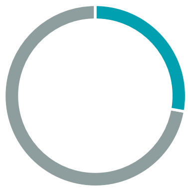
Board skills and experience

The Board has a balance of skills, understanding, perspectives and experience relevant to the Group's activities. Collectively, the Board members possess an understanding of the Group's core defence, security, transport and energy markets. This is complemented by members' experience and expertise in other industries and disciplines including procurement, accountancy, financial management, financial services, legal and growing international businesses. This range of skills and experience informs the Board's decision-making and enables it to provide effective leadership. The particular skills and experience that each Director brings to the Board are described in their biographies on pages **58-59**.

Executive Directors are permitted to accept one appointment as a Non-Executive Director (other than Chairman) in another listed company. The Board considers that such roles enrich the skills and experience of its Executive Directors to the overall benefit of the Company. Executive Directors are permitted to retain any fees they receive from such external appointments.

Board composition

Executive Chairman	1
Executive Directors	1
Non-Executive Directors	5



Board of Directors

Female	29%
Male	71%

Board tenure and independence

	Tenure years	Independence	Experience on other plc boards
Executive Chairman			
Douglas Caster	7	No	Yes*
Non-Executive Directors			
Martin Broadhurst	5	Yes	No
Geeta Gopalan	less than 1	Yes	Yes
John Hirst	3	Yes	Yes
Victoria Hull	less than 1	Yes	Yes
Sir Robert Walmsley	9	No	Yes
Executive Directors			
Amitabh Sharma	1	No	Yes

*Douglas Caster holds Non-Executive Director position at Morgan Advanced Materials plc (since January 2015) and a Chairman position at Metalysis Limited (since February 2014).

Non-Executive Directors

Martin Broadhurst, Geeta Gopalan, Victoria Hull, John Hirst and Sir Robert Walmsley are the Group's Non-Executive Directors. The Board considers all Non-Executive Directors (with the exception of Sir Robert Walmsley, who will have served a nine year term in April 2018) to be independent. In assessing independence, the Board considers that they are independent of management and free from business or any other relationship, which could interfere with the exercise of independent judgement, now or in the future.

The Executive Chairman has also considered the Non-Executive Directors' performance in the year and has determined them to be effective and to have demonstrated commitment to their roles. The Board considers that any shareholdings of the Executive Chairman and Non-Executive Directors serve to align their interests with those of its shareholders.

The key role of the Non-Executive Directors is to provide an appropriate level of challenge and constructive criticism to the plans of the Executive Directors on behalf of stakeholders. The Non-Executive Directors met without the Executive Chairman or Executive Directors being present during the year to discuss aspects relating to the Board and the Company and gave appropriate feedback.

On behalf of the Company, the Non-Executive Directors are active in developing relationships at a senior level with the Company's key suppliers, customers and business partners.

Insurance

The Group maintains an appropriate level of Directors' and Officers' Liability insurance cover in the event of any legal action against its Directors and Officers.

Board appointments – the process

In making appointments to the Board, the Board, through the Nomination Committee, is careful to identify the skills, knowledge and experience needed for each role and to complement the existing skills mix provided by other Board members. To ensure selection from the widest possible talent pool, it is Ultra's normal practice to engage the services of independent external search consultants in recruiting new Directors.

The executive search firm Inzito was engaged to assist with the recruitment process for the appointment of Victoria Hull and Geeta Gopalan as Non-Executive Directors. The Company does not have any other connection with Inzito.

Ultra's succession planning process is described on page **53**.

Directors' induction and training

All new appointments to the Board receive an induction to the Group covering: the Group's strategy, governance framework, policies and procedures, the products and services of the Group's businesses, the key markets in which the businesses operate, the key risks which the Group faces (together with the actions and plans which are in place to mitigate these risks), corporate and organisational structure, financing principles, and legal and regulatory matters.

Visits to operating businesses are arranged. New directors are encouraged to meet business and divisional management teams to gain a feel for the Group's style and culture.

Opposite is a summary of what Geeta Gopalan and Victoria Hull's induction programmes involved.

The General Counsel & Company Secretary presents to the Board annually on corporate governance. The Board is briefed on significant changes in the law or governance codes affecting their duties as Directors. Experts present to the Board on specialist areas, such as pensions and tax. Specific training is arranged for Directors as and when appropriate, and as may be requested by any member of the Board. The Directors are able to call on independent professional advice at any time should this be necessary in order for them to carry out their duties.

Inductions for Geeta Gopalan and Victoria Hull
Following the appointment of Geeta Gopalan and Victoria Hull to the Board in April 2017, both Non-Executive Directors are undertaking a comprehensive induction programme. This includes meeting with Committee Chairs and advisors, meeting senior executives and visiting some of Ultra's businesses.

Board evaluation
The Executive Chairman commissions externally facilitated annual Board evaluations. Board evaluations run on a two-year cycle. One year, the effectiveness of the Board and its Committees is evaluated; the following year, individual Directors' performance is evaluated.

Early in the year, Mr Telfer of Auxesis Consulting Ltd facilitated a Board discussion on the evaluation of the effectiveness of the Board and its Committees that was conducted in 2016 and reported upon in the 2016 Annual Report and Accounts. An update on the progress made on these actions is set out in the table below.

Board evaluation action points

Focus	Actions	Progress
Increase the level of diversity on the Board	• Board diversity will be actively considered by the Nomination Committee in reviewing succession planning for the Non-Executive Directors.	• Board diversity has increased following the appointments in April 2017 of Victoria Hull and Geeta Gopalan to the Board.
Development of Senior Managers	• Creating opportunities to increase the exposure of potential successors to the Board, such as attending Board dinners and presenting to the Board. • Increasing Senior Managers' exposure to shareholders.	• Over the course of the year, a number of update sessions and board presentations have been delivered by Senior Managers; the Board intends for this practice to continue.
Ensure correct balance at Board meetings between operational and strategic matters	• Scheduling Board reviews of major decisions made by the Board. • Competitor analysis presentations will be made to the Board. • Reducing the number of scheduled Board meetings in a year from ten to nine to accommodate Strategic Board meetings as required.	• Two competitor analysis presentations were delivered to the Board in 2017. • As planned, the number of scheduled Board meetings was reduced from ten to nine in 2017 to accommodate further Strategic Board meetings.

In November 2017, following directorate changes and Douglas Caster's appointment as Executive Chairman, Mr Telfer also facilitated the Board's self-assessment of individual Directors' performance. All Directors completed a detailed questionnaire requiring them to give feedback on their perception of Board members' contribution. The objective of the process was to encourage the improved performance and effectiveness of the Board. A report of the results was given to the Executive Chairman, detailing any significant points pertaining to the individual Directors and broader issues regarding the combined strengths and weaknesses of the Board as a whole. Mr Telfer reviewed the report with the Executive Chairman to discuss possible actions arising and the feedback to be provided to individual Directors. Individual feedback reports were given to each Director.

The assessment concluded and the Board considers that each Director contributes effectively and demonstrates commitment to the role. In addition, there is an appropriate balance of skills, experience, independence, diversity and knowledge of the Company to enable the Directors to discharge their respective duties and responsibilities effectively. Commitment of time by all Directors to Board and Committee meetings and other duties is also considered sufficient for the effective discharge of their responsibilities.

Notwithstanding the conclusions drawn in respect of the valuable contributions made by each Director and the balanced composition of the Board, in light of the significant organisational changes faced by the Group, the Board agreed that a robust oversight of the Group's risk management and internal controls was required.

Accordingly, an Executive Risk Committee to be chaired by the Executive Chairman is in the process of being set up. Key business risks, including cultural and corporate governance risks, will be closely monitored by the Risk Committee (which will report directly to the Executive Team).

Mr Telfer has considerable experience working at board level. He was the Group Human Resources Director of Ultra up until June 2004 (when he left Ultra to set up his own consultancy) and so is able to facilitate the evaluation from a position of having a good understanding of the foundation of the Group's culture. He provides a valuable insight into Ultra's challenges and needs and is able to assess the Board and its Committees in the context of the Group's development.

Corporate Governance Report continued

Accountability

Risk management and internal control
The Board is responsible for the Group's risk management framework and internal control systems and for reviewing their effectiveness. The Group has internal control systems across finance, operations, human resources and compliance and key controls have been identified. The Board, via the Audit Committee, monitors the internal control systems on an on-going basis. The risk framework and internal control systems play a key role in the management of risks that may impact the fulfilment of the Board's objectives. They are designed to identify and manage, rather than eliminate, the risk of Ultra failing to achieve its business objectives and can only provide reasonable, not absolute, assurance against material misstatement of losses.

Details of the processes the Board has in place to identify, evaluate and manage the principal risks faced by the Group can be found in the risk section of the Strategic Report.

In accordance with the Code, the Board confirms that:

- There is a continuing process for identifying, evaluating and managing the principal risks faced by the Group
- The systems have been in place for the year under review and up to the date of approval of this Annual Report and Accounts
- The systems are regularly reviewed by the Board and the Board considers them to be effective
- No significant failings or weaknesses have been identified
- The systems accord with the FRC guidance on risk management, internal control and related financial business reporting.

In light of developments during the year, the Board have reviewed risk management and internal control processes and consider that they continue to be effective. Further details on the process for financial controls can be found in the Audit Committee Report.

P38-45
Principal risks & uncertainties
Read about risk assessment processes, risk appetite statement, principal risks and viability statement.

P73-77
Audit Committee Report

Relations with shareholders

Commitment to dialogue
The Board is committed to a high-quality dialogue with shareholders. The Executive Directors lead in this respect. The Senior Independent Director and other Non-Executive Directors are available to meet with shareholders on request.

Annual programme
A full programme of engagement with shareholders, potential investors and analysts is undertaken each year by the Executive Directors. Ultra organises focused events and/or site visits to provide greater insight into the strengths and potential of its extensive portfolio of specialist capabilities. Visits and presentations in the year included various roadshows, investor conferences and hosted visits for analysts. These range from introductory briefings on the Group as a whole to presentations on specific areas of capability.

Ultra invited investors and members of the financial community to the DSEI Exhibition in September 2017, where a significant proportion of the Group's products and capabilities were exhibited.

Meetings are held with institutional investors and financial analysts after the release of the interim and full year financial results, at which detailed briefings are given. These briefings are also available from the Investors' section of the Group's website (**www.ultra-electronics.com**), together with copies of all regulatory announcements, press releases and copies of the published full year and interim Reports and Accounts.

The Board is regularly updated by the Company's stockbrokers on analysts' and major shareholders' views on the Company. The Board receives a report at each Board meeting on any changes to the holdings of the Company's main institutional shareholders.

All shareholders are invited to attend the Annual General Meeting on 27 April 2018, where they will have the opportunity to meet with Directors and to ask questions.

Voting at the Annual General Meeting is conducted by way of a show of hands. Proxy votes lodged for each Annual General Meeting are announced at the meeting and published on the Group's website (**www.ultra-electronics.com**). Electronic communication with shareholders is preferred wherever possible since this is both more efficient and environmentally friendly. However, shareholders may opt to receive hard copy communications if they wish.

In 2017:

- Main institutional shareholders (those with a 3% shareholding or more) were consulted about the proposed acquisition of the Sparton Corporation
- The Executive Chairman and the Group Finance Director held meetings and calls with a number of institutional shareholders following the directorate changes and release of Ultra's trading statement on 10 November 2017.

All shareholders are invited to attend the Annual General Meeting on 27 April 2018, where they will have the opportunity to meet with Directors and to ask questions.

Shareholder analysis

The majority of Ultra's shares are held by institutional shareholders. The Executive Chairman and other members of the Executive Team have significant holdings in the Company, including shares awarded through share option or long-term incentive schemes.

Shareholder analysis by category of shareholder as at 31 December 2017

Category	Holding	%
Unit trusts	34,832,078	44.81
Mutual fund	12,680,977	16.31
Pension funds	11,106,771	14.29
Other managed funds	5,269,826	6.78
Investment trust	3,024,314	3.89
Custodians	3,019,085	3.88
Private investor	2,696,731	3.47
Exchange-traded fund	1,815,747	2.34
Insurance companies	1,284,689	1.65
Sovereign wealth	1,009,560	1.30
Charity	550,233	0.71
Hedge fund	440,020	0.57
Other	1,193	0.00
Total	**77,731,224**	**100.00**

Shareholder analysis by size of shareholding as at 31 December 2017

Size of shareholding	Total number of holdings	% of holders	Total number of shares	% issued capital
1-50	153	8.57	3,196	0.00
51-100	110	6.16	8,918	0.01
101-250	380	21.29	69,534	0.09
251-500	257	14.40	94,979	0.12
501-1,000	257	14.40	186,238	0.24
1,001-5,000	285	15.97	611,929	0.79
5,001-10,000	67	3.75	470,772	0.61
10,001-25,000	79	4.43	1,259,482	1.62
25,001-50,000	48	2.69	1,744,462	2.24
over 50,000	149	8.34	73,281,714	94.28
Total	**1,785**	**100.00**	**77,731,224**	**100.00**

Financial calendar

21 March 2018	Annual Report & Accounts published
5 April 2018	Ex-dividend date
6 April 2018	Record date
27 April 2018	Annual General Meeting
3 May 2018	Final dividend payment date
6 August 2018	Interim results announced
22 September 2018	Interim dividend payment date

Corporate Governance Report continued

Directors' responsibilities statement
The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors are required to prepare the Group financial statements in accordance with IFRSs as adopted by the European Union and Article 4 of the International Accounting Standards Regulation (IAS) and have elected to prepare the Company's financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) including FRS 101. Under company law, the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs and of the profit or loss of the Company, as well as the undertakings included in the consolidation for that period.

In preparing the Company's financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently
- Make judgements and accounting estimates that are reasonable and prudent
- State whether applicable UK Accounting Standards have been followed subject to any material departures disclosed and explained in the financial statements
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In preparing the Group financial statements, International Accounting Standard 1 requires that Directors:

- Properly select and apply accounting policies
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures, when compliance with the specific requirements in IFRS are insufficient, to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance
- Make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website (**www.ultra-electronics.com**). Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We confirm that, to the best of our knowledge, taken as a whole:

- The financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole
- The Strategic Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation, together with a description of the principal risks and uncertainties that they face
- The Annual Report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

The Annual Report (including the Strategic Report and Directors' responsibilities statement) on pages **6-94** was approved by the Board on 5 March 2018 and signed on its behalf by:

Douglas Caster, Executive Chairman
Amitabh Sharma, Group Finance Director

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Nomination Committee Report

> I am pleased to present the Nomination Committee Report, which summarises our work over the past year.
>
> **Douglas Caster**, Chairman of the Nomination Committee

Dear Shareholder
The Nomination Committee met five times in 2017. At the start of the year, our focus was on undertaking a rigorous review of the tenure of long-serving Non-Executive Directors, and succession planning to ensure a balance of skills, experience and knowledge was maintained on the Board and its Committees. We also reviewed the succession planning and career progression of senior employees, and the recruitment and development of talent across the Group. After Rakesh Sharma stepped down as Chief Executive on 10 November 2017, our main focus has been on ensuring a robust selection and recruitment process for a new Chief Executive.

We currently believe that the Board and its Committees continue to have the appropriate mix of skills and experience to operate effectively, but of course this is kept under regular review. Collectively, the Directors bring a range of expertise and experiences to Board deliberations which help to ensure constructive and challenging debate around the boardroom table. The Board's skills are illustrated on page **66**.

The Committee has written terms of reference, which include all matters recommended by the Code. These terms of reference are reviewed and approved annually and are available from the Investors' section of the Group's website (**www.ultra-electronics.com/investors**).

Douglas Caster,
Chairman of the Nomination Committee

How the Nomination Committee spent its time in 2017

Board composition

Regularly review the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board in line with the Code's requirements.

- The Committee considered the composition of the Board. Sir Robert's tenure as Non-Executive Director was due to expire in April 2018, but he was asked by the Board to remain for a further year as Senior Independent Director. In line with the Code, the Committee considered his performance and ability to continue to contribute to the Board. Sir Robert is actively involved in the defence market and the Committee considers that he continues to bring relevant knowledge, skills and experience to the Board, all of which was considered to be especially invaluable in a time of significant organisational change.

Succession planning

Consider succession planning for Directors and senior executives below Board level.

- Succession planning continued to be an area of focus for the Committee during 2017, and in particular, the search for a new Chief Executive. The executive search firm Korn Ferry was engaged to identify potential candidates for the position of Chief Executive after Rakesh Sharma stepped down on 10 November 2017. The Company does not have any other connection with Korn Ferry. The role specification and selection criteria was determined by the Nomination Committee. The curricula vitae of the candidates were considered by the Nomination Committee. A sub-committee of the Committee is currently in the process of interviewing the short-listed candidates and will select those candidates it considers should go through to final interviews. Each member of the Nomination Committee will be invited to attend the final interviews. Following this process, the Nomination Committee will meet to agree upon the successful candidate before any recommendation is put to the Board.
- In consideration of Executive-level succession planning, the Committee received a report explaining the annual Organisation, Succession & Development Plan (OSDP) process, the output from which is reviewed annually by the Executive Team. The aim is to have a successor identified for all senior positions. Where a permanent successor has not been identified, key roles would be covered by colleagues on an interim basis whilst external recruitment is undertaken. The success of the OSDP process is evidenced by the balance between internal and external appointments at senior levels. For Managing Director/President appointments, approximately 80% of appointments have been internal over recent years. Individuals with the potential to fill more senior roles over the medium and long term are also identified through this process.
- A number of actions were taken in the year to strengthen the succession pipeline, including:
  - Developing the "Chief Executive's Mentoring Club"
  - Addressing the demographic imbalances that exist in some businesses
  - Taking advantage of the larger pool of talent below Managing Director/President level as a result of business consolidations and providing employees with increased scope to broaden their experience within the business.

Continued overleaf >

Nomination Committee Report continued

How the Nomination Committee spent its time in 2017 continued

Board pipeline	
Identify and nominate suitable candidates for appointment to the Board, including chairmanship of the Board and its Committees, against a specification for the role and capabilities required for the position.	• The Board appointments of Geeta Gopalan and Victoria Hull were agreed with effect from 28 April 2017.

Board evaluation	
Consider the results of the annual Board evaluation.	• The results of the Board performance evaluation process were considered.

The Committee's focus for 2018

In 2018, the focus of the Nomination Committee will be to:

- Appoint a new Chief Executive
- Identify a replacement for Sir Robert Walmsley as Senior Independent Director
- Review and consider strengthening the position of Executive Directors on the Board as part of the Committee's regular review of the Board's composition.

Diversity

Board Diversity Policy

The Board Diversity Policy was implemented with effect from 29 July 2013. The key statement and objectives of that policy are set out below.

Statement

A Board composed of the right balance of skills, experience and diversity of views is best placed to support a company in its strategic objectives. The Board recognises the benefits of diversity. Diversity of skills, background, knowledge, international and industry experience, and gender, amongst many other factors, will be taken into consideration when seeking to appoint a new Director to the Board and all Board appointments will always be made on merit.

Objectives

The Board will ensure Directors have an appropriate mix of skills and experience and bring independent character and judgment.

The Board believes that this is best achieved by continuing its broad, diversity-aware "best person for the role" approach to recruiting, regardless of age, disability, gender re-assignment, marriage or civil partnership, pregnancy or maternity, race, religion or belief, sex or sexual orientation. For this reason, the Board has chosen not to set any specific objectives, but will instead continue to maintain its practice of embracing diversity in all its forms when compiling a shortlist of suitable candidates and recommending any future Board appointments.

Progress against the Board Diversity Policy

Following the appointment of Victoria Hull and Geeta Gopalan with effect from 28 April 2017, the proportion of female members of the Board is currently at 29% (2/7 Directors). There were no women on the Board from March 2016 until the appointments of Geeta and Victoria. The Board believes that these appointments not only contribute to greater diversity at Board level, but are also important in Ultra's business sector, which until recently has traditionally been regarded as "male", with a lower level of female participation compared with other industries.

The Committee recognises that diversity is more than just gender-based, and will continue to ensure that it uses rigorous recruiting practices to ensure the best candidates are nominated for appointment to the Board, based on objective requirements and assessments, whilst taking into account diversity in its broadest sense.

You can read more about Ultra's initiatives to improve diversity across the Group, including information on the gender split across the Board, Executive Team and the Group as a whole, in the Sustainability section of our Strategic Report on page **55-56**.

The Board will ensure Directors have an appropriate mix of skills and experience and bring independent character and judgment.

Audit Committee Report

As the Chairman of the Audit Committee, I am pleased to present our Audit Committee Report for the year ended December 2017.

John Hirst, Chairman of the Audit Committee

Dear Shareholder
Throughout the year, the Committee continued to focus on the integrity of financial reporting, internal controls and risk management processes. The Board's report on the systems of internal control and their effectiveness can be found in the Corporate Governance Report on page **68**. An assessment of the Group's principal risks and uncertainties can be found on pages **38-45** and the going concern and long-term viability statements can be found on page **45**.

As we indicated in the 2016 Report, in 2017, the Committee considered the impact of the April 2016 version of the Code on the Committee's work, conducted a "deep dive" into the "delivering change" risk (amongst others, as highlighted below), and reviewed Ultra's tax strategy statement in line with the Finance Act 2016. In addition, we oversaw the development of the Company's Risk Management Framework, with a particular focus on business-level risks (including approving the appointment of Divisional and business-level "risk champions" and reviewing business-level "deep dives"). The GDPR was, and continues to be, a focus area for the Committee.

In 2017, we also oversaw an external audit undertaken by Deloitte (including reviewing the matrix of coverage and ensuring that the audit scope was in line with the scope of such reviews undertaken by Ultra's peers). The impact of IFRS 15 on the Group was assessed by KPMG, across each of the 18 businesses in the Group, a process that was designed and implemented, and its results reviewed, by the Committee.

John Hirst, Chairman of the Audit Committee

Composition

The composition of the Committee is set out on pages **58-59**. The Chairman of the Committee has the recent and relevant financial and accounting experience required by the Code. He is supported in his role by the other members of the Committee who have a wide range of business experience and expertise, as reported in their biographies on pages **58-59**.

Meetings and attendance

The Committee met five times during the year under review. In addition to the members of the Committee, regular attendees included the Executive Chairman and the Group Finance Director. The Chief Executive and the Group Marketing Director each also regularly attended Committee meetings prior to their departure from Ultra. The General Counsel & Company Secretary is the Secretary to the Committee. Deloitte is the Group's External Auditor. To ensure full and open communication, Deloitte was represented at all scheduled Committee meetings, and the lead director from PwC attended those meetings at which key findings from Internal Audit reports were reviewed by the Committee.

During 2017, the Chairman of the Committee met with Deloitte and PwC in the absence of Executive and Non-Executive Directors. In addition, the Committee met with Deloitte without Executive Directors present, where Deloitte reported on its views of the Group's financial management process and any matters that they thought should be brought to the attention of the Committee. The Committee has written terms of reference which include all matters recommended by the Code. These terms of reference are reviewed and approved by the Board annually and are available from the Investors' section of the Group's website (**www.ultra-electronics.com/investors**).

The Board is kept fully informed of the Committee's work and the minutes of each Committee meeting are circulated to Board members.

Ultra is committed to ensuring it has robust and effective risk management and control processes.

Audit Committee Report continued

How the Audit Committee spent its time in 2017

Financial statements and accounting policies

Review management's significant issues and judgements, the Group's financial statements and the formal announcement on the Group's financial performance. Review the Group's going concern and long-term viability statement assumptions.

- The Committee considered and recommended to the Board for approval the annual and interim financial statements and related results announcements.
- The Committee discussed the key accounting policies and practices adopted by the Group. In addition, it reviewed the key accounting judgements and matters that required the exercise of significant management judgement.
- The Committee agreed the going concern statement and long-term viability statement.

Internal controls, including the financial reporting control framework and financial reporting developments

Assess the effectiveness of the Group's system of internal control and risk management.

- The Committee considered reports on the internal control environment and risk management and their effectiveness.
- The Committee considered compliance by the businesses with the Group's Business Continuity and IT Disaster Recovery Policies.
- The Committee discussed the Internal Controls Status Report which summarised the results from the six-monthly Divisional internal control review meetings.
- The Committee reviewed the principal risks, the Group's risk appetite and risk metrics and considered their alignment to the achievement of Ultra's strategic objectives.
- An assessment was undertaken of the key controls in place and future planned management actions to address the risks.
- Risk "deep dives" were conducted into the following areas: pension and pension strategy, cyber, and "delivering change", and improvements in the relevant processes were actioned by the Company.
- The Committee considered reports on known or suspected fraud.

Further details of the approach to risk management can be found on pages **38-45**.

Internal audit

Review the effectiveness of the Internal Audit function and discuss control issues identified by Internal Audit.

- Following its review of the adequacy of the internal control framework for the Group, the Committee agreed the Internal Audit plan for the year.
- The Committee considered summary reports from the risk-based and rotational reviews and progress reports on the implementation of remedial actions, and considered the controls around the S3 Programme rollout (with the follow-up report due in 2018), the Group's bid review process and month-end process.

External audit, auditor engagement and policy

Review the scope and effectiveness of the External Audit process; including negotiating the terms of the External Auditor's appointment, scope, fees and independence and supervising any audit tender process.

- The Committee considered reports from the External Auditor on the outcomes of their audit process and the External Audit plan for the year.
- The Committee reviewed the External Auditor's engagement policy, independence and effectiveness, and audit and non-audit fees.

Update on the actions reported in the 2016 Annual Report & Accounts

Areas of focus	Actions taken
Considering the impact of the April 2016 version of the Code on the Committee's work	Briefing papers in respect of the Committee's continued compliance with the Code were presented to the Committee.
Conducting a "deep dive" into the "delivering change" principal risk	A "deep dive" into the "delivering change" risk was undertaken and the relevant processes actioned by the Company.
Reviewing Ultra's tax strategy statement in line with the Finance Act 2016	Ultra's tax strategy statement was reviewed in line with the Finance Act 2016 and recommended changes were implemented.

The Committee's focus for 2018

In addition to the annual routine matters for consideration, the main areas of focus for the Committee for 2018 will be:

- Focusing on the risks highlighted in the 2017 internal audit, including the S3 Programme rollout, the bid review process and the month-end process
- Conducting risk "deep dives" into the following areas: "innovation and development" and "supply chain"
- Overseeing the implementation of the GDPR throughout the Group

Significant financial judgements and financial reporting for 2017	How the Committee addressed these judgements
Valuation of and impairment testing of goodwill and intangible assets	The Committee reviewed the methodology and assumptions used to determine the balance sheet values. The Committee also considered reports from and held discussions with the External Auditors.
Valuation of Oman Airport IT Contract termination and Ithra liquidation provisions	The Committee considered the level of the provisions for this matter.
IFRS 15	The Committee considered the impact of IFRS 15 on the Group.
Long-term contract accounting	The Committee considered the judgements taken into the forecast cost to complete estimates for significant contracts.

Financial control

The Group has in place internal control and risk management arrangements in relation to the Group's financial reporting processes and the preparation of its consolidated accounts. The arrangements include procedures to ensure the maintenance of records which accurately and fairly reflect transactions to enable the preparation of financial statements in accordance with International Financial Reporting Standards. They also require reported data to be reviewed and reconciled, with appropriate monitoring internally and by the Audit Committee.

Business Performance Reports (comparing actuals, budget, forecasts and prior year) are prepared for all businesses on a monthly basis and reviewed, where relevant, by the Divisional Finance Directors, the Group Finance Director, members of the Executive Team and the Board.

When preparing and reviewing financial information, the businesses do not work to a materiality threshold. All variances judged to be significant are investigated and explained.

In addition, there is a Group-wide process specifically for monitoring financial controls and risks. Management have delegated control ownership to each of the businesses and established a framework for reporting whether the controls are designed and operating effectively. Every six months, Divisional Internal Control Meeting (DICM) meetings are attended by the Group Finance Director, the Divisional Finance Director and by Internal Audit.

At the DICM meetings, the internal controls processes and issues for each business are discussed. These include:

- Results from the Senior Accounting Officer review
- Self-assessment against the Group Operating Manual
- Outstanding Internal and External Audit recommendations
- Compliance with the Group's Information Security Policy.

Summary results from these reviews are included in the Internal Controls Improvement Status Report, which is presented to the Audit Committee biannually.

Following the November profit warning, the Board and Executive Team have implemented enhanced controls and procedures in certain specific areas, including strategic planning and forecasting.

Operational controls

The Group Operating Manual sets out the mandatory Group policies and procedures to be followed and is communicated widely across the Group.

The Managing Directors and Presidents, the Finance Directors and the Vice Presidents of Finance of each Business are required to give a formal written representation to the Board each year. This representation confirms that they accept responsibility for maintaining effective internal controls in line with the Group Operating Manual and that they have disclosed full details of any fraud or suspected fraud within their business.

Audit Committee Report continued

> The performance, effectiveness and independence of the Company's External Auditor, Deloitte, is reviewed annually by the Committee.

Internal audit

PwC are appointed by Ultra as its internal auditor. The use of an experienced external firm provides independent assurance on the effectiveness of the system of internal control. A risk and rotational based approach is taken by the Company in determining its Internal Audit plan, thereby ensuring that the plan is clearly linked to the Company's strategy and is flexible enough to highlight and address emerging risks. The Internal Audit plan and resources are considered and monitored by the Committee, together with all internal control findings and remedial actions.

All newly acquired, individually operating businesses are audited within a year of their acquisition date. Where required, additional audits are identified during the year in response to changing priorities and requirements.

The lead director of PwC reports directly to the Chairman of the Committee and presents the findings to the Committee biannually. Progress reports on follow-up remedial actions are reported regularly to the Committee. PwC confirms whether appropriate action has been taken to address the risks when they next visit the business concerned.

The effectiveness of Internal Audit is assessed by the review of Internal Audit reports, meetings with the Chairman of the Committee without management being present and views from senior management and the Group Finance Director.

External auditor

The performance, effectiveness and independence of the Company's External Auditor, Deloitte, is reviewed annually by the Committee. The Committee received a briefing by Deloitte on the firm's policies on these matters and noted that such policies are subject to external monitoring by the Audit Quality Review Team, which is a part of the FRC's Conduct Division.

In addition, the Committee considered the questions contained in a questionnaire issued by the Institute of Chartered Accountants of Scotland in October 2007 to assess performance, effectiveness and independence.

The effectiveness of the External Audit process is assessed by the Committee, which meets regularly throughout the year with the senior audit partner and senior audit managers. Key to the overall effectiveness of the process is that both the Company and the auditor make the other aware of accounting and financial reporting issues as and when they arise, and this exchange is not limited to the period in which formal audit and review engagements take place.

The Committee believes that sufficient and appropriate information is obtained to form an overall judgement on the effectiveness of the external audit process.

The Committee concluded that Deloitte had been sufficiently transparent and incisive and that the audits had been effective. In addition, the Committee concluded that Deloitte was both independent and objective and that the reappointment of Deloitte as external auditor should be recommended to the shareholders. Accordingly, a resolution to reappoint Deloitte will be put to shareholders at the 2018 Annual General Meeting.

The senior audit partner employed by Deloitte on the Group's audit is subject to a strict policy of regular rotation such that there is a change in this role at least once every five years. This is in accordance with professional practice guidelines. Deloitte was appointed in 2002. A new partner was appointed in 2016. The Committee considers that for an organisation of the size and complexity of Ultra, the tendering of external audit must be well planned to ensure that the Group complies with best practice corporate governance as well as ensuring the Group receives a high quality, efficient and effective external audit service. The Committee considers that it would be appropriate to conduct an External Audit tender by no later than 2023 at which point Deloitte would be precluded from being Ultra's external auditor. The Company is in compliance with the requirements of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 and the Code.

There are no contractual obligations that restrict the Committee's choice of external auditor.

The Auditor's engagement letter and the scope of the year's annual audit cycle is discussed in advance by the Committee, ensuring that any changes in circumstances arising since the previous year are taken into account. With respect to non-audit services undertaken by Deloitte, Ultra has a policy to ensure that the provision of such services do not impair Deloitte's independence or objectivity.

It is the policy of the Group that non-audit services provided by Ultra's External Auditor are restricted to regulatory reporting, consultancy services associated with financial restructuring, responding to new reporting requirements, due diligence assessments of potential acquisitions and consultancy work. In connection with due diligence work and consultancy, the Board believes that the External Auditor's familiarity with Ultra's accounting practices and the techniques that are involved in Ultra's long-term contracting activities serves them well in carrying out such work.

The Group Finance Director has authority to commission the External Auditor to undertake non-audit work where there is a specific project with a cost that is not expected to exceed £50,000. Any individual assignments with an estimated fee in excess of £50,000 must be referred in advance to the Chairman of the Committee for his approval. The non-audit work has to be reported to the Committee at its next meeting. Before commissioning non-audit services, the Group Finance Director or the Chairman of the Committee, as appropriate, must ensure that the external auditor is satisfied that there is no issue regarding independence and objectivity and that other potential providers are adequately considered. The fees in relation to the proposed acquisition of the Sparton Corporation were reviewed and agreed in line with this process. In addition, consideration must be given to the provisions of the Financial Reporting Council Guidance on Audit Committees with regard to the preservation of independence and objectivity. The external auditor certified to the Company that it is acting independently and that, after review, the Company (through the Chairman of the Audit Committee and the Group Finance Director) has satisfied itself of the auditor's independence. In providing a non-audit service, the external auditor should not: audit their own work; make management decisions for the Company; create a mutuality of interest; or find themselves in the role of advocate for Ultra.

The EU audit legislation came into effect on 1 June 2016. For the year commencing 1 January 2018, Ultra is subject to restrictions on non-audit fees arising from EU audit legislation. From 2020, the maximum non-audit fees that the statutory auditor can bill in any one year is set at 70% of the average of the audit fees billed over the preceding three years. All non-audit services provided by Deloitte in the year will be tracked relative to this cap.

The Committee considers that certain non-audit services should be provided by the external auditor, because its existing knowledge of the business makes it the most efficient and effective way for non-audit services to be carried out. The majority of non-audit fees in 2017 were incurred in respect of the work required on the class 1 proposed acquisition of the Sparton Corporation. In awarding this non-audit work to Deloitte, the Committee took account of Deloitte's knowledge of the Group as auditor, the benefits of Deloitte reviewing the financial data in detail before announcement, and considered Deloitte able to provide an effective service.

The fees paid to Deloitte in respect of audit and non-audit services are shown on page **112** of the Financial Statements.

The Group has a policy on employment of former employees of the external auditor. This requires that any such employment is considered on a case by case basis and takes into account the Auditing Practices Board's Ethical Standards on such appointments. Such appointments require approval by a combination of the Group Finance Director, Audit Committee and Board, depending on the seniority of the appointment.

Fraud

The Internal Audit process, carried out by PwC, described on page **76**, and the Group's internal control framework help to protect the Group against fraud. Regular business reviews take place at all businesses, in which detailed balance sheet and cash flow reviews are carried out by the relevant Divisional Managing and Financial Directors. In addition, the Group Finance Director and Group Chief Operating Officer each review the performance of the businesses with the Divisional team monthly and directly with the businesses at least biannually. Significant differences between forecast and reported financial results are highlighted and require explanation by the business unit concerned. The internal control framework that is in place is supplemented by the External Audit process which represents a second independent review of controls and procedures, with selective transaction testing of higher risk areas. There is a fraud reporting process in place. All cases of fraud would be immediately investigated and the situation reported to the Committee and the Board.

Whistleblowing

An independently hosted Employee Hotline (EthicsPoint) is used to provide a process for reporting ethical concerns. Such concerns can be filed anonymously. Employees are informed of this process through posters (which are translated into local languages) and through the Group intranet (which is accessible by all employees). Employee concerns are forwarded to the Senior Independent Director or, in the case of issues covered by US security legislation, to the Chairman of the Security Committee of either Ultra's Special Security Agreement company or Ultra's Proxy Board company, as appropriate. During 2017, six reports were filed via this system (three in respect of conflicts of interest, one alleging threatening behaviour, one relating to perceived discrimination or harassment, and one seeking information for a different service). Each of these reports was investigated fully at the relevant time, responses were provided promptly via the system, and the matters were subsequently closed.

Anti-bribery

Ultra has robust anti-bribery policies and procedures in place. All Directors and employees are required to sign Ultra's code of conduct on anti-bribery and commit to act in accordance with it. Within one week of joining Ultra, all Directors and employees undertake anti-bribery training. Additional anti-bribery training is given as appropriate. Compliance with the code of conduct on anti-bribery is mandatory and monitored. The Group intranet contains a statement regarding compliance with Ultra's anti-bribery policies. The Audit Committee Report was approved by the Board on 5 March 2018 and signed on its behalf by:

John Hirst, Chairman of the Audit Committee

"The Internal Audit process, carried out by PwC, and the Group's internal control framework help to protect the Group against fraud."

Remuneration Report

> As the Chairman of the Remuneration Committee, I am pleased to present the Remuneration Report for the financial year ended 31 December 2017.
>
> **Martin Broadhurst**, Chairman of the Remuneration Committee

1. ANNUAL STATEMENT

Dear Shareholder

As the Chairman of the Remuneration Committee, I am pleased to present the Remuneration Report, as prepared by the Remuneration Committee (the Committee) and approved by the Board, for the financial year ended 31 December 2017. It has been prepared in accordance with Schedule 8 of The Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 as amended in August 2013 and has been divided into the following three sections:

1. This **ANNUAL STATEMENT**, which summarises the major decisions on, and any substantial changes to, Directors' remuneration;
2. The **DIRECTORS' REMUNERATION POLICY**, which sets out Ultra's policy on the remuneration of Executive and Non-Executive Directors; and
3. The **ANNUAL REPORT ON REMUNERATION**, which discloses how the Remuneration Policy was implemented in the financial year ended 31 December 2017 and how the Remuneration Policy will be implemented in the financial year ending 31 December 2018.

Ultra's Remuneration Policy was put to a shareholder vote at the last AGM, where it received a 93.11% vote in favour. The Committee is grateful for the support.

Board changes

During the year, the Committee had to consider the leaver terms of Rakesh Sharma as Chief Executive and Mark Anderson as Group Marketing Director. The leaver terms, which can be found on page **89** of this report, are in line with the Remuneration Policy. The Committee also considered the terms of Douglas Caster's appointment to the interim role of Executive Chairman, which are also in line with the Policy. The Committee noted Douglas's two existing Non-Executive roles, of which one is at a non-listed company, and were comfortable that he would have sufficient time available to fulfil his role as Executive Chairman until a successor to Rakesh Sharma could be found.

Performance and reward during 2017

In 2017, revenue and underlying operating profit* were £775.4m (2016: £785.8m) and £120.1m (2016: £131.1m) respectively; underlying earnings per share* were 116.7p (2016: 134.6p); operating cash flow was £116.5m (2016: £120.4m); and total shareholder return was -2% (2016: 8%).

Bonuses for 2017 were based on financial and strategic measures. The underlying profit before tax threshold was not met and no bonus was payable for this element. Although the operating cash flow threshold was met, this is only paid if the profit threshold is met. As a result of not meeting threshold on the profit element, no bonus is payable in relation to the financial measures. Based on the strategic targets set at the start of the year, the outturn for the Group Finance Director, and for Mark Anderson (the former Group Marketing Director who, in accordance with his leaver terms, would be entitled to a pro-rata bonus for the period worked), was 10% of both their maximum opportunity. The Committee has considered whether an annual bonus payment, in the context of the Company's challenging year, was appropriate. The Committee has determined that no annual bonus will be paid to the Group Finance Director or to Mark Anderson for the year ended 31 December 2017. In accordance with his respective leaver terms, Rakesh Sharma was not eligible to be considered for a bonus. The 2015 LTIP awards, which had been due to crystallise in 2018 based on three-year TSR and EPS performance to 31 December 2017, will not vest as a result of performance targets not being met.

Key activities of the Committee during 2017

In addition to the board changes outlined above, the Committee also oversaw activities undertaken to implement the new share plans as approved at the 2017 AGM and towards compliance with gender pay gap reporting requirements. The Committee reviewed the salaries of the Chief Operating Officer and the three Divisional Managing Directors. The Committee also carried out a tendering exercise leading to the reappointment of AON as advisers to the Committee.

Implementation of the Policy for 2018

In line with the Remuneration Policy, the Group Finance Director was appointed in 2016 with a salary below competitive levels. Following a 10.3% increase in 2017 his salary will be increased by 9.4% effective 1 April 2018 to an industry competitive level of £350,000, reflecting his performance to date and the fact that he has gained further experience in the role. The annual bonus opportunity for the Group Finance Director remains 125% of base salary, with 20% of any bonus deferred for three years. Metrics and weightings will remain unchanged, with 25% of maximum payable based on a profit target and 75% based on an operating cash flow target. The Committee intends to grant a Long-Term Incentive award of 125% to the Group Finance Director, with metrics and weightings unchanged. Once a suitable candidate is identified, the Committee will consider the terms for a new Chief Executive, which will be in line with the Policy.

In conclusion, the Board firmly considers that the Directors' Remuneration Policy continues to be aligned with the strategic aims of the Group in adding to shareholder value and supporting the long-term success of the Company.

Martin Broadhurst,
Chairman of the Remuneration Committee

Revenue

£775.4m **-1.3%**

2016: **£785.8m**

Underlying operating profit*

£120.1m **-8.4%**

2016: **£131.1m**

Underlying earnings per share*

116.7p **-13.3%**

2016: **134.6p**

Operating cash flow

£116.5m **-3.2%**

2016: **£120.4m**

Total shareholder return*

-2%

2016: **8%**

*see footnote on page **150**

2. DIRECTORS' REMUNERATION POLICY

The Policy described in this section was approved by shareholders at the 2017 AGM on 28 April 2017. Minimal wording changes have been made to the Policy below to reflect the approval of the Long-Term Incentive Plan ("LTIP") at last year's AGM and to remove the legacy pension arrangement for the former Chief Executive. The full version of the Policy approved by shareholders can be found in last year's Annual Report available online at **www.ultra-electronics.com**.

Policy overview
The Group's Remuneration Policy is to reward senior management competitively, enabling Ultra to recruit, motivate and retain executives of a high calibre, whilst avoiding making excessive remuneration payments. The remuneration of Executive Directors and senior managers is aligned with the Group's objectives and the interests of shareholders.

How the remuneration element supports our strategy	Operation of the remuneration element	Maximum potential	Performance targets
SALARY			
Reflects the value of the individual and their role and responsibilities Reflects underlying performance of the individual Provides an appropriate level of basic fixed income avoiding excessive risk arising from over-reliance on variable income	Normally reviewed annually, effective 1 April Paid in cash on a monthly basis; pensionable Is benchmarked against companies with similar characteristics and sector comparators Targeted at or below median Reviewed in the context of the salary increase budget across the Group	While there is no defined maximum salary, it is the Committee's policy to set pay for Executive Directors at industry competitive levels taking market capitalisation and annual sales into account Annual salary increases take into account: • Underlying performance of the individual • Underlying performance of the business • Underlying annual salary increases within the overall Group • Any changes to the scope of the role in terms of size or complexity • Underlying salary increases for similar industry roles It is recognised that annual salary increases may also include a "catch-up" element in addition to the factors listed above to increase the salary towards, or to, a competitive industry level where the Executive Director was appointed with a salary significantly below the competitive level Annual salary increases for Executive Directors will not normally exceed the average increase awarded to other UK-based Company employees although increases may be above this if there is an increase in: (i) the scale, scope or responsibility of the role; and/or (ii) the experience of the incumbent where this has a positive impact on Group performance	None

Remuneration Report continued

2. DIRECTORS' REMUNERATION POLICY continued

How the remuneration element supports our strategy	Operation of the remuneration element	Maximum potential	Performance targets
ANNUAL BONUS			
Provides focus on delivering/ exceeding annual budget Rewards and helps retain key executives and is aligned to the Group's risk profile Maximum bonus only payable for achieving demanding targets	Payable in cash Non-pensionable 20% of bonus awarded is deferred into Ultra shares for three years Dividend equivalents will accrue in favour of participants during the three year deferral period and will be received with any shares that vest after the applicable deferral period Executive Directors are required to retain at least 50% of the post-tax shares received upon vesting of the deferred bonus until shareholding guidelines are met Malus and clawback provisions apply	125% of salary p.a.	At least 75% of bonus potential based on financial measures (e.g. underlying profit before tax; and operating cash flow). 0% of the maximum bonus is payable at threshold performance No more than 25% based on non-financial strategic/personal targets No bonus will be paid in respect of the non-financial element of the bonus if the Committee considers the Company's financial performance to be unsatisfactory or there is an exceptional negative event during or just after the relevant financial year
LONG-TERM INCENTIVE PLAN			
Aligned to main strategic objective of delivering long-term value creation Aligns Executive Directors' interests with those of shareholders Rewards and helps retain key executives and is aligned to the Group's risk profile	Discretionary annual grant of nil cost options or conditional share awards Two-year post-vesting holding period for vested awards granted in 2016 onwards. Executive Directors are required to retain at least 50% of the post-tax shares received upon vesting until shareholding guidelines are met Malus and clawback provisions apply	Normal limit: • 150% of salary p.a. for the Chief Executive • 125% of salary p.a. for other Executive Directors Exceptional limit: • 175% of salary p.a., e.g. recruitment or retention of an employee Dividend equivalents may be payable on LTIP awards, in cash or shares, to the extent that awards vest	Performance measured over three years Up to four performance measures which are set by the Committee before each grant 20% of award vests at threshold performance
PENSION			
To provide competitive, yet cost-effective retirement benefits	Defined contribution and/or salary supplements paid on a cash neutral basis	Up to a maximum of 20% of base salary for Executive Directors	n/a
OTHER BENEFITS			
To provide benefits consistent with role	Benefits include: private medical cover; life insurance; critical care insurance; permanent health insurance; car and fuel allowance; relocation and expatriation expense; and other benefits payable where applicable	No prescribed limit is set. However, the total value will not exceed the amount the Committee considers reasonable	n/a

How the remuneration element supports our strategy	Operation of the remuneration element	Maximum potential	Performance targets
SHARE OWNERSHIP GUIDELINES			
To provide alignment of interests between Executive Directors and shareholders	Executive Directors are required to build and maintain a shareholding equivalent to two years' base salary through the retention of at least 50% of the post-tax shares received on the vesting of LTIP awards and at least 50% of the post-tax shares received upon vesting of the deferred bonus	n/a	Aim to hold a shareholding equal to 200% of base salary for all Executive Directors
ALL-EMPLOYEE SHARE PLANS			
The Executive Directors are eligible to participate in the Company's UK tax-advantaged All-Employee Share Ownership Plan (AESOP) and the Savings Related Share Option Scheme on the same terms as other employees To encourage employee share ownership and increase alignment with shareholders	Under the AESOP, UK employees are offered the opportunity to buy shares at market value from pre-tax salary. Shares are normally held in trust until the maturity date or until employment with Ultra ends Under the Savings Related Share Option Scheme, employees are entitled to save from post-tax pay for the purchase of Ultra shares at a discount of up to 20%	Under the AESOP, up to the prevailing HMRC limits, or any lower limit set by Ultra, per annum from pre-tax salary Under the Savings Related Share Option Scheme, up to the prevailing HMRC limits, or any lower limit set by Ultra, per annum from post-tax salary	n/a
NON-EXECUTIVE DIRECTOR FEES			
Reflects time commitments and responsibilities of each role Reflects fees paid by similar-sized companies to ensure that the Company attracts Non-Executive Directors of the highest calibre and with the right skills, knowledge and experience to support our strategy The Chairman/Executive Chairman's remuneration is set by the Remuneration Committee which meets without him to agree this. The remaining Non-Executive Directors' fees are proposed by a sub-committee of the Executive Directors and approved by the Board	Cash fee paid monthly Fees are normally reviewed on an annual basis Fixed twelve-month contracts with no notice periods An additional fee is paid to the Chairman of the Audit, Remuneration and Nomination Committees and to the Senior Independent Director Any reasonable business related expenses (including tax thereon) which are determined to be a taxable benefit can be reimbursed	Aggregate annual limit imposed by the Articles of Association	n/a

Notes to Directors' Remuneration Policy table:

(1) A description of how the Company intends to implement the Policy in 2018 is set out in the Annual Report on Remuneration.

(2) The Remuneration Policy, described above, provides an overview of the structure that operates for the most senior executives in the Group. Lower levels of incentive operate for employees below executive level, with remuneration driven by market comparators and the impact of the role. Long-Term Incentives are reserved for those anticipated as having the greatest potential to influence the Group's earnings growth and share price performance, although as the Committee is aware of the benefits which wider employee share ownership can generate, all employees are encouraged to participate in the AESOP and Savings Related Share Option Scheme in the countries in which they are offered.

(3) The choice of the performance metrics applicable to the annual bonus scheme reflect the Committee's view that any incentive compensation should be appropriately challenging and largely tied to financial performance. Operating cash flow and profit are both Key Performance Indicators of the Group. The performance conditions applicable to the LTIP 2018 awards were selected by the Committee on the basis that:

- TSR, one of the Group's Key Performance Indicators, aligns the performance objectives of the Executive Directors more closely with the interests of the Shareholders;
- Organic revenue growth provides an indication of the rate at which the Group's business activity is expanding;
- Organic operating profit growth demonstrates that the additional revenue is being gained without profit margins being compromised; and
- ROIC is felt to be an appropriate measure for the Company to focus on over the medium-to-long term and an appropriate measure of how well the Company is performing and being managed.

(4) None of the employee share plans operate performance conditions.

(5) As highlighted above, Ultra has a share ownership policy which requires the Executive Directors to build up and maintain a target holding equal to 200% of base salary. Details of the extent to which the Executive Directors had complied with the policy are set out on page **89**.

(6) For the avoidance of doubt, in approving this amended Directors' Remuneration Policy, authority is given to Ultra to honour any commitments entered into with current or former Directors (such as, but not limited to, the payment of a pension or the vesting/exercise of past share awards) that have been disclosed to and approved by Shareholders in previous Remuneration Reports. Details of any payments to former Directors will be set out in the Annual Report on Remuneration as they arise.

Remuneration Report continued

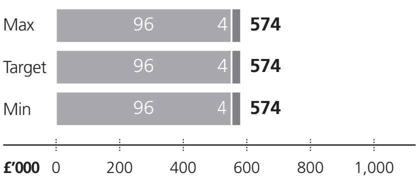
2. DIRECTORS' REMUNERATION POLICY continued

Remuneration scenarios for Executive Directors

The charts below show how the composition of the Executive Directors' remuneration packages varies at three performance levels, namely, at minimum (i.e. fixed pay including pensions and taxable benefits), target and maximum levels under the Policy. The charts show the proportion of the total package comprised of each element.

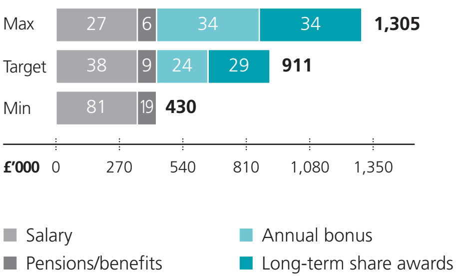
Executive Chairman

Remuneration composition levels (%)



Group Finance Director

Remuneration composition levels (%)



Notes to remuneration scenarios:

(1) Base salary levels are based on those applying from 1 April 2018.

(2) Benefit values for 2018 have been based on 2017 actual values.

(3) Annual bonus outturn is assumed to be 50% of maximum at target level. For maximum, outturn assumes a maximum bonus award level of 125% of salary.

(4) LTIP awards assume an LTIP grant policy of 125% of salary for the Group Finance Director which vests in full at maximum performance, while 20% is assumed to vest at target level of performance. No share price appreciation has been included.

Director recruitment policy

The Nomination Committee typically considers both internal and external candidates before any new appointment is made. New Executive Directors are provided with remuneration consisting of base salary, short-term incentive, long-term incentive and other benefits.

Salary

Ultra's policy is to set pay for Executive Directors at industry-competitive levels, taking market capitalisation and annual sales into account. It is recognised that a new appointee may not have as much experience as someone at a competitive level and may therefore be offered a salary below competitive levels, but at a level that is sufficient to attract the right person for the job. Their salary would then be increased to an industry competitive level as they gain experience. In exceptional circumstances, the Committee may exercise its discretion to offer an above-industry, competitive-level salary in order to attract the best person.

Short-term incentives

Short-term incentives are offered in line with those paid to other Executive Directors. Maximum opportunities will be in line with current plan maximums for existing Executive Directors (i.e. 125% of salary p.a.). The Company may also apply different performance measures if it feels that these appropriately meet the strategic objectives and aims of the Company whilst incentivising the new appointment.

Long-term incentives

Long-term incentives are offered in line with those paid to other Executive Directors. Maximum opportunities will be subject to the maximum levels described in the Policy table.

Other benefits

Other benefits are offered in line with those paid to other Executive Directors.

Buy-outs

To facilitate recruitment, the Committee may make an award to buy out incentive arrangements forfeited on leaving a previous employer. In doing so, the Committee will take account of all relevant factors including any performance conditions attached to such awards and the time over which they would have vested or been paid. Ultra may make use of the flexibility provided in the Listing Rules (LR 9.4.2) to make awards if appropriate. Where possible, incentives will be bought out on a like-for-like basis with respect to vesting/payment dates, currency (i.e. cash versus shares) and the use of performance targets.

Non-Executive Directors

The approach to the recruitment of Non-Executive Directors is to pay an annual fixed fee, having considered existing Non-Executive Directors' fee levels, market levels and expected time commitments. In deciding whether to accept any fee increase the Non-Executive Directors consider Company performance.

Executive Director service contracts

The Group's policy is to ensure that the Executive Directors' service contracts have a notice period of one year, which the Committee considers appropriately reflects both current market practice and the balance between the interests of the Group and each Executive Director. The following table provides more information on each Executive Director's service contract:

Name	Effective date of contract	Notice period
D. Caster*	10 Nov 2017	3 months
A. Sharma	2 May 2016	12 months

* As Executive Chairman.

No Executive Directors have provisions in their contracts for compensation on early termination other than for the notice period.

External appointments of Executive Directors

Executive Directors may accept no more than one external appointment as a Non-Executive Director (excluding chairman). Up to 50% of any time spent undertaking such external duties can be taken as additional unpaid leave with the remainder being treated as annual holiday.

> "The Nomination Committee typically considers both internal and external candidates before any new appointment is made."

Executive Director exit policy

Ultra may terminate an Executive Director's contract early with contractual notice, or by way of a payment in lieu of notice, at its discretion. Neither notice nor a payment in lieu of notice will be given in the event of gross misconduct. Payments in lieu of notice will equate to the basic salary and benefits payable during the notice period or, if notice has already been given, the remainder of the notice period. Payment in lieu of notice will be made by way of a lump sum or by phased instalments over the notice period. If an employee gains employment during the notice period, where payments are phased, they would be reduced. There is no contractual entitlement to annual incentive payments in respect of the notice period. An annual bonus may be payable with respect to the period of the financial year served; although it will be pro-rated for time and paid at the normal payment date as defined by the bonus scheme rules. The relevant Executive Director's service contract may deviate from the terms of the Ultra exit policy, and, as long as the terms set out in such service contract are no more beneficial for the relevant Executive Director than the Ultra exit policy, the terms set out in the relevant service contract will prevail.

The treatment of awards under the Group's share plans is determined in accordance with the plan rules (some of which allow the exercise of discretion).

The default under the 2007 LTIP, and the 2017 LTIP, is that awards lapse on ceasing employment. However, if a participant leaves because of death or for any other reason at the discretion of the Committee, awards vest either when they would normally have vested had the participant not left or on leaving. Any performance condition is applied at vesting and a pro-rata reduction is made to reflect the reduced award term relative to the normal three-year vesting period (although the Committee can decide not to pro-rate a particular award if it regards it as inappropriate).

Under the Savings Related Share Option Scheme, options lapse on leaving employment except in certain specified good leaver circumstances. In such event, options may be exercised in a short period of time after leaving.

Shares acquired by Executive Directors under the All-Employee Share Ownership Plan are purchased from pre-tax pay or with dividends paid on shares previously acquired under the plan. Accordingly, they are not subject to forfeiture on leaving employment.

Non-Executive Director appointment letters

The Non-Executive Directors have appointment letters fixed for 12 months with no notice period. Details of their appointment letters are in the table below:

Name	Date of renewal	Notice period
D. Caster [1, 2]	21 Apr 2017	Nil
M. Broadhurst	2 Jul 2017	Nil
G. Gopalan	28 Apr 2017	Nil
J. Hirst	1 Jan 2018	Nil
V. Hull	28 Apr 2017	Nil
Sir Robert Walmsley	31 Jan 2018	Nil

[1] As Chairman.

[2] D. Caster was appointed by the Company as Non-Executive Director and Chairman on 21 April 2011 under a letter of appointment dated the same date. As noted above, D. Caster's contract as Executive Chairman is effective from 10 November 2017.

There are no provisions in their appointment letters for compensation on early termination.

How employment conditions elsewhere in the Group are considered

Base salary increases take into account a number of factors including the underlying base salary increases within the overall Group. Pay is only set centrally for Executive Directors, Executive Team members, Divisional staff, Business Managing Directors/Presidents, UK Directors and Head Office staff. All other salaries are set within the operating businesses. In all cases there are two levels of approval. The Committee does not consult with employees when setting the remuneration of Executive Directors. It uses independent comparison metrics to benchmark remuneration with other companies.

How shareholders' views are taken into account

The Committee considers shareholder feedback received during the year. In shaping the Remuneration Policy, the Committee carried out extensive consultation with major shareholders, with the vast majority expressing support for the proposed changes. Minor amendments were made to reflect views expressed by some shareholders. At the 2017 Annual General Meeting, 99.33% of our shareholders voted in favour of the Annual Report on Remuneration and 93.11% voted in favour of the Remuneration Policy.

Malus and clawback policy

Consistent with best practice, Ultra operates malus (i.e. the ability to reclaim deferred remuneration prior to payment/vesting) and clawback (i.e. the ability to reclaim amounts paid) provisions in respect of the annual bonus (including bonus deferral) and LTIP. The triggers that may result in the malus and/or clawback provisions being invoked cover misstatement, error in respect of the calculation of a payment where an individual has (or would have) been dismissed for gross misconduct, and where there has been an exceptional negative event.

Our voting result at the 2017 Annual General Meeting was 99.33% in favour of the Annual Report on Remuneration.

99.33%

Remuneration Report continued

3. ANNUAL REPORT ON REMUNERATION

Implementation of the Directors' Remuneration Policy in 2018

A summary of how the Directors' Remuneration Policy will be applied for the year ending 31 December 2018 is set out below.

Salaries

Current Executive Chairman and Executive Director salary levels, and increases effective in April 2018, are as follows:

	2018 Salary £'000	2017 Salary £'000	Increase awarded from 1 April 2018 %
D. Caster	**550**	550	0.000
A. Sharma	**350**	320	9.375

Reflecting the fact that his role of Executive Chairman is an interim appointment until a successor is appointed, Douglas Caster will not receive an increase. Amitabh Sharma will receive a base salary of £350,000 from 1 April 2018. In line with the Remuneration Policy, Amitabh Sharma was appointed with a salary below competitive levels and his salary has now been increased to an industry-competitive level following two increases.

Directors' pension entitlements

Under the agreement entered into on becoming Executive Chairman, Douglas Caster is not entitled to become a member of the defined contribution scheme and does not receive a cash supplement in lieu of pension.

Amitabh Sharma is eligible to participate in the defined contribution scheme, receiving annual company contributions of 18% of salary. He can elect to receive cash supplements in lieu of pension contributions on a cash-neutral basis where he has exceeded the annual allowance or the lifetime allowance.

Non-Executive Directors' fees

Non-Executive Directors' fees will remain unchanged from 1 April 2018. The fee structure is as follows:

	Fees £'000
Chairman	**202**
Non-Executive Director	**53**
Committee Chair	**5**

Annual bonus for 2018

The maximum bonus for Executive Directors in 2018 will be 125% of base salary; 20% of the bonus paid will be deferred into Ultra shares for three years. The Executive Chairman is not eligible for a bonus in respect of 2018.

Up to 25% of maximum will be payable for the achievement of an agreed profit target and up to 75% payable for the achievement of an agreed operating cash flow target. For the financial measure, 0% of the maximum will be payable for threshold performance. For the profit target, vesting occurs on a straight line basis from threshold to maximum. For the operating cash target, vesting occurs on a straight line basis from threshold to target and on a straight line basis from target to maximum.

No bonus will be paid if the Committee considers the Company's financial performance to be unsatisfactory or there is an exceptional negative event during (or just after) the relevant financial year. As the Committee considers that commercial sensitivities restrict the disclosure of forward-looking annual bonus targets, retrospective disclosure of the targets will be provided in next year's Annual Report on Remuneration.

Long-term awards to be granted in 2018

Consistent with the Directors' Remuneration Policy, the Committee intends to grant an annual LTIP award in the form of shares worth 125% to salary for the Group Finance Director during 2018. The Committee will consider an award to the future Chief Executive on their recruitment and will ensure that any award is in line with the remuneration policy. The Executive Chairman will not receive an LTIP award.

For 2018, it is intended that the following measures and weightings will apply:

- Total Shareholder Return – measured against the constituents of the FTSE 250 (excluding investment trusts): **25%**
- Return on Invested Capital (ROIC): **25%**
- Annual growth in organic underlying operating profit: **25%**
- Annual growth in organic revenue: **25%**

Long-term awards to be granted in 2018 continued

Performance measure		Targets	Vesting 0%
		TSR ranking of the Company against the Comparator Group	
Total Shareholder Return (TSR)[1]	Below threshold	Below median	0%
	Threshold	Median	5%
	Stretch	Upper quartile or above	25%
		Return On Invested Capital	
ROIC[2]	Below threshold	< 15.0%	0%
	Threshold	15.00%	5%
	Stretch	25.00%	25%
		Annual growth in organic operating profit	
Organic Operating Profit Growth[3]	Below threshold	< 2.0%	0%
	Threshold	2.00%	5%
	Stretch	5.00%	25%
		Annual growth in organic revenue	
Organic Revenue Growth[3]	Below threshold	< 2.0%	0%
	Threshold	2.00%	5%
	Stretch	5.00%	25%

[1] Measured against the constituents of the FTSE 250 (excluding investment trusts). Awards vest on a straight-line basis between threshold and stretch.

[2] The ROIC measure will be the average ROIC calculated on an annual basis over the three-year performance period where ROIC is defined for the Group as underlying operating profit* expressed as a percentage of average invested capital (calculated as an average of the opening and closing balance sheets). Average invested capital will be calculated as net assets (after adjusting for exchange rate fluctuations) adjusted for amortisation and impairment charges arising on acquired intangible assets and goodwill, and the add-back of other non-underlying performance items, such as tax and fair value movements on derivatives, impacting the balance sheet. Awards vest on a straight-line basis between threshold and stretch.

[3] Growth targets are expressed as annual growth rates and averaged over the three-year period. These will be (i) based on a fixed foreign exchange rate and (ii) exclude the impact of acquisitions for the first 12 months. Awards vest on a straight-line basis between threshold and stretch.

Single total figure of remuneration – Audited

Directors' emoluments are detailed below:

	Basic salary/ fees	Benefits[8]	Pension[9]	Subtotal	Annual performance bonus[10]	LTIP[11]	Subtotal	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
2017								
Executive Directors								
D. Caster[1, 2]	78	3	-	81	-	-	-	81
R. Sharma[4, 5]	546	20	199	765	-	-	-	765
A. Sharma	312	17	56	385	-	-	-	385
M. Anderson[6]	215	22	39	276	-	-	-	276
Non-Executive Directors								
D. Caster[3]	184	-	-	184	-	-	-	184
M. Broadhurst	58	-	-	58	-	-	-	58
G. Gopalan[7]	35	-	-	35	-	-	-	35
J. Hirst	58	-	-	58	-	-	-	58
V. Hull[7]	35	-	-	35	-	-	-	35
Sir Robert Walmsley	58	-	-	58	-	-	-	58
Total	1,579	62	294	1,935	-	-	-	1,935

[1] Douglas Caster transferred from Chairman to Executive Chairman on 10 November 2017. Remuneration is shown in respect of his time as Executive Chairman.

[2] Douglas Caster is a Non-Executive Director of Morgan Advanced Materials and Non-Executive Chairman of Metalysis. Since his appointment as Executive Chairman, Douglas received fees of £23,976 in aggregate in relation to these roles.

[3] Douglas Caster transferred from Chairman to Executive Chairman on 10 November 2017. Remuneration is shown in respect of his time as Chairman.

[4] Rakesh Sharma ceased to be a Director on 10 November 2017.

[5] Rakesh Sharma is a Non-Executive Director of PayPoint. For his tenure as Chief Executive during 2017, Rakesh received fees of £23,300 in relation to this role.

[6] Mark Anderson ceased to be a Director on 1 June 2017 and left the Group on 31 October 2017. See page **89** for further details of Mark Anderson's exit package.

[7] Geeta Gopalan and Victoria Hull joined the board on 28 April 2017.

[8] Benefits comprise: taxable car benefit, life assurance and private medical insurance (Douglas Caster does not receive private medical insurance).

[9] Pensions: Rakesh Sharma received a cash supplement in lieu of pension contribution of 36.4% of salary. Amitabh Sharma, who is an eligible member (and Mark Anderson, who was an eligible member) of the defined contribution scheme, received pension contributions of 18% of basic salary. Amitabh Sharma can also elect to receive cash supplement given in lieu of pension contributions on a cash-neutral basis where he has exceeded the annual allowance or the lifetime allowance.

[10] 20% of this bonus is deferred into shares for three years.

[11] No current Executive Directors have LTIP awards vesting in the year.

*see footnote on page **150**

Remuneration Report continued

3. ANNUAL REPORT ON REMUNERATION continued

Single total figure of remuneration – Audited continued

	Basic salary/ fees	Benefits[1]	Pension[2]	Subtotal	Annual performance bonus	LTIP[3]	Subtotal	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
2016								
Executive Directors								
R. Sharma	532	30	195	757	437	-	437	1,194
A. Sharma	192	10	35	237	156	-	156	393
M. Anderson	253	25	45	323	196	-	196	519
M. Waldner[4]	65	3	12	80	-	-	-	80
Non-Executive Directors								
D. Caster	196	-	-	196	-	-	-	196
M. Broadhurst	56	-	-	56	-	-	-	56
G. Gopalan	-	-	-	-	-	-	-	-
J. Hirst	56	-	-	56	-	-	-	56
V. Hull	-	-	-	-	-	-	-	-
Sir Robert Walmsley	56	-	-	56	-	-	-	56
Total	1,406	68	287	1,761	789	-	789	2,550

[1] Benefits comprise: taxable car benefit, taxable fuel benefit/fuel allowance, life assurance and private medical insurance.
[2] Pensions: Rakesh Sharma's pension was calculated in accordance with the rules of the defined benefit scheme. Amitabh Sharma, who is an eligible member (and Mark Anderson, who was an eligible member) of the defined contribution scheme, received pension contributions of 18% of basic salary. Amitabh Sharma can also elect to receive cash supplements given in lieu of pension contributions on a cash-neutral basis where he has exceeded the annual allowance or the lifetime allowance.
[3] The 2014 LTIP awards which had been due to crystallise in 2017 did not vest. The aggregate gain made by the Directors under the LTIP during the year was £nil.
[4] Mary Waldner left the group on 16 March 2016, and therefore was not eligible for a bonus in respect of 2016 performance.

Annual bonus for year under review – Audited

Annual bonuses in relation to 2017 were based upon the achievement of a sliding scale of underlying profit before tax and operating cash flow targets, as well as individual strategic objectives. Financial targets were derived from the annual budgets approved by the Board. They were adjusted where appropriate to provide a suitable degree of "stretch" challenge and incentive to outperform. Profit and cash are two of the Key Performance Indicators by which the Group is measured. Please refer to page **20** for details.

The bonus targets set by the Committee for 2017 were: a maximum of 28.8% of salary (subject to the achievement of £123.0m* underlying profit before tax); and a maximum of 86.2% of salary (subject to achieving an underlying operating cash flow of £120.9m* and the Committee exercising its discretion on movements in working capital to ensure working capital management throughout the financial year was in the short and long-term interests of the Company). The remaining 10% of the bonus potential reflected strategic goals.

The Committee assessed the achievement of performance against each target as follows:

	Threshold* £'000	Maximum £'000	Actual achieved £'000	Bonus payable %
Underlying profit before tax	110,700	123,000	110,002	0%
Operating cash flow*	67,300	120,900	116,507	0%

* Operating cash flow is payable only if the profit element achieves threshold and therefore no bonus is payable for this element.

Director	Strategic goals
Amitabh Sharma	• Successful implementation of CSS and PCS ERP systems in accordance with S3 strategy
Mark Anderson	• Achieve a book to bill of £850.8m (excluding acquisitions and divestments)

In addition, the Committee assessed performance against the strategic goals which were based on the following:

The Committee determined that bonuses of 10% of salary (max 10%) would be payable to Amitabh Sharma. However, in assessing the strategic goals, the Committee retained discretion not to make a payment if it considered that Ultra's financial performance was unsatisfactory or there was an exceptional negative event during (or just after) the relevant financial year. The Committee has considered whether an annual bonus payment, in the context of the Company's challenging year is appropriate. The Committee has determined that no bonus will be paid to the Group Finance Director (or Mark Anderson who was eligible for a bonus, pro-rata for the period worked).

LTIP vesting for year under review – Audited
No awards vested to Executive Directors in 2017.

Under his leaver terms, Rakesh Sharma's existing awards under the LTIP will lapse. Under his leaver terms, Mark Anderson's existing awards under the LTIP shall vest at the normal time in accordance with the rules of the LTIP, pro-rated to reflect the proportion of each performance period completed. The following provides the outcome of the performance conditions of these 2015 awards.

The LTIP awards granted in 2015 were based on performance to the year ended 31 December 2017. As disclosed in previous Annual Reports, the performance condition for this award was as follows:

Metric	Performance condition	Threshold target	Stretch target	Actual	% Vesting
Total Shareholder Return (TSR)	TSR against constituents of the FTSE 250 Index (excluding investment trusts). 20% vesting for median performance, increasing pro-rata to 100% vesting for upper quartile performance or above. TSR measured over three financial years with a three month average at the start and end of the performance period.	Median ranking	Upper quartile ranking	< Median	0%
Earnings Per Share Underpin	In addition to the main TSR condition, an "underpin" requires total growth of 15% over the three-year performance period. In the event that this underpin is not met, the level of vesting falls to zero.	15%	n/a	2015: 0.6% 2016: 8.6% 2017: -13.3%	n/a
Total					**0%**

The awards for those former Executive Directors granted 2015 LTIP awards therefore lapsed.

Executive	Number of shares at grant	Number of shares to vest	Number of shares to lapse	Total	Estimated value[1] £
A. Sharma (if applicable)	-	n/a	n/a	-	-
R. Sharma	37,379	-	37,379	-	-
M. Anderson	14,207	-	14,207	-	-

[1] The estimated value of the vested shares is based on the average share price during the 3 months to 31 December 2017.

Share awards granted during the year – Audited

	Scheme	Date of grant	Basis of award	Face value[4] £	Vesting at threshold	Vesting at maximum	Performance period
R. Sharma[1,2]	LTIP*	9 March 2017	150% of salary	824,985.79	20%	100%	3 years to 31 December 2019
A. Sharma[2]	LTIP*	9 March 2017	125% of salary	399,990.55	20%	100%	3 years to 31 December 2019
M. Anderson[2,3]	LTIP*	9 March 2017	125% of salary	325,609.53	20%	100%	3 years to 31 December 2019

*Structured as a conditional award
[1] Under his leaver arrangements these awards shall lapse.
[2] In addition, Rakesh Sharma purchased 96 Partnership shares and 76 Dividend Shares, Amitabh Sharma purchased 96 partnership shares and 2 Dividend Shares and Mark Anderson purchased 85 partnership shares and 8 Dividend Shares under the AESOP during 2017.
[3] Under their leaver arrangements these awards shall vest at the normal time in accordance with the rules of the LTIP, pro-rated to reflect the proportion of the performance period completed.
[4] Face value of the award calculated at time of grant using the average of the five previous days' mid-market price.

Remuneration Report continued

3. ANNUAL REPORT ON REMUNERATION continued

Share awards granted during the year – Audited continued
For the awards presented above, four performance metrics apply:

Performance measure		Targets	Vesting 0%
		TSR ranking of the Company against the Comparator Group	
Total Shareholder Return (TSR)[1]	Below threshold	Below median	0%
	Threshold	Median	5%
	Stretch	Upper quartile or above	25%
		Return On Invested Capital	
ROIC[2]	Below threshold	< 15.0%	0%
	Threshold	15.00%	5%
	Stretch	25.00%	25%
		Annual growth in organic operating profit	
Organic Operating Profit Growth[3]	Below threshold	< 2.0%	0%
	Threshold	2.00%	5%
	Stretch	5.00%	25%
		Annual growth in organic revenue	
Organic Revenue Growth[3]	Below threshold	< 2.0%	0%
	Threshold	2.00%	5%
	Stretch	5.00%	25%

[1] Measured against the constituents of the FTSE 250 (excluding investment trusts). Awards vest on a straight-line basis between threshold and stretch.
[2] The ROIC measure will be the average ROIC calculated on an annual basis over the three-year performance period where ROIC is defined for the Group as underlying operating profit* expressed as a percentage of average invested capital (calculated as an average of the opening and closing balance sheets). Average invested capital will be calculated as net assets (after adjusting for exchange rate fluctuations) adjusted for amortisation and impairment charges arising on acquired intangible assets and goodwill, and the add-back of other non-underlying performance items, such as tax and fair value movements on derivatives, impacting the balance sheet. Awards vest on a straight-line basis between threshold and stretch.
[3] Growth targets are expressed as annual growth rates and averaged over the three-year period. These will be (i) based on a fixed foreign exchange rate and (ii) exclude the impact of acquisitions for the first 12 months. Awards vest on a straight-line basis between threshold and stretch.

Change in Chief Executive's remuneration
The following table illustrates the change (as a percentage) in elements of the Chief Executive's remuneration from 2016 to 2017, and compares that to the average remuneration of employees of the Group, excluding the Chief Executive in the UK, who were employed on 1 January 2016 and 1 January 2017. This group best reflects the remuneration environment of the Chief Executive. The Chief Executive combines the remuneration of R. Sharma up to his departure, with that of D. Caster for his period as Executive Chairman.

	Chief Executive % change	All UK employees % change
Salary	2.8	3.4
Taxable benefits	-1.5	3.8
Bonus	*	10.4

* Decreased from £437,000 to nil.

Relative importance of spend on pay
The following table shows the Group's actual spend on pay (for all employees) relative to other financial indicators:

	2017 £m	2016 £m	Change %
Staff costs[1]	**259.0**	255.0	+1.6
Dividends[2]	**38.4**	33.5	+14.6
Revenue[3]	**775.4**	785.8	-1.3
Statutory profit before tax[3]	**60.6**	67.6	-10.4

[1] £1.5m (2016: £2.2m) of the staff costs figures relate to pay for the Executive Directors.
[2] The dividends figures relate to amounts payable in respect of the relevant financial year.
[3] Although not required, revenue and statutory profit before tax have also been provided as this disclosure is considered to add further context to the annual spend on pay.

*see footnote on page 150

Total defined benefit pension entitlements – Audited

The defined benefit scheme closed to future accrual on 5 April 2016 and therefore no Executives accrued direct benefits under defined benefit schemes during the year.

Under the scheme, a pension equal to two-thirds of pensionable salary at retirement is provided at the normal retirement age of 63 years. Where pensionable service is less than 20 years, the pension is calculated at one-thirtieth of the pensionable salary for each year of service. With the Group's consent, Executive Directors may retire from age 55. After age 58, Group consent to early retirement is not required. The pension is reduced in the event of early retirement. In the event of death-in-service, a spouse's pension of up to a maximum of 33% of pensionable earnings is payable, together with an allowance for dependent children up to a maximum of 33% of pensionable earnings where relevant. On the death of a retired Executive Director, a spouse's pension of 50% of the Executive Director's pension is payable. Once the pension is in payment, the part of the Executive Director's pension above the Guaranteed Minimum Pension will be increased each year in line with the increase in the retail price index. This is capped at 7.5% for service prior to 1 April 2008 and at 5% thereafter, above which increases are at the Trustees' and the Group's discretion. As Rakesh Sharma ceased accruing a direct benefit from 6 April 2014, his pension provision was determined on an annual basis by the scheme actuary such that it is equivalent in value to the value of defined benefits formerly accrued.

Payments for loss of office and payments to past Directors – Audited

Rakesh Sharma stepped down as a director of the company on 10 November 2017. He will receive monthly payments of his salary at the rate of £550,000 p.a. during his 12 months' notice period. He will also receive payments in respect of pension at the rate of £200,000 p.a. (equal to the Company contribution of 36.4% of base salary), and his other contractual benefits, with an annual value of £30,000, will continue in the normal way during this period. Payments are subject to mitigation. He will not receive any bonus in respect of the Group's financial year ending on 31 December 2017. Mr Sharma's interest in awards under the LTIP will lapse. The treatment of his Save As You Earn ("SAYE") and AESOP entitlements will be in accordance with the rules of the respective schemes.

Mark Anderson stepped down from the board on 1 June 2017 and left the company on 31 October 2017. Mark received the sum of £186,694.43 as payment in lieu of the balance of his contractual notice period. As disclosed on page **86** the Committee has determined that no bonus will be paid to Mark Anderson. As Mark's employment was terminated on the grounds of redundancy, he will be treated as a "Good Leaver" under the rules of the LTIP. His existing awards under the LTIP shall vest at the normal time in accordance with the rules of the LTIP, prorated to reflect the proportion of each performance period completed as at 31 October 2017. The treatment of his SAYE and AESOP entitlements will be in accordance with the rules of the schemes.

Statement of Directors' shareholdings – Audited

	Legally owned		LTIP awards[1]	AESOP		SAYE				Share ownership met
	2017	2016	Unvested	Restricted[2]	Unrestricted	Under option	Exercised	Total	% Share ownership guidelines	Y/N
Executive Directors										
D. Caster	308,160	300,000	-	-	-	-	-	308,160	n/a	-
R. Sharma	22,051	41,688	113,269	3,272	-	1,192	-	139,784	n/a	-
A. Sharma	7,519	4,966	18,956	148	-	794	-	27,319	200%	N
M. Anderson	639	546	43,622	-	369[3]	610	-	45,240	n/a	-
Non-Executive Directors										
M. Broadhurst	1,600	1,000	-	-	-	-	-	1,600	-	-
G. Gopalan	-	-	-	-	-	-	-	-	-	-
J. Hirst	4,055	2,000	-	-	-	-	-	4,055	-	-
V. Hull	1,684	-	-	-	-	-	-	1,684	-	-
Sir Robert Walmsley	3,000	1,600	-	-	-	-	-	3,000	-	-

[1] There were no vested LTIP share awards within the period. In addition, the interest in LTIP awards as at 31 December 2017 includes the 2015 award (37,379 shares under award for Rakesh Sharma and 14,207 shares under award for Mark Anderson). Under his leaver conditions, Rakesh Sharma's awards will lapse. Mark Anderson is eligible to receive these awards subject to the performance conditions and pro-rated to reflect the proportion of each performance period completed on date of departure. As a result of not meeting performance conditions to 31 December 2017, the shares awarded under the 2015 LTIP Grant will lapse in 2018.

[2] The restricted shares under the AESOP are held in the Ultra Electronics Holdings plc Employee Benefit Trust.

[3] The unrestricted shares under the AESOP have been released from the Ultra Electronics Holdings plc Employee Benefit Trust.

Remuneration Report continued

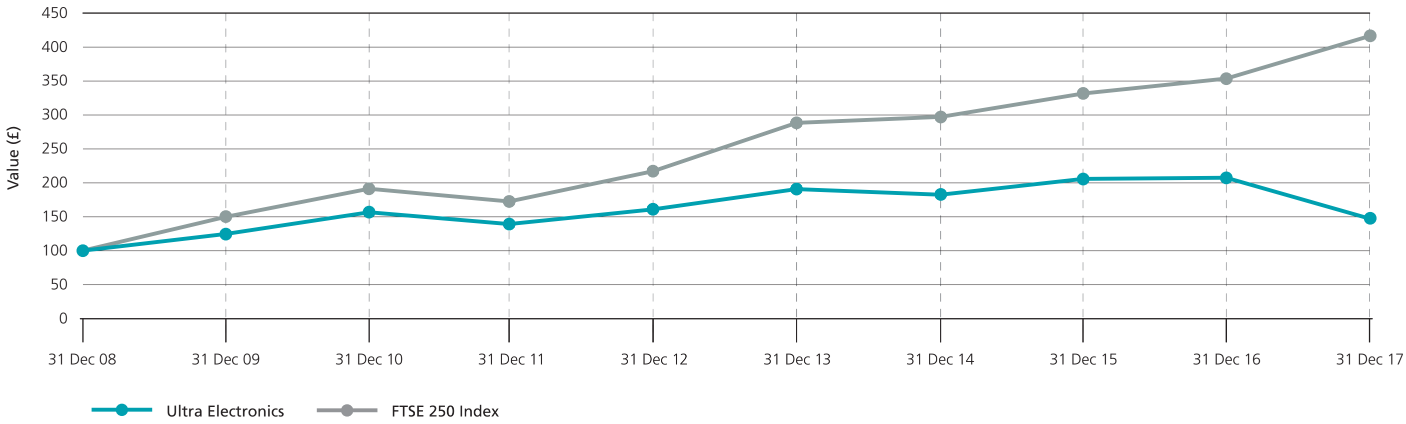
3. ANNUAL REPORT ON REMUNERATION continued

Total shareholder return graph and single figure remuneration table

The graph below shows the TSR performance of Ultra in comparison with the FTSE 250 Index over the past nine years. The graph shows the value at the end of 2017 of £100 invested at the start of the evaluation period, in Ultra and in the Index. The Committee considers the FTSE 250 to be relevant index for the TSR comparison as Ultra is a member of the index and because together the index members represent a broad range of UK-quoted companies.

Total shareholder return – compared to FTSE 250 Index

Source: Thomson Reuters Datastream



Total shareholder return graph and single figure remuneration table continued

The table below presents single-figure remuneration for the Chief Executive over the past nine years, together with past annual bonus payouts and relevant LTIP vesting figures.

	Year ended	Total remuneration £'000	Annual bonus % max. payout	LTIP % max. payout
D. Caster[1]	31 December 2017	81	-	-
R. Sharma[2]	31 December 2017	765	-	-
R. Sharma	31 December 2016	1,194	82	-
R. Sharma	31 December 2015	1,197	88	-
R. Sharma	31 December 2014	680	-	-
R. Sharma	31 December 2013	612	-	-
R. Sharma	31 December 2012	597	-	-
R. Sharma[3]	31 December 2011	722	76	-
D. Caster[4]	31 December 2011	141	-	-
D. Caster	31 December 2010	1,068	46	81
D. Caster	31 December 2009	1,512	67	100

[1] Executive Chairman from 10 November 2017.
[2] Chief Executive to 10 November 2017.
[3] Chief Executive from 21 April 2011.
[4] Chief Executive to 21 April 2011.

Shareholder voting at the last AGM

At the 2017 Annual General Meeting, the 2016 Directors' Remuneration Report received the following votes from shareholders:

	Total number of votes	% of votes cast
Votes for	**59,669,864**	99.33
Votes against	**402,746**	0.67
Total votes cast (for and against)	**60,072,610**	100
Votes withheld	**656,074**	
Total votes cast (including withheld votes)	**60,728,684**	

At the 2016 Annual General Meeting, the 2015 Director's Remuneration Report received the following votes from shareholders:

	Total number of votes	% of votes cast
Votes for	**59,758,222**	99.60
Votes against	**242,295**	0.40
Total votes cast (for and against)	**60,000,517**	100
Votes withheld	**4,249,816**	
Total votes cast (including withheld votes)	**64,250,333**	

Directors' interests under Long-Term Incentive Plans

Details of the Directors' interests in these arrangements are given below:

Interests under the Ultra Electronics Long-Term Incentive Plan 2007 and the Ultra Electronics Long-Term Incentive Plan 2017

	A. Sharma	M. Anderson	R. Sharma	Market price of shares granted	Crystallising dates of outstanding awards
2014 award	-	12,240	32,234	£18.38	March 2017
2015 award	-	14,207	37,379	£17.45	March 2018
2016 award	-	13,984	36,793	£17.73	March 2019
Interests at 1 January 2017	-	40,431	106,406		
2014 award lapsed during the year	-	(12,240)	(32,234)		
2015 award lapsed during the year	-	-	-		
2016 award lapsed during the year	-	-	-		
2017 award	18,956	15,431	39,097	£21.10	March 2020
Interests at 31 December 2017	**18,956**	**43,622**[1]	**113,269**[1]		

[1] This interest in LTIP awards as at 31 December 2017 includes the 2015 award (37,379 shares under award for Rakesh Sharma and 14,207 shares under award for Mark Anderson) which, in line with his leaver terms, will lapse for Rakesh Sharma. As a result of not meeting performance conditions to 31 December 2017, Mark Anderson's will lapse in 2018.

The 2014 award lapsed during the year as a result of the performance targets not being met. Ultra's share price on 29 December 2017 was £13.47. The range during 2017 was £11.42 to £22.04.

Directors' interests under the All-Employee arrangements

Name of Director	Interests as at 1 January 2017	Shares acquired during year	Interests as at 31 December 2017	Shares acquired from 1 January 2018 to 2 March 2018	Interests as at 2 March 2018
A. Sharma	50	**98**	**148**	**31**	**179**
R. Sharma	3,100	**172**	**3,272**	**32**	**3,304**
M. Anderson	276	**93**	**369**[1]	**-**	**-**

[1] Or as at date of departure

During the year, the Share Ownership Plan Trust, established and operated in connection with the AESOP, purchased 27,018 (2016: 30,648) Ultra Electronics Holdings plc shares, with a nominal value of £1,351 (2016: £1,532) for £515,711 (2016: £594,895).

The role and composition of the Remuneration Committee

Role

The role of the Committee is to:

- Determine and agree with the Board the framework and broad policy for the remuneration of the Executive Directors, Chairman of the Board and senior management reporting to the Executive Directors (the Executive Team);
- Ensure that the Executive Directors are fairly rewarded for their individual contributions to the Group's overall performance with due regard to the interests of shareholders and to the financial and commercial health of the Group;
- Ensure that contractual arrangements, including the termination of Executive Directors, are fair both to the individuals concerned and to the Group.

The Committee's terms of reference include all matters indicated by the Code and are approved and reviewed by the Board annually. The terms of reference are available from the Investors' section of the Group's website (**www.ultra-electronics.com/investors**).

Composition

Martin Broadhurst was Chairman of the Committee and Sir Robert Walmsley and John Hirst were members throughout the year. At the 2017 AGM Geeta Gopalan and Victoria Hull became members of the Committee. The General Counsel & Company Secretary is Secretary to the Committee. Although not Committee members, amongst others, the Chairman/Executive Chairman and Chief Executive attend Committee meetings by invitation, except where matters directly relating to their own remuneration are discussed. The Executive Chairman will continue to attend by invitation in 2018.

Advice

Wholly independent advice on executive remuneration and share schemes is received from New Bridge Street, part of Aon plc. New Bridge Street is a member of the Remuneration Consultants Group and is a signatory to its Code of Conduct. New Bridge Street was appointed by the Committee after a tender process and, during the year, provided the Group with advice on the operation of Ultra's LTIP and other share schemes, remuneration benchmarking services and an annual update on market and best practice. During 2017, insurance broking services were also provided to the Group by other subsidiaries of Aon plc which the Committee considers in no way prejudices New Bridge Street's position as the Committee's independent advisers. Fees charged by New Bridge Street for advice provided to the Committee for 2017 amounted to £33,658 (excluding VAT). Pension advisory services were provided to the Committee and the Group by Towers Watson. Fees charged by Towers Watson for advice provided to the Committee for 2017 amounted to £88,415 (excluding VAT). In addition, the Committee consults the Executive Chairman with regard to the remuneration and benefits packages offered to Executive Directors (other than in relation to his own remuneration and benefits package) and members of the Executive Team.

The 2018 Annual General Meeting

The Committee encourages shareholders to vote in favour of the Directors' Remuneration Report resolution at the 2018 AGM. The Directors' Remuneration Report was approved by the Board on 5 March 2018 and signed on its behalf by:

Martin Broadhurst, Chairman of the Remuneration Committee

Directors' Report

For the year ended 31 December 2017

> The Directors present their annual report on the affairs of the Group, together with the accounts and independent auditor's report.
>
> **Anant Prakash**, General Counsel & Company Secretary

Ultra Electronics Holdings plc is the Group holding company and it is incorporated in the United Kingdom under the Companies Act 1985.

The Directors present their Annual Report on the affairs of the Group, together with the Accounts and independent auditor's report for the year ended 31 December 2017. Details in relation to health and safety, the environment and greenhouse gas emissions, business ethics and employment practices are included in the Sustainability section on pages **46-57** of the Strategic Report. The Corporate Governance Report on pages **61-70** forms part of this report, and the financial risk management objectives and policies can be found on pages **38-45**.

Strategic Report

In accordance with the Companies Act 2006 (the Act), Ultra is required to set out information which helps the shareholders assess how the Directors have performed their duty to promote the success of the Group, together with a fair review of the Group's business and a description of the principal risks and uncertainties facing the Group. The information that satisfies these requirements can be found in the Strategic Report on pages **38-45**.

Results and dividends

The Group results and dividends are as follows:

	2017 £'000
Balance on retained earnings, beginning of year	228,034
Total comprehensive income for the year	68,978
Dividends: 2016 final paid of 33.6p per share	(23,647)
2017 interim paid of 16.1p per share	(11,312)
Equity-settled employee share schemes	558
Balance on retained earnings, end of year	**262,611**

The final 2017 dividend of 35.0p per share is proposed to be paid on 3 May 2018 to shareholders on the register of members on 6 April 2018. The interim dividend was paid on 21 September 2017, making a total of 49.6p (2016: 47.8p) per share in the year.

Future developments

A review of the activities and future developments of the Group is contained in the Executive Chairman's review on pages **6-9**.

Research and development

The Directors are committed to maintaining a significant level of research and development expenditure in order to expand the Group's range of proprietary products. During the year a total of £161.1 million (2016: £146.9 million) was spent on engineering and business development of which £131.2 million (2016: £112.8 million) was funded by customers and £29.9 million (2016: £34.1 million) by the Group.

Supplier payment policy

Individual operating businesses are responsible for agreeing the terms and conditions under which they conduct business transactions with their suppliers. It is Group policy that payments to suppliers are made in accordance with those terms, provided that the supplier is also complying with all relevant terms and conditions. Trade payable days of the Group for the year ended 31 December 2017 were 68 days (2016: 65 days) based on the ratio of Group trade payables at the end of the year to the amounts invoiced during the year by suppliers.

Employment policy

It is the policy of Ultra to create a working environment in which there is no discrimination and all employment decisions are based entirely on merit and the ability of people to perform their intended roles. Ultra aims to continue to build a workforce that is recruited from the widest possible talent pool (see page **53**).

Political expenditure

Neither the Company nor any of its subsidiaries have made any political donations during the year (2016: £nil).

Appointment and replacement of Directors

Martin Broadhurst, Douglas Caster, John Hirst, Amitabh Sharma and Sir Robert Walmsley will stand for re-election at the Annual General Meeting on 27 April 2018. Geeta Gopalan and Victoria Hull will stand for election.

Directors and their interests

The Directors who served throughout the year and to the date of signing these financial statements (see biographies on pages **58-59**), and their interests in the shares and share options of Ultra at 2 March 2018 are shown in the Annual Report on Remuneration (see pages **84-91**).

Directors and their interests continued
The Company has in place procedures for managing conflicts and potential conflicts of interest. The Company's Articles of Association also contain provisions to allow the Directors to authorise conflicts or potential conflicts of interest so that a Director is not in breach of his or her duty under UK company law. If Directors become aware of a conflict or potential conflict of interest they should notify in accordance with the Company's Articles of Association. Directors have a continuing duty to update any changes to their conflicts of interest. Directors are excluded from the quorum and vote in respect of any matters in which they have a conflict of interest. No material conflicts were reported by Directors in 2017.

Branches
The Company and its subsidiaries have established branches, where appropriate, in a number of countries outside the UK. Their results are, however, not material to the Group's financial results.

Contractual arrangements
The Group contracts with a large number of customers in order to sell its wide portfolio of specialist capabilities to a broad range of customers around the world. The Group's largest customers are the US Department of Defense and UK Ministry of Defence. A wide range of separate contracts are entered into with these customers by different Ultra businesses through different project offices and project teams. The Group also contracts with numerous suppliers across the world and manages these arrangements to ensure that it is not over-dependent on a single supplier. This is normally achieved through dual sourcing specialist components.

Purchase of own shares
During the year Ultra purchased no (2016: nil) ordinary shares and no (2016: nil) ordinary shares were distributed following vesting of awards under the Ultra Electronics Long-Term Incentive Plan. At 31 December 2017, the Group held 235,247 ordinary shares under the Ultra Electronics Long-Term Incentive Plan (representing 0.3% of the ordinary shares in issue as at 31 December 2017).

Substantial shareholdings
As at 2 March 2018, Ultra had been notified, in accordance with Chapter 5 of the Disclosure and Transparency rules, of the following voting rights as shareholders of Ultra:

	Nature of holding	Percentage of ordinary share capital	Number of 5p ordinary shares	Date of announcement
Heronbridge Investment Management	Indirect	5.06	3,933,407	17 November 2017
Invesco Ltd	Indirect	5.47	4,252,702	15 November 2017
Legal & General Investment Mgmt Ltd	Indirect	5.44	4,232,528	15 November 2017
FMR LLC	Indirect	9.99	7,770,603	31 August 2017
Standard Life Aberdeen	Indirect	6.61	5,139,768	16 August 2017
BlackRock Inc.	Indirect	5.69	4,419,740	9 November 2017
Royal London Asset Management Ltd	Direct	3.08	2,171,768	28 February 2017
Artemis Investment Management LLP	Direct & Indirect	4.69	3,299,530	9 August 2016
Fidelity International Limited	Indirect	9.49	6,672,460	4 July 2016
J O Hambro Capital Management Ltd	Direct	5.02	3,528,628	11 March 2016

Capital structure
Details of the authorised and issued share capital, together with details of the movements in Ultra's issued share capital during the year, are shown in note 26. Ultra has one class of ordinary shares which carry no right to fixed income and each share carries the right to one vote at general meetings of Ultra.

There are no specific restrictions either on the size of a holding or on the transfer of shares, which are both governed by the general provisions of the Company's Articles of Association and prevailing legislation.

Details of employee share schemes are set out in note 26. No person has any special rights of control over Ultra's share capital and all issued shares are fully paid.

With regard to the appointment and replacement of Directors, Ultra is governed by its Articles of Association, the UK Corporate Governance Code, the Act and related legislation. The Articles of Association themselves may be amended by special resolution of the shareholders. The powers of Directors are described in the "Terms of Reference for the Board", which is available from the Investors' section on the Group website (**www.ultra-electronics.com/investors**).

Annual General Meeting
The next Annual General Meeting of Ultra will be held at 10.00 a.m. on 27 April 2018 at 417 Bridport Road, Greenford, Middlesex UB6 8UA. A separate circular providing details of the Annual General Meeting has been sent to Shareholders with the Annual Report and Accounts.

Auditor
Each of the Directors at the date of approval of this Report confirms that:

(1) So far as the Director is aware, there is no relevant audit information of which Ultra's auditor is unaware; and

(2) The Director has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that Ultra's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Act.

The Directors' Report was approved by the Board on 5 March 2018 and signed on its behalf by:

Anant Prakash, General Counsel & Company Secretary
Registered Office: 417 Bridport Road, Greenford, Middlesex UB6 8UA
Registered Number: 02830397

Executives and advisors

Executive Team members

Douglas Caster
Executive Chairman

Amitabh Sharma
Group Finance Director

Carlos Santiago
Chief Operating Officer

Chris Binsley
Corporate Marketing Director

Anant Prakash
General Counsel & Company Secretary

Graeme Stacey
Divisional Managing Director
Aerospace & Infrastructure

Mike Baptist
Divisional Managing Director
Communications & Security

William Terry
Divisional President
Maritime & Land

Business MDs and Presidents

Swami Iyer
President
3eTI

Tim Stanley
President
Advanced Tactical Systems

Sebastien Jodeau
Managing Director
Airport Systems

Doug Burd
Managing Director
Avalon Systems
& Ultra Electronics, Australia

Mike Williams
Managing Director
Command & Sonar Systems

Gavin Newport
Managing Director
Communication & Integrated Systems

Craig Steger-Lewis
Managing Director
Corvid Paygate

Andrew Nanson
Managing Director
Corvid Protect Holdings

Pete Crawford
President
EMS

Paul Fardellone
President
Flightline Systems

Brian Sinnott
President
Forensic Technology

Dan Pikora
President
Herley

Leo Gaessler
Acting President
Maritime Systems

Nick Gaines
Managing Director
Nuclear Control Systems

Dan Upp
President
Nuclear Sensors & Process Instrumentation

Rochelle Borden
President
Ocean Systems

Mike Hawkins
Managing Director
PMES

Mike Clayton
Managing Director
Precision Control Systems

Iwan Jemczyk
President
TCS

Thomas Link
President
USSI

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Investec Bank plc
2 Gresham Street
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Registrars

Equiniti
Aspect House
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West Sussex BN99 6DA

Group financials, Company financials and five-year review

4. Group financials

5. Company financials

6. Five-year review

Independent auditor's report
to the members of Ultra Electronics Holdings plc

Opinion on financial statements of Ultra Electronics Holdings plc

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including FRS 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Ultra Electronics Holdings plc (the Parent Company) and its subsidiaries (the Group) which comprise:

- the Consolidated Income Statement;
- the Consolidated Statement of Comprehensive Income;
- the Consolidated and Parent Company Balance Sheets;
- the Consolidated and Parent Company Statements of Changes in Equity;
- the Consolidated Cash Flow Statement;
- the Consolidated and Parent Company Statements of Accounting Policies; and
- the related notes 1 to 47.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Parent Company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Within this report key audit matters are identified with the symbols below:

New for 2017 Same as prior year

Key audit matters	The key audit matters that we identified in the current year were: • Revenue and profit recognition • Management override of controls • Valuation of goodwill and intangible assets • Defined benefit pension liabilities valuation.
Materiality	The materiality that we used for the Group financial statements was £5.5m which was determined on the basis of 5% of underlying profit before tax.
Scoping	We focused our Group audit scope primarily on the audit work at 20 (2016: 20) locations, 12 (2016: 12) of these were subject to a full audit, whilst the remaining 8 (2016: 8) were subject to specified audit procedures where the extent of our testing was based on our assessment of the risks of material misstatement. These 20 locations accounted for 88% (2016: 87%) of Group revenue and 94% (2016: 94%) of underlying profit before tax.
Significant changes in our approach	Due to the facts and circumstances which led to the trading statement of revised full year expectations being issued in November 2017 we consider there to be a heightened risk of management bias through the override of internal controls. We have therefore performed additional procedures in respect of the risk of management override of controls and consider this to be a key audit matter as set out opposite.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement on page **45** to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the Group's and the Company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages **40**-**45** that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on pages **38**-**39** that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on page **45** as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We are also required to report whether the directors' statement relating to the prospects of the Group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Further to the inclusion this year of the risk of management override of controls as noted above in the summary of our audit approach, the valuation of Ithra-related provisions is no longer considered to be a key audit matter. This is on the basis of the status of potential legal proceedings and associated legal matters addressed during the year.

Key audit matter continued overleaf >

Independent auditor's report continued

Key audit matters continued

Revenue and profit recognition

Key audit matter description

The Group recognised revenue of £775.4m in 2017 (2016: £785.8m) of which £467.0m (2016: £443.5m) related to revenue recognised in respect of long-term contracts accounted for under IAS 11. There is a risk arising from either error or fraud, that revenue and profit is recognised incorrectly based on judgements within the cost to complete estimate for significant long-term contracts. We consider that those contracts with a design phase have a heightened risk of cost escalation due to extended or unforeseen effort necessary to achieve contract milestones.

Further, given the bespoke nature and the length of time to develop and manufacture many of Ultra's products and solutions, the contracts between Ultra and its customers can contain complex terms or contract variations and therefore there is also a risk that revenue is not recognised in accordance with such terms.

Refer to page **138** (key sources of estimation uncertainty – contract revenue and profit recognition); pages **139-140** (accounting policies – revenue recognition and long-term contracts); page **75** (Audit Committee report – significant judgements considered).

How the scope of our audit responded to the key audit matter

Our audit work assessed the adequacy of the design and implementation of controls over long-term contract accounting.

To confirm that revenue recognised to date is based on the current best estimate of the degree of work performed under the contract, for a sample of contracts we reviewed the evidence for the progress made against the contract, such as milestone completion.

To verify the margin achieved on the contracts, we sought to confirm the costs to complete, by agreeing to evidence of committed spend, budgeted rates or actual costs incurred to date when compared to the remaining work to be performed under the contract. We reviewed the contract risk registers to provide evidence of the judgement taken when providing for the cost of mitigating technical risks and meeting future milestones.

We understood and challenged management's judgements by referring to evidence including signed contract terms and the latest project status reports, and discussed contract progress and future risks with contract engineers. We also assessed the reliability of management estimates through consideration of the historical accuracy of prior period management estimates.

For our sample of contracts, we made enquiries as to any unusual contract terms or side agreements separate to the original contract, in addition to testing a sample of billings and costs incurred to date.

Key observations

We considered the costs to complete and therefore the revenue and margin recognised on the sampled contracts to be appropriate, based on the assessment of the risks remaining in the contracts and work performed to date.

Management override of controls

Key audit matter description

We consider that the risk of error or fraud as a result of management override of controls is heightened in relation to the facts and circumstances which led to the trading statement of revised full year expectations being issued in November 2017.

There are a number of areas within the Group financial statements which contain accounting estimates made by management or which have been determined as a result of management's judgements as set out on page **138** (key accounting judgements and key sources of estimation uncertainty), in particular those areas of judgement and estimation uncertainty related to long-term contract accounting, the valuation of goodwill and intangible assets, and the valuation of pension liabilities. In addition, management also exercised judgement in the presentation of the Group's income statement, and the classification of items excluded from underlying profit measures, in particular the S3 programme as set out in note 2 to the financial statements.

Accordingly, there is a risk that the Group's results are influenced through management bias in determining such estimates and judgements. This risk can manifest itself through the posting of invalid journals, recorded to influence the financial statements, which circumvent the controls in place to stop the recording of inappropriate journals.

Management override of controls
continued

How the scope of our audit responded to the key audit matter
Our audit work has assessed the design and implementation of controls which address the risk of management override at both a business unit and on a Group basis.

We reviewed the areas of judgement and estimation uncertainty related to the areas noted above, to determine whether any evidence existed of management bias. Further details of our audit response are included in the other key audit matters.

We challenged the distinction between underlying and non-underlying items of income or expense, particularly in relation to the classification of S3 programme costs. This was done based on a review against the approved S3 programme plan, whether the costs were incremental to the ongoing business, and the nature of the costs incurred. We reviewed the disclosure in note 2 to the financial statements to assess whether it is consistent with our understanding.

We profiled the full year's transactions listing to identify manual journals displaying characteristics of potential fraud. For the journals identified together with the Group consolidation journals, we have understood the business rationale and obtained appropriate audit evidence to support the journal.

Key observations
We did not identify any material matters or bias arising from management override of controls.

Valuation of goodwill and intangible assets

Key audit matter description
The Group held £394.5m (2016: £415.6m) of goodwill arising on its acquisitions made and £118.4m (2016: £155.2m) of acquired intangibles as at 31 December 2017. There is a risk that inappropriate judgements relating to future cash flow forecasts and discount rates are used which lead to the overstatement of the value in use, being the recoverable amount of these assets. This could therefore result in an impairment being required. This is particularly relevant given the volatility and uncertainty in defence spending in both new and traditional markets.

As a result of the lower level of headroom and future cash flow forecast growth assumed we have focused this key audit matter on the following goodwill and acquired intangible asset balances:

- goodwill attributable to the C2ISR and Infrastructure cash generating unit groups; and
- the acquired intangible assets associated with the Herley business.

Refer to page **138** (key sources of estimation uncertainty – impairment testing); page **140** (accounting policy – impairment of fixed assets); page **75** (Audit Committee report – significant judgements considered); and page **116** and **117** (note 14 and 15 of the Financial Statements).

How the scope of our audit responded to the key audit matter
Our audit work assessed the adequacy of the design and implementation of controls over monitoring the carrying value of goodwill and acquired intangibles.

We challenged the discount rate and cash flow assumptions used by management in their impairment assessment. We used valuation specialists within the audit team to benchmark the discount rate against independently available data, together with performing peer group analysis. We obtained support for secured orders and used our understanding of these orders to underpin the Group's cash flow forecasts, considered external date on forecast market growth, and reviewed the historical performance of the businesses.

Having challenged the assumptions, we checked that the impairment model had been prepared on the basis of management's assumptions and was arithmetically accurate. We challenged the appropriateness of management's sensitivities based on our work performed on the key assumptions, and recalculated these sensitised scenarios.

With regards to the disclosures within the Annual Report, we assessed whether they appropriately reflect the facts and circumstances within management's assessment of impairment over goodwill and acquired intangibles and specifically on the disclosure relating to the Infrastructure cash generating unit group under a sensitised scenario.

Key observations
We are satisfied that headroom exists over the carrying value of the Infrastructure and C2ISR cash generating unit groups, and the acquired intangible assets associated with the Herley business, and therefore no impairment has been recognised.

We consider that the disclosure in note 14 of a goodwill impairment to the Infrastructure cash generating unit group after a reasonable possible change in assumptions is appropriate.

Independent auditor's report continued

Key audit matters continued

Defined benefit pension liabilities valuation

Key audit matter description

The Group operates defined benefit pension schemes in the UK, Switzerland and Canada. At 31 December 2017 the defined benefit pension scheme obligation was £389.0m which resulted in a net IAS 19 'Employment Benefits' deficit of £82.7m. The UK scheme accounted for 99% of this net deficit.

There is a risk that the assumptions used in determining the defined benefit obligation for the UK scheme are not appropriate resulting in an inappropriate pension valuation which would have a material impact on the financial statements. The most sensitive assumptions are the discount rate, inflation rate and life expectancy.

Refer to page **138** (key sources of estimation uncertainty – retirement benefit costs); and page **141** (accounting policies – pensions).

How the scope of our audit responded to the key audit matter

Our audit work assessed the adequacy of the design and implementation of controls over the accounting for defined benefit pension schemes.

We included a pension specialist within our audit team to assess the appropriateness of the assumptions through benchmarking to industry data and comparison with the peer group.

We reviewed the suitability of the methodology used to value the defined benefit pension scheme obligation.

Key observations

Our assessment concluded that Ultra's pension assumptions overall lie in the middle of our acceptable range.

Our application of materiality

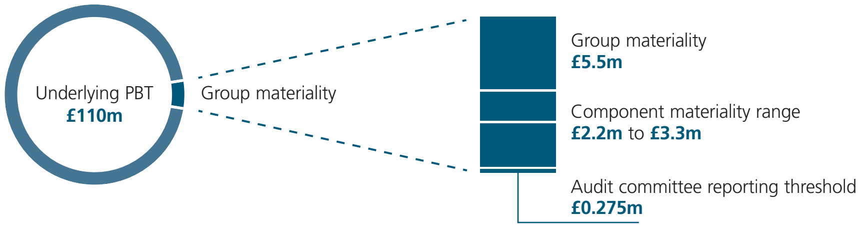
We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Materiality	£5.5m (2016: £6.0m)	£2.2m (2016: £3.0m)
Basis for determining materiality	5% of underlying profit before tax Underlying profit before tax is reconciled to statutory profit before tax in note 2 of the financial statements. In 2016, we determined materiality based on 7% of adjusted underlying profit before tax. This was adjusted for amortisation of acquired intangible assets.	Parent Company materiality represents less than 1% of net assets, but is capped at 40% (2016: 50%) of the Group materiality.
Rationale for the benchmark applied	Underlying profit before tax is a key performance measure for the Group and it is therefore an appropriate basis on which to determine materiality. We changed our benchmark as we consider that management's underlying profit before tax is more relevant to the users of the financial statements because it eliminates the impact of acquisitions now and in the future.	The Parent Company is non-trading, and we therefore consider that a balance sheet based metric is most appropriate to determine materiality. The Parent Company is also a component of the consolidated Group financial statements, and so the determined materiality has been capped by the level of materiality identified for the component audits.

Our application of materiality continued

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £275k (2016: £300k) for the Group and £100k (2016: £100k) for the Parent Company, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.



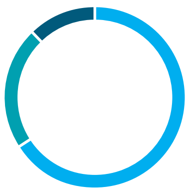
An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we focused our Group audit scope primarily on the audit work at 20 (2016: 20) locations, 12 (2016: 12) of these were subject to a full audit, whilst the remaining 8 (2016: 8) were subject to either an audit of specified account balances or specified audit procedures where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the Group's operations at those locations.

These 20 locations, which are largely located in the UK and USA, represent the principal business units and account for 88% (2016: 87%) of the Group's revenue and 94% (2016: 94%) of the Group's underlying profit before tax. They also provided an appropriate basis for undertaking audit work to address the risks of material misstatement identified above. Our audit work at the 20 units was executed at levels of materiality applicable to each individual entity which did not exceed 60% of Group materiality (£3.3m).

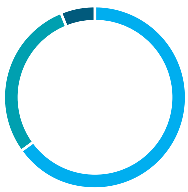
At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The Group audit team follows a programme of planned visits that has been designed so that the Senior Statutory Auditor or another senior member of the Group audit team visits each of the significant overseas component locations at least once every three years. Every year, regardless of whether we have visited or not, we include the component audit partner and other senior members of the component audit team in our team briefing, direct the scope of their work for the purposes of our Group audit, discuss their risk assessment and review documentation of the findings from their work. In 2017, a senior member of the Group audit team visited all of the UK components as well as the following overseas components: USSI, EMS, Herley, 3eTI, Ocean Systems, TCS, and Forensic Technologies.



Full audit scope	66
Specified audit procedures	22
Review at Group level	12

Revenue %



Full audit scope	65
Specified audit procedures	29
Review at Group level	6

Underlying Profit Before Tax %

Independent auditor's report continued

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report including the titles of the other information, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- Fair, balanced and understandable – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Audit Committee reporting – the section describing the work of the audit committee does not appropriately address matters communicated by us to the Audit Committee; or
- Directors' statement of compliance with the UK Corporate Governance Code – the parts of the directors' statement required under the Listing Rules relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website (**www.frc.org.uk/auditorsresponsibilities**). This description forms part of our auditor's report.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and of the Parent Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records
Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration
Under the Companies Act 2006 we are also required to report if, in our opinion, certain disclosures of directors' remuneration have not been made or the part of the directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Other matters

Auditor tenure
Following the recommendation of the Audit Committee, we were appointed by the Board of directors on 17 April 2003 to audit the financial statements for the year ending 31 December 2003 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 14 years, covering the years ending 31 December 2003 to 31 December 2017.

Consistency of the audit report with the additional report to the Audit Committee
Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Alex Butterworth

Alexander Butterworth ACA, Senior Statutory Auditor
for and on behalf of **Deloitte LLP**
Statutory Auditor
Reading, United Kingdom
5 March 2018

Group highlights
for the year ended 31 December 2017

	2017 £'000	2016 £'000	Change %
Revenue	775,400	785,764	-1.3
Operating profit	61,484	89,725	-31.5
Underlying operating profit*	120,136	131,134	-8.4
Profit before tax	60,592	67,621	-10.4
Underlying profit before tax*	110,002	120,059	-8.4

	2017 pence	2016 pence	Change %
Basic earnings per share	66.2	82.8	-20.0
Underlying earnings per share*	116.7	134.6	-13.3
Dividend per share	49.6	47.8	+3.8

* Ultra uses underlying figures as key performance indicators. A reconciliation is set out in note 2 between operating profit and underlying operating profit, between profit before tax and underlying profit before tax and between cash generated by operations and underlying operating cash flow. The calculation for underlying earnings per share is set out in note 13.

Underlying operating profit is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, Oman contract termination related costs and adjustments to contingent consideration net of acquisition and disposal related costs.

Underlying profit before tax is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, Oman contract termination related costs, fair value movements on derivatives, unwinding of discount on provisions, defined benefit pension interest charges and curtailment gain and adjustments to contingent consideration net of acquisition and disposal related costs.

Underlying earnings per share is before acquisition and disposal related costs, amortisation of intangibles arising on acquisition, the S3 programme, impairment charges, fair value movement on derivative financial instruments, defined benefit pension interest charges and curtailment gain and unwinding of discount on provisions.

Further detail on non-statutory performance measures is set out on page **143**.

Consolidated income statement
for the year ended 31 December 2017

	Note	2017 £'000	2016 £'000
Revenue	3	775,400	785,764
Cost of sales		(545,178)	(536,561)
Gross profit		230,222	249,203
Other operating income	4	249	1,770
Distribution costs		(1,066)	(1,081)
Administrative expenses		(134,857)	(144,893)
Other operating expenses	5	(15,648)	(8,777)
Oman contract termination costs	7	(7,958)	-
Impairment charge	2	(1,608)	-
S3 programme	2	(7,850)	(6,497)
Operating profit	6	61,484	89,725
Loss on disposals (net)	31	-	(4,076)
Retirement benefit scheme curtailment gain	30	-	15,500
Investment revenue	9	12,439	197
Finance costs	10	(13,331)	(33,725)
Profit before tax		60,592	67,621
Tax	11	(11,666)	(9,363)
Profit for the year		48,926	58,258
Attributable to:			
Owners of the Company		48,956	58,260
Non-controlling interests		(30)	(2)
Earnings per ordinary share (pence)			
Basic	13	66.2	82.8
Diluted	13	66.1	82.8

The accompanying notes are an integral part of this consolidated income statement. All results are derived from continuing operations.

Consolidated statement of comprehensive income
for the year ended 31 December 2017

	Note	2017 £'000	2016 £'000
Profit for the year		48,926	58,258
Items that will not be reclassified to profit or loss:			
Actuarial profit/(loss) on defined benefit pension schemes	30	24,135	(49,343)
Tax relating to items that will not be reclassified	11	(4,113)	9,973
Total items that will not be reclassified to profit or loss		20,022	(39,370)
Items that may be reclassified to profit or loss:			
Exchange differences on translation of foreign operations		(44,089)	99,349
Reclassification of exchange differences on disposals		-	(1,895)
Profit/(loss) on loans used in net investment hedges		20,567	(43,078)
Transfer from profit and loss on cash flow hedge		27	-
Profit on cash flow hedge		407	-
Tax relating to items that may be reclassified	11	(74)	43
Total items that may be reclassified to profit or loss		(23,162)	54,419
Other comprehensive income for the year		(3,140)	15,049
Total comprehensive income for the year	27	45,786	73,307
Attributable to:			
Owners of the Company		45,816	73,309
Non-controlling interests		(30)	(2)

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

Consolidated balance sheet
31 December 2017

	Note	2017 £'000	2016 £'000
Non-current assets			
Goodwill	14	**394,529**	415,593
Other intangible assets	15	**136,889**	173,637
Property, plant and equipment	16	**59,150**	66,195
Deferred tax assets	24	**15,659**	21,377
Derivative financial instruments	22	**2,025**	3
Trade and other receivables	19	**32,225**	16,352
		640,477	693,157
Current assets			
Inventories	17	**76,627**	78,177
Trade and other receivables	19	**205,627**	215,731
Tax assets		**11,127**	9,444
Cash and cash equivalents		**149,522**	74,625
Derivative financial instruments	22	**437**	251
		443,340	378,228
Total assets		**1,083,817**	1,071,385
Current liabilities			
Trade and other payables	20	**(215,080)**	(193,243)
Tax liabilities		**(2,255)**	(7,339)
Derivative financial instruments	22	**(11,203)**	(12,507)
Borrowings	21	**(51,752)**	-
Short-term provisions	25	**(8,665)**	(16,633)
		(288,955)	(229,722)
Non-current liabilities			
Retirement benefit obligations	30	**(82,732)**	(113,177)
Other payables	20	**(8,114)**	(9,972)
Deferred tax liabilities	24	**(11,337)**	(6,555)
Derivative financial instruments	22	**(2,688)**	(11,594)
Borrowings	21	**(172,227)**	(331,325)
Long-term provisions	25	**(5,553)**	(5,469)
		(282,651)	(478,092)
Total liabilities		**(571,606)**	(707,814)
Net assets		**512,211**	363,571
Equity			
Share capital	26	**3,887**	3,523
Share premium account	27	**200,911**	64,020
Own shares	27	**(2,581)**	(2,581)
Hedging reserve	27	**(48,059)**	(68,986)
Translation reserve	27	**95,403**	139,492
Retained earnings	27	**262,611**	228,034
Equity attributable to owners of the company		**512,172**	363,502
Non-controlling interests	27	**39**	69
Total equity		**512,211**	363,571

The financial statements of Ultra Electronics Holdings plc, registered number 02830397, were approved by the Board of Directors and authorised for issue on 5 March 2018.

On behalf of the Board
D. Caster, Executive Chairman
A. Sharma, Group Finance Director

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

Consolidated cash flow statement
for the year ended 31 December 2017

	Note	2017 £'000	2016 £'000
Net cash flow from operating activities	28	**77,565**	92,834
Investing activities			
Interest received		**455**	197
Purchase of property, plant and equipment		**(7,098)**	(4,645)
Proceeds from disposal of property, plant and equipment		**102**	293
Expenditure on product development and other intangibles		**(5,680)**	(2,728)
Disposal of subsidiary undertakings	31	**-**	22,040
Acquisition of subsidiary undertakings	31	**-**	(5,199)
Net cash (used in)/from investing activities		**(12,221)**	9,958
Financing activities			
Issue of share capital		**137,255**	2,976
Dividends paid		**(34,959)**	(32,583)
Loan syndication costs		**(2,040)**	-
Repayments of borrowings		**(168,975)**	(114,419)
Proceeds from borrowings		**83,493**	60,000
Minority investment		**-**	2,000
Net cash from/(used in) financing activities		**14,774**	(82,026)
Net increase in cash and cash equivalents	28	**80,118**	20,766
Cash and cash equivalents at beginning of year		**74,625**	45,474
Effect of foreign exchange rate changes		**(5,221)**	8,385
Cash and cash equivalents at end of year		**149,522**	74,625

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

Consolidated statement of changes in equity
for the year ended 31 December 2017

Equity attributable to equity holders of the parent

	Share capital £'000	Share premium account £'000	Reserve for own shares £'000	Hedging reserve £'000	Translation reserve £'000	Retained earnings £'000	Non-controlling interest £'000	Total equity £'000
Balance at 1 January 2016	**3,514**	**61,052**	**(2,581)**	**(25,908)**	**42,038**	**238,728**	**-**	**316,843**
Profit for the year	-	-	-	-	-	58,260	(2)	58,258
Other comprehensive income for the year	-	-	-	(43,078)	97,454	(39,327)	-	15,049
Total comprehensive income for the year	**-**	**-**	**-**	**(43,078)**	**97,454**	**18,933**	**(2)**	**73,307**
Non-controlling interest's investment made in subsidiary	-	-	-	-	-	1,929	71	2,000
Equity-settled employee share schemes	9	2,968	-	-	-	984	-	3,961
Dividend to shareholders	-	-	-	-	-	(32,583)	-	(32,583)
Tax on share-based payment transactions	-	-	-	-	-	43	-	43
Balance at 31 December 2016	**3,523**	**64,020**	**(2,581)**	**(68,986)**	**139,492**	**228,034**	**69**	**363,571**
Balance at 1 January 2017	**3,523**	**64,020**	**(2,581)**	**(68,986)**	**139,492**	**228,034**	**69**	**363,571**
Profit for the year	-	-	-	-	-	48,956	(30)	48,926
Other comprehensive income for the year	-	-	-	20,927	(44,089)	20,022	-	(3,140)
Total comprehensive income for the year	**-**	**-**	**-**	**20,927**	**(44,089)**	**68,978**	**(30)**	**45,786**
Issue of share capital	352	133,195	-	-	-	-	-	133,547
Equity-settled employee share schemes	12	3,696	-	-	-	682	-	4,390
Dividend to shareholders	-	-	-	-	-	(34,959)	-	(34,959)
Tax on share-based payment transactions	-	-	-	-	-	(124)	-	(124)
Balance at 31 December 2017	**3,887**	**200,911**	**(2,581)**	**(48,059)**	**95,403**	**262,611**	**39**	**512,211**

Notes to accounts – Group
31 December 2017

1 Segment information

For management purposes, the Group is organised into three operating segments – Aerospace & Infrastructure, Communications & Security and Maritime & Land. These segments are consistent with the internal reporting as reviewed by the Executive Chairman. Each segment includes businesses with similar operating and market characteristics.

	2017 External revenue £'000	2017 Inter-segment £'000	2017 Total £'000	2016 External revenue £'000	2016 Inter-segment £'000	2016 Total £'000
Revenue						
Aerospace & Infrastructure	203,174	10,219	213,393	204,685	8,114	212,799
Communications & Security	242,708	7,000	249,708	258,975	2,807	261,782
Maritime & Land	329,518	14,920	344,438	322,104	21,869	343,973
Eliminations	-	(32,139)	(32,139)	-	(32,790)	(32,790)
Consolidated revenue	775,400	-	775,400	785,764	-	785,764

All inter-segment trading is at arm's length.

2017	Aerospace & Infrastructure £'000	Communications & Security £'000	Maritime & Land £'000	Total £'000
Underlying operating profit	32,638	28,235	59,263	120,136
Amortisation of intangibles arising on acquisition	(1,136)	(20,070)	(7,242)	(28,448)
Impairment charge	-	(1,608)	-	(1,608)
Oman contract termination costs	(7,958)	-	-	(7,958)
Adjustments to contingent consideration net of acquisition and disposal related costs	1,163	(366)	(13,585)	(12,788)
S3 programme	(1,085)	(3,446)	(3,319)	(7,850)
Operating profit	23,622	2,745	35,117	61,484
Investment revenue				12,439
Finance costs				(13,331)
Profit before tax				60,592
Tax				(11,666)
Profit after tax				48,926

The acquisition and disposal related costs of £12,788,000 include those associated with the proposed Sparton Corporation acquisition and 3 Phoenix staff retention payments (see note 31) which were put in place at the time of the acquisition of that business.

The S3 programme is the Group's Standardisation & Shared Services programme.

2016	Aerospace & Infrastructure £'000	Communications & Security £'000	Maritime & Land £'000	Total £'000
Underlying operating profit	32,378	39,703	59,053	131,134
Amortisation of intangibles arising on acquisition	(1,604)	(26,964)	(4,087)	(32,655)
Adjustments to contingent consideration net of acquisition and disposal related costs	(337)	(1,457)	(463)	(2,257)
S3 programme	(2,594)	(2,406)	(1,497)	(6,497)
Operating profit	27,843	8,876	53,006	89,725
Loss on disposals (net)				(4,076)
Retirement benefit scheme curtailment gain				15,500
Investment revenue				197
Finance costs				(33,725)
Profit before tax				67,621
Tax				(9,363)
Profit after tax				58,258

1 Segment information (continued)

Capital expenditure, additions to intangibles, depreciation and amortisation

	Capital expenditure and additions to intangibles (excluding goodwill and acquired intangibles)		Depreciation and amortisation	
	2017 £'000	2016 £'000	**2017 £'000**	2016 £'000
Aerospace & Infrastructure	**3,546**	1,647	**4,783**	5,894
Communications & Security	**4,840**	3,460	**25,516**	34,127
Maritime & Land	**4,392**	2,266	**11,862**	9,512
Total	**12,778**	7,373	**42,161**	49,533

The 2017 depreciation and amortisation expense includes £31,995,000 of amortisation charges (2016: £38,034,000) and £10,166,000 of property, plant and equipment depreciation charges (2016: £11,499,000).

Total assets by segment

	2017 £'000	2016 £'000
Aerospace & Infrastructure	**227,932**	233,110
Communications & Security	**428,884**	463,713
Maritime & Land	**248,231**	268,862
	905,047	965,685
Unallocated	**178,770**	105,700
Consolidated total assets	**1,083,817**	1,071,385

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

Total liabilities by segment

	2017 £'000	2016 £'000
Aerospace & Infrastructure	**61,376**	55,751
Communications & Security	**81,443**	71,832
Maritime & Land	**102,085**	104,042
	244,904	231,625
Unallocated	**326,702**	476,189
Consolidated total liabilities	**571,606**	707,814

Unallocated liabilities represent derivatives at fair value, current and deferred tax liabilities, retirement benefit obligations, bank loans and loan notes.

Revenue by destination

The following table provides an analysis of the Group's sales by geographical market:

	2017 £'000	2016 £'000
United Kingdom	**161,293**	185,135
Continental Europe	**78,199**	82,818
Canada	**22,844**	18,617
USA	**384,330**	391,754
Rest of World	**128,734**	107,440
	775,400	785,764

During the year, there was one direct customer (2016: one) that individually accounted for greater than 10% of the Group's total turnover. Sales to this customer in 2017 were £146.6m (2016: £141.9m) across all segments.

1 Segment information (continued)

Other information (by geographic location)

	Non-current assets		Total assets		Additions to property, plant & equipment and intangible assets (excluding acquisitions)	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000	2017 £'000	2016 £'000
United Kingdom	206,433	205,253	342,792	344,157	4,742	3,213
USA	317,613	362,313	426,826	478,083	6,069	3,356
Canada	91,057	96,449	123,646	126,995	1,341	767
Rest of World	7,689	7,762	11,784	16,450	626	37
	622,792	671,777	905,048	965,685	12,778	7,373
Unallocated	17,685	21,380	178,769	105,700	-	-
	640,477	693,157	1,083,817	1,071,385	12,778	7,373

2 Additional non-statutory performance measures

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

	2017 £'000	2016 £'000
Operating profit	61,484	89,725
Amortisation of intangibles arising on acquisition *(see note 15)*	28,448	32,655
Impairment charge *(see note 15)*	1,608	-
Oman contract termination related costs *(see note 7)*	7,958	-
Adjustments to contingent consideration net of acquisition and disposal related costs *(see note 1)*	12,788	2,257
S3 programme	7,850	6,497
Underlying operating profit	120,136	131,134
Profit before tax	60,592	67,621
Amortisation of intangibles arising on acquisition *(see note 15)*	28,448	32,655
Impairment charge *(see note 15)*	1,608	-
Adjustments to contingent consideration net of acquisition and disposal related costs *(see note 1)*	12,788	2,257
Unwinding of discount on provisions *(see note 10)*	-	367
(Gain)/loss on fair value movements of derivatives *(see note 22)*	(11,983)	19,103
Net interest charge on defined benefit pensions *(see note 10)*	2,741	2,983
S3 programme	7,850	6,497
Loss on disposals (net) *(see note 31)*	-	4,076
Oman contract termination related costs *(see note 7)*	7,958	-
Retirement benefit scheme curtailment gain *(see note 30)*	-	(15,500)
Underlying profit before tax	110,002	120,059
Cash generated by operations *(see note 28)*	97,432	112,002
Purchase of property, plant and equipment	(7,098)	(4,645)
Proceeds on disposal of property, plant and equipment	102	293
Expenditure on product development and other intangibles	(5,680)	(2,728)
Oman contract termination related costs/Oman performance bond	9,836	8,230
S3 programme	8,949	5,613
Acquisition and disposal related payments	12,966	1,669
Underlying operating cash flow	116,507	120,434

The above analysis of the Group's operating results, earnings per share and cash flows, is presented to provide readers with additional performance indicators that are prepared on a non-statutory basis. This presentation is regularly reviewed by management to identify items that are unusual and other items relevant to an understanding of the Group's performance and long-term trends with reference to their materiality and nature. This additional information is not uniformly defined by all Companies and may not be comparable with similarly titled measures and disclosures by other organisations. The non-statutory disclosures should not be viewed in isolation or as an alternative to the equivalent statutory measure. See page **143** for further details.

3 Revenue

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

	2017 £'000	2016 £'000
Sales of goods	308,416	342,284
Revenue from long-term contracts	466,984	443,480
	775,400	785,764

The determination of revenue from long-term contacts is a critical accounting estimate as set out on page **138**.

4 Other operating income

Amounts included in other operating income were as follows:

	2017 £'000	2016 £'000
Foreign exchange gains	249	1,770
	249	1,770

5 Other operating expenses

Amounts included in other operating expenses were as follows:

	2017 £'000	2016 £'000
Amortisation of internally generated development costs	1,197	2,876
Foreign exchange losses	14,451	5,901
	15,648	8,777

6 Operating profit

Operating profit is stated after charging/(crediting):

	2017 £'000	2016 £'000
Raw materials and other bought in inventories expensed in the year	224,215	201,221
Staff costs *(see note 8)*	258,981	254,956
Depreciation of property, plant and equipment	10,166	11,499
Amortisation of internally generated intangible assets	1,197	2,876
Amortisation of acquired intangible assets (and other intangibles)	30,798	35,158
Impairment of intangible assets *(see note 15)*	1,608	-
Contingent consideration release	(1,194)	-
Government grant income *(see note 23)*	(2,029)	(1,663)
Net foreign exchange loss/(gain)	7,007	(6,634)
Loss on disposal of property, plant and equipment	565	291
Operating lease rentals		
– plant and machinery	1,352	1,269
– other	12,474	13,022
Research and development costs	28,314	32,639
Auditor's remuneration for statutory audit work (including expenses)	1,199	893

The Company-only audit fee included in the Group audit fee shown above was £20,000 (2016: £20,000).

Analysis of auditor's remuneration

	2017 £'000	2016 £'000
Fees payable for the audit of the annual accounts	348	204
Fees payable for the audit of subsidiaries	851	689
Total for statutory Group audit services	1,199	893
Analysis of non-audit services:		
Audit related services	-	13
Tax compliance	5	4
Corporate finance services – due diligence and reporting accountant work	1,498	107
Other advisory	8	330
Total for non-audit services	1,511	454

During the year, the auditor provided due diligence and reporting accountant work principally relating to the Circular Announcement in relation to the proposed Sparton acquisition. As set out on pages **76-77**, the Audit Committee concluded that the auditor was best placed to perform these services.

7 Oman contract termination costs

In 2015, 'Ithra' ("Ultra Electronics in collaboration with Oman Investment Corporation LLC"), the legal entity established with the sole purpose of delivering the Oman Airport IT contract, was placed into voluntary liquidation. A liquidator was appointed to pursue claims against the customer on behalf of the interested parties. In 2017, £7,958,000 (2016: £nil) of legal costs associated with the Oman Airport IT contract termination were charged to the income statement.

8 Staff costs

Particulars of employees (including Executive Directors) are shown below.
Employee costs during the year amounted to:

	2017 £'000	2016 £'000
Wages and salaries	228,270	223,823
Social security costs	20,616	21,099
Pension costs	10,095	10,034
	258,981	254,956

The wages and salaries figure for 2017 includes £6.5m in relation to 3 Phoenix staff retention arrangements which were put in place at the time of the acquisition of that business.

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

	2017 Number	2016 Number
Production	1,729	1,917
Engineering	1,457	1,579
Selling	227	300
Support services	759	670
	4,172	4,466

Information on Directors' remuneration is given in the section of the Remuneration Report described as having been audited and those elements required by the Companies Act 2006 and the Financial Conduct Authority form part of these accounts.

9 Investment revenue

	2017 £'000	2016 £'000
Bank interest	456	197
Fair value movement on derivatives	11,983	-
	12,439	197

10 Finance costs

	2017 £'000	2016 £'000
Amortisation of finance costs of debt	1,281	848
Interest payable on bank loans, overdrafts and other loans	9,309	10,424
Total borrowing costs	10,590	11,272
Retirement benefit scheme finance cost	2,741	2,983
Unwinding of discount on provisions	-	367
Fair value movement on derivatives	-	19,103
	13,331	33,725

11 Tax

	2017 £'000	2016 £'000
UK taxes		
Corporation tax	**2,441**	5,549
Adjustment in respect of prior years	**(122)**	(1,848)
	2,319	3,701
Overseas taxes		
Current taxation	**5,400**	10,879
Adjustment in respect of prior years	**(1,690)**	326
	3,710	11,205
Total current tax	**6,029**	14,906
Deferred tax		
Origination and reversal of temporary differences	**7,676**	(7,124)
(Recognition)/derecognition of deferred tax assets	**(2,077)**	1,576
UK tax rate change	**-**	5
US tax rate change	**38**	-
Total deferred tax charge/(credit)	**5,637**	(5,543)
Total tax charge	**11,666**	9,363

Corporation tax in the UK is calculated at 19.25% (2016: 20.0%) of the estimated assessable profit for the year.

The Finance (No.2) Act 2015 and Finance Act 2016 provide for reductions in the main rate of corporation tax from 20% to 19% for the financial year beginning 1 April 2017 and to 17% for the financial year beginning 1 April 2020. UK deferred tax at the balance sheet date has been calculated at 17%. Deferred tax in other territories has been calculated at enacted tax rates that are expected to apply to the period when assets are realised or liabilities are settled. As a result of US tax reform, US deferred tax balances at 31 December 2017 have been calculated at 24% (2016: 38%).

Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

In addition to the amount charged to the income statement, the following amounts relating to tax have been recognised directly in other comprehensive income:

	2017 £'000	2016 £'000
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Actuarial (gain)/loss on defined benefit pension schemes	**(4,113)**	9,973
Revaluation of interest rate hedge	**(74)**	-
Total income tax charge recognised directly in other comprehensive income	**(4,187)**	9,973

In addition to the amount charged to the income statement and other comprehensive income, the following amounts relating to tax have been recognised directly in equity:

	2017 £'000	2016 £'000
Current tax		
Excess tax deductions related to share-based payments on exercised options	**-**	(124)
Deferred tax		
Change in estimated excess tax deductions related to share-based payments	**(124)**	167
Total income tax recognised directly in equity	**(124)**	43

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

	2017 £'000	2016 £'000
Group profit before tax	**60,592**	67,621
Tax on Group profit at standard UK corporation tax rate of 19.25% (2016: 20.0%)	**11,664**	13,524
Tax effects of:		
Income/expenses that are not taxable/allowable in determining taxable profits	**5,113**	2,405
Effect of change in UK tax rate	**-**	5
Effect of change in US tax rate	**38**	-
(Recognition)/derecognition of deferred tax assets	**(2,077)**	1,576
Expenses for which no deferred tax asset recognised	**1,000**	-
Different tax rates of subsidiaries operating in other jurisdictions	**1,238**	2,683
CFC exemption	**(4,401)**	(4,327)
Non-taxable gain on disposal	**-**	(1,835)
Patent Box	**(623)**	(813)
Adjustments in respect of prior years	**(286)**	(3,855)
Tax expense for the year	**11,666**	9,363

11 Tax (continued)

Included within the tax reconciliation are a number of non-recurring items, principally non-tax deductible one-off costs which fluctuate from year to year and the recognition of Canadian deferred tax assets in 2017, which were not recognised in 2016. In addition, a deferred tax asset is not recognised for certain expenses in our US business in 2017 and this will continue to be assessed annually. The differences attributable to the UK CFC (Controlled Foreign Company) exemption, Patent Box and higher overseas tax rates are expected to recur in the future (the level of profits in overseas jurisdictions and changes to the UK and overseas tax rates will affect the size of this difference in future.) The benefit of the CFC exemption is subject to an ongoing EU State Aid investigation into the UK's Controlled Foreign Company regime. In October 2017 the European Commission issued a preliminary finding that the Group financing partial exemption is illegal State Aid. In common with other UK-based international companies whose arrangements are in line with current UK CFC legislation we may be affected by the eventual outcome of the investigation and are monitoring developments. No provision for this potential liability has been made in these financial statements as it is not clear what, if any, the eventual financial result will be.

12 Dividends

Amounts recognised as distributions to equity holders in the year:

	2017 £'000	2016 £'000
Final dividend for the year ended 31 December 2016 of 33.6p (2015: 32.3p) per share	**23,647**	22,631
Interim dividend for the year ended 31 December 2017 of 14.6p (2016: 14.2p) per share	**11,312**	9,952
	34,959	32,583
Proposed final dividend for the year ended 31 December 2017 of 35.0p (2016: 33.6p) per share	**27,124**	23,597

The 2017 proposed final dividend of 35.0p per share is planned to be paid on 3 May 2018 to shareholders on the register at 6 April 2018. It was approved by the Board after 31 December 2017 and has not been included as a liability as at 31 December 2017.

13 Earnings per share

	2017 pence	2016 pence
Basic underlying *(see below)*	**116.7**	134.6
Diluted underlying *(see below)*	**116.5**	134.5
Basic	**66.2**	82.8
Diluted	**66.1**	82.8

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

	2017 £'000	2016 £'000
Earnings		
Earnings for the purposes of basic earnings per share being profit for the year	**48,956**	58,260
Underlying earnings		
Profit for the year	**48,956**	58,260
(Profit)/loss on fair value movements on derivatives (net of tax)	**(9,411)**	16,008
Amortisation of intangibles arising on acquisition (net of tax)	**20,005**	22,419
Unwinding of discount on provisions (net of tax)	**-**	367
Acquisition and disposal related costs net of contingent consideration (net of tax)	**10,394**	2,100
Net interest charge on defined benefit pensions (net of tax)	**2,275**	2,386
Retirement benefit scheme curtailment gain (net of tax)	**-**	(12,400)
Impairment charges (net of tax)	**997**	-
S3 programme (net of tax)	**5,983**	5,503
Oman contract termination costs (net of tax)	**7,097**	-
Disposals (net of tax)	**-**	48
Earnings for the purposes of underlying earnings per share	**86,296**	94,691

The adjustments to profit are explained in note 2.

	2017 Number of shares	2016 Number of shares
The weighted average number of shares is given below:		
Number of shares used for basic earnings per share	**73,959,565**	70,330,384
Effect of dilutive potential ordinary shares – share options	**86,340**	73,320
Number of shares used for fully diluted earnings per share	**74,045,905**	70,403,704

	2017 £'000	2016 £'000
Underlying profit before tax *(see note 2)*	**110,002**	120,059
Tax rate applied for the purposes of underlying earnings per share	**21.58%**	21.13%

On 7 July 2017, a total of 7,047,168 ordinary shares of 5 pence were placed, representing 9.9% of Ultra's issued ordinary share capital prior to the placing.

14 Goodwill

	2017 £'000	2016 £'000
Cost		
At 1 January	478,565	428,166
Exchange differences	(26,758)	55,577
Derecognised on disposal *(see note 31)*	-	(8,305)
Other changes	-	3,127
At 31 December	451,807	478,565
Accumulated impairment losses		
At 1 January	(62,972)	(52,281)
Exchange differences	5,694	(10,691)
Carrying amount at 31 December	394,529	415,593

Other changes in 2016 related to the re-assessment of initial fair values at Herley, which predominantly related to inventory and provisions, and to Furnace Parts adjustments to deferred tax balances.

The Group's market-facing-segments, which represent Cash Generating Unit (CGU) groupings, are; Aerospace, Infrastructure, Nuclear, Communications, C2ISR, Maritime, Land and Underwater Warfare. These represent the lowest level at which the goodwill is monitored for internal management purposes. Goodwill is allocated to CGU groupings as set out below:

	2017 Discount rate %	2016 Discount rate %	2017 £'000	2016 £'000
Aerospace	10.1	10.1	32,531	32,784
Infrastructure	10.1	10.1	28,276	28,159
Nuclear	10.1	10.1	18,030	19,411
Aerospace & Infrastructure			78,837	80,354
Communications	10.1	10.1	90,894	93,182
C2ISR	10.1	10.1	115,135	124,926
Communications & Security			206,029	218,108
Maritime	10.1	10.1	33,716	36,025
Underwater Warfare	10.1	10.1	75,947	81,106
Maritime & Land			109,663	117,131
Total – Ultra Electronics			394,529	415,593

Goodwill is initially allocated, in the year a business is acquired, to the CGU group expected to benefit from the acquisition. Subsequent adjustments are made to this allocation to the extent that operations, to which goodwill relates, are transferred between CGU groups. The size of a CGU group varies but is never larger than a reportable operating segment. There have been no changes in the year.

The recoverable amounts of CGUs are determined from value-in-use calculations. In determining the value-in-use for each CGU, the Group prepares cash flows derived from the most recent financial budgets and strategic plans, representing the best estimate of future performance. These plans, which have been approved by the Board, include detailed financial forecasts and market analysis covering the expected development of each CGU over the next five years. The cash flows for the following ten years are also included and assume a growth rate of 2.5% (2016: 2.5%) per annum. Cash flows beyond that period are not included in the value-in-use calculation.

The key assumptions used in the value-in-use calculations are those regarding the discount rate, future revenues, growth rates, forecast gross margins, underlying operating profit* and operating cash conversion.* Management estimates the discount rate using pre-tax rates that reflect current market assessments of the time value of money and risks specific to the Group, being the Weighted Average Cost of Capital (WACC). The WACC is then risk-adjusted to reflect risks specific to each business. The pre-tax discount rate used during 2017 was 10.1% (2016: 10.1%). Future revenues are based on orders already received, opportunities that are known and expected at the time of setting the budget and strategic plans and future growth rates. Budget and strategic plan growth rates are based on a combination of historic experience, available government spending data, and management and industry expectations of the growth rates that are expected to apply in the major markets in which each CGU operates. Longer-term growth rates, applied for the ten-year period after the end of the strategic planning period, are set at 2.5%. Ultra considers the long-term growth rate to be appropriate for the sectors in which it operates. Forecast gross margins reflect past experience, factor in expected efficiencies to counter inflationary pressures, and also reflect likely margins achievable in the shorter-term period of greater defence spending uncertainty.

Within each of the strategic plans, a number of assumptions are made about business growth opportunities, contract wins, product development and available markets. A key assumption is that there will be continued demand for Ultra's products and expertise from a number of US government agencies and prime contractors during the strategic plan period.

Sensitivity analysis has been performed on the value-in-use calculations to:
(i) reduce the post-2022 growth assumption from 2.5% to nil;
(ii) apply a 20% reduction to forecast operating profits in each year of the modelled cash inflows; and
(iii) consider specific market factors as noted above.

*see footnote on page 150

14 Goodwill (continued)

Certain of these sensitivity scenarios give rise to a potential impairment in Infrastructure. Headroom, which represents the value derived from the key growth assumptions in the Infrastructure value-in-use calculations, is £6.0m. Sensitivity (ii) results in a £0.9m impairment in Infrastructure; the CGU grouping is sensitive to the ability of the remaining operations to win sufficient new customers over the medium term.

For all other CGUs, the value-in-use calculations exceed the CGU carrying values in the sensitivity scenarios.

15 Other intangible assets

	Acquired intangibles				Internally generated capitalised development costs	Software, patents and trademarks	Total
	Customer relationships £'000	Intellectual property £'000	Profit in order book £'000	Other acquired £'000	£'000	£'000	£'000
Cost							
At 1 January 2016	250,836	113,324	30,883	7,646	23,235	26,529	452,453
Foreign exchange differences	37,707	16,849	4,074	1,119	2,271	3,164	65,184
Fair value adjustment	-	-	-	-	-	(123)	(123)
Additions	-	-	-	-	1,949	779	2,728
Disposals	(66,084)	(12,585)	-	-	(466)	(327)	(79,462)
At 1 January 2017	**222,459**	**117,588**	**34,957**	**8,765**	**26,989**	**30,022**	**440,780**
Foreign exchange differences	(12,574)	(7,114)	(1,882)	(388)	(1,264)	(1,621)	(24,843)
Additions	-	-	-	-	1,582	4,098	5,680
Reclassification from tangible fixed assets	-	-	-	-	-	418	418
Disposals	-	-	-	-	-	(1,595)	(1,595)
At 31 December 2017	**209,885**	**110,474**	**33,075**	**8,377**	**27,307**	**31,322**	**420,440**
Accumulated amortisation							
At 1 January 2016	(141,958)	(56,761)	(27,863)	(2,505)	(11,065)	(19,178)	(259,330)
Foreign exchange differences	(22,195)	(8,880)	(3,687)	(390)	(1,096)	(2,267)	(38,515)
Disposals	58,396	9,971	-	-	49	320	68,736
Charge	(19,935)	(9,719)	(1,872)	(1,129)	(2,876)	(2,503)	(38,034)
At 1 January 2017	**(125,692)**	**(65,389)**	**(33,422)**	**(4,024)**	**(14,988)**	**(23,628)**	**(267,143)**
Foreign exchange differences	7,373	4,223	1,789	217	783	1,222	15,607
Impairment charges	-	-	-	-	(1,608)	-	(1,608)
Disposals	-	-	-	-	-	1,588	1,588
Charge	(18,193)	(8,359)	(954)	(942)	(1,197)	(2,350)	(31,995)
At 31 December 2017	**(136,512)**	**(69,525)**	**(32,587)**	**(4,749)**	**(17,010)**	**(23,168)**	**(283,551)**
Carrying amount							
At 31 December 2017	**73,373**	**40,949**	**488**	**3,628**	**10,297**	**8,154**	**136,889**
At 31 December 2016	96,767	52,199	1,535	4,741	12,001	6,394	173,637

Of the £8,154,000 (2016: £6,394,000) net book value within the software, patents and trademarks category, £291,000 (2016: £417,000) related to patents and trademarks. The amortisation of intangible assets charge is included within administrative expenses. Intangible assets, other than goodwill, are amortised over their estimated useful lives, typically as follows:

Customer relationships	5 to 21 years
Intellectual property	5 to 10 years
Profit in acquired order book	1 to 3 years
Other acquired	1 to 5 years
Development costs	2 to 10 years
Other intangibles:	
Software	3 to 5 years
Patents and trademarks	10 to 20 years

16 Property, plant and equipment

	Land and buildings			
	Freehold £'000	Short leasehold £'000	Plant and machinery £'000	Total £'000
Cost				
At 1 January 2016	37,023	23,492	107,947	168,462
Foreign exchange differences	4,268	2,301	11,527	18,096
Fair value adjustments	-	-	(764)	(764)
Additions	308	447	3,890	4,645
Disposals	(38)	(331)	(7,760)	(8,129)
At 1 January 2017	**41,561**	**25,909**	**114,840**	**182,310**
Foreign exchange differences	(1,640)	(1,076)	(5,073)	(7,789)
Additions	1,697	230	5,171	7,098
Disposals	(11)	(2,911)	(19,786)	(22,708)
Reclassified to software *(see note 15)*	-	-	(418)	(418)
At 31 December 2017	**41,607**	**22,152**	**94,734**	**158,493**
Accumulated depreciation				
At 1 January 2016	(6,213)	(12,343)	(81,723)	(100,279)
Foreign exchange differences	(1,192)	(1,569)	(8,910)	(11,671)
Charge	(1,022)	(2,393)	(8,084)	(11,499)
Disposals	38	295	7,001	7,334
At 1 January 2017	**(8,389)**	**(16,010)**	**(91,716)**	**(116,115)**
Foreign exchange differences	359	794	3,744	4,897
Charge	(1,148)	(2,040)	(6,978)	(10,166)
Disposals	8	2,899	19,134	22,041
At 31 December 2017	**(9,170)**	**(14,357)**	**(75,816)**	**(99,343)**
Carrying amount				
At 31 December 2017	**32,437**	**7,795**	**18,918**	**59,150**
At 31 December 2016	33,172	9,899	23,124	66,195

Freehold land amounting to £6,748,000 (2016: £7,070,000) has not been depreciated. Included within Land and Buildings is £nil (2016: £nil) of assets in the course of construction.

17 Inventories

	2017 £'000	2016 £'000
Raw materials and consumables	**48,965**	48,147
Work in progress	**18,787**	21,452
Finished goods and goods for resale	**8,875**	8,578
	76,627	78,177

The amount of any write-down of inventory recognised as an expense in the year was £1,666,000 (2016: £4,912,000).

18 Long-term contract balances

	2017 £'000	2016 £'000
Contracts in progress at the balance sheet date:		
Amounts receivable from contract customers included in trade and other receivables	**116,732**	112,271
Amounts due to contract customers included in trade and other payables	**(58,707)**	(52,456)
	58,025	59,815
Contract costs incurred plus recognised profits less recognised losses to date	**1,429,148**	1,480,046

Advances received from customers for contract work amounted to £55,817,000 (2016: £48,378,000).

19 Trade and other receivables

Non-current	2017 £'000	2016 £'000
Amounts receivable from contract customers *(see note 18)*	**32,225**	16,352
	32,225	16,352

Current	2017 £'000	2016 £'000
Trade receivables	**102,934**	98,977
Provisions against receivables	**(1,505)**	(1,307)
Net trade receivables	**101,429**	97,670
Amounts receivable from contract customers *(see note 18)*	**84,507**	95,919
Other receivables	**12,897**	11,891
Prepayments and accrued income	**6,794**	10,251
	205,627	215,731

Trade receivables do not carry interest. The average credit period on sale of goods is 32 days (2016: 36 days).

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value.

The ageing profile of unprovided overdue trade receivables was as follows:

	2017 £'000	Related provision £'000	Total £'000	2016 £'000	Related provision £'000	Total £'000
1 to 3 months	**16,361**	**(112)**	**16,249**	15,765	(157)	15,608
4 to 6 months	**4,374**	**(480)**	**3,894**	1,968	(56)	1,912
7 to 9 months	**871**	**(71)**	**800**	434	(72)	362
Over 9 months	**1,214**	**(842)**	**372**	1,666	(1,022)	644
Total overdue	**22,820**	**(1,505)**	**21,315**	19,833	(1,307)	18,526

The Group makes provisions against its trade receivables where there are serious doubts as to future recoverability based on prior experience, on assessment of the current economic climate and on the length of time that the receivable has been overdue. All trade receivables that have been overdue for more than a year are provided for in full.

Movement in the provision for trade receivables was as follows:

Current	2017 £'000	2016 £'000
Balance at beginning of year	**1,307**	959
Foreign exchange differences	**(23)**	105
Increase in provision for trade receivables regarded as potentially uncollectable	**617**	633
Decrease in provision for trade receivables recovered during the year	**(396)**	(390)
Balance at end of year	**1,505**	1,307

Credit risk

Credit risk is defined as the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group mitigates this risk of financial loss by only dealing with creditworthy counterparties.

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

Whilst the Group has elements of concentration of credit risk, with exposure to a number of large counterparties and customers, the customers are mainly government agencies or multi-national organisations with whom the Group has long-term business relationships. The Group has a small number of customers with individually significant amounts outstanding. These customers are considered to have low credit risk.

Ongoing credit evaluation is performed on the financial condition of accounts receivable and, when appropriate, action is taken to minimise the Group's credit risk.

The carrying amount of financial assets recorded in the financial statements *(see note 22),* net of any allowances for losses, represents the Group's maximum exposure to credit risk.

20 Trade and other payables

	2017 £'000	2016 £'000
Amounts included in current liabilities:		
Trade payables	89,205	68,341
Amounts due to contract customers *(note 18)*	55,166	46,310
Other payables	21,007	30,207
Accruals and deferred income	49,702	48,385
	215,080	193,243
Amounts included in non-current liabilities:		
Amounts due to contract customers *(note 18)*	3,541	6,146
Other payables	12	243
Accruals and deferred income	4,561	3,583
	8,114	9,972

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

21 Borrowings

	2017 £'000	2016 £'000
Amounts due in less than one year:		
Bank loans	44,359	-
Unsecured loan notes	7,393	-
	51,752	-
Amounts due after more than one year:		
Bank loans	120,375	268,120
Unsecured loan notes	44,359	56,897
Loans from government *(see note 23)*	7,493	6,308
	172,227	331,325
Total borrowings:		
Amount due for settlement within 12 months	51,752	-
Amount due for settlement after 12 months	172,227	331,325
	223,979	331,325

The Group's main financial covenants are that the ratio of net consolidated total borrowings/EBITDA is less than three, and that the net interest payable on borrowings is covered at least three times by EBITA.

22 Financial instruments and financial risk management

Derivative financial instruments

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

Fair value measurements recognised in the balance sheet

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted (unadjusted) active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

All of Ultra's financial instruments have been assessed as Level 2 or Level 3. Further details on the SADI loan, which is classified as Level 3, are set out in note 23.

Fair value measurements recognised in the balance sheet

	Level 3 £'000	Level 2 £'000	2017 Total £'000
Financial assets at fair value			
Foreign exchange derivative financial instruments (through profit and loss)	-	2,028	2,028
Interest rate swap	-	434	434
Total	-	2,462	2,462
Financial liabilities at fair value			
SADI loan *(see note 23)*	7,493	-	7,493
Foreign exchange derivative financial instruments (through profit and loss)	-	13,891	13,891
Total	7,493	13,891	21,384

22 Financial instruments and financial risk management (continued)

	Level 3 £'000	Level 2 £'000	2016 Total £'000
Financial assets at fair value			
Foreign exchange derivative financial instruments (through profit and loss)	-	254	254
Financial liabilities at fair value			
SADI loan *(see note 23)*	6,308	-	6,308
Foreign exchange derivative financial instruments (through profit and loss)		24,101	24,101
Total	6,308	24,101	30,409

	Current assets/(liabilities)		Non-current assets/(liabilities)	
	2017 £'000	2016 £'000	**2017 £'000**	2016 £'000
Financial assets/(liabilities) carried at fair value through profit or loss				
Foreign exchange currency liabilities	**(11,203)**	(12,507)	**(2,688)**	(11,594)
Foreign exchange currency assets	**437**	251	**2,025**	3

Financial assets

The financial assets of the Group were as follows:

	2017 £'000	2016 £'000
Cash and cash equivalents	**149,522**	74,625
Currency derivatives used for hedging	**2,462**	254
Amounts receivable from contract customers	**116,732**	112,271
Other receivables	**12,897**	11,891
Trade receivables	**101,429**	97,670
Prepayments and accrued income	**6,794**	10,251

The Directors consider that the carrying amount for all financial assets approximates to their fair value.

Financial liabilities

The financial liabilities of the Group were as follows:

	2017 £'000	2016 £'000
Currency derivatives used for hedging	**13,891**	24,101
Bank loans and overdrafts	**164,734**	268,120
Loan notes	**51,752**	56,897
Government loans	**7,493**	6,308
Trade payables	**89,205**	68,341
Amounts due to contract customers	**58,707**	52,456
Deferred consideration	**2,302**	3,956
Accruals and other payables	**65,615**	64,045

The Directors consider that the carrying amount for all financial liabilities approximates to their fair value.

Liquidity risk

The Group maintains committed banking facilities with core banks to provide prudent levels of borrowing headroom.

The Group's banking facilities are provided by a small group of banks, led by The Royal Bank of Scotland. For most of the year there were two revolving credit facilities in place: the first facility, originally established in 2012 and amended in 2015, provided £100 million and was due to expire in August 2019 and the second facility, established in 2014, provided £200 million and was also due to expire in August 2019. On 7 November 2017 these facilities were replaced with a new £300 million of revolving credit with an expiry date of November 2022. The facility has the option to be extended, subject to lender consent, by a further two years to November 2024. The facility also incorporates an uncommitted £150 million accordion. The facility is denominated in Sterling, US Dollars, Canadian Dollars, Australian Dollars and Euros and is used for balance sheet and operational needs. A US$225m term-loan, which expires in August 2019, was put in place at the time of the Herley acquisition.

A £5 million overdraft, and US$10 million overdraft are available for short-term working capital funding.

All bank loans are unsecured. Interest was predominantly charged at 1.20% (2016: 1.35%) over base or contracted rate.

At 31 December 2017, the Group had available £300,000,000 (2016: £213,000,000) of undrawn, committed borrowing facilities.

The Group is strongly cash-generative and the funds generated by operating companies are managed regionally to fund short-term local working capital requirements. Where additional funding is required, this is provided centrally through the Group's committed banking facilities.

The Group, through its Canadian subsidiary Ultra Electronics Tactical Communication Systems (TCS), participates in two Canadian programmes that provide government support in relation to the development of certain of its products. Further disclosure is provided in note 23.

The Group has a private shelf agreement with Prudential Investment Management, Inc. US$10m of loan notes were issued in 2011 with a maturity date of July 2018 and a further US$60m of loan notes were issued in January 2012 with a maturity date of January 2019.

22 Financial instruments and financial risk management (continued)

Liquidity risk (continued)

The following table details the Group's remaining contractual maturity for its financial liabilities:

	Within 1 year £'000	1 to 2 years £'000	2 to 5 years £'000	Over 5 years £'000	**Total £'000**
2017					
Bank loans and overdrafts	**48,640**	**122,253**	**-**	**-**	**170,893**
Loan notes	**9,115**	**44,462**	**-**	**-**	**53,577**
Government loans	**-**	**-**	**-**	**7,493**	**7,493**
Trade payables	**89,205**	**-**	**-**	**-**	**89,205**
Currency derivatives used for hedging	**11,203**	**2,285**	**384**	**19**	**13,891**
Deferred consideration	**55**	**-**	**2,247**	**-**	**2,302**
Accruals and other payables	**62,270**	**2,748**	**597**	**-**	**65,615**
2016					
Bank loans and overdrafts	5,645	53,923	225,933	-	285,501
Loan notes	2,049	10,022	48,881	-	60,952
Government loans	-	-	-	6,308	6,308
Trade payables	68,341	-	-	-	68,341
Currency derivatives used for hedging	12,506	6,355	5,216	24	24,101
Deferred consideration	51	1,196	2,709	-	3,956
Accruals and other payables	61,339	1,270	1,111	325	64,045

Capital risk management

The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The capital structure of the Group consists of debt, which includes the borrowings disclosed in note 21, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in the Group Statement of Changes in Equity.

The Group is not subject to externally imposed capital requirements.

Currency risk

The Group uses currency derivatives in the form of forward currency contracts to hedge its foreign currency transaction risk. The currencies giving rise to this risk are primarily US Dollars and Canadian Dollars.

At 31 December 2017, the net fair value of the Group's currency derivatives is estimated to be a liability of approximately £11,863,000 (2016: liability £23,847,000), comprising £2,462,000 assets (2016: £254,000) and £13,891,000 liabilities (2016: £24,101,000). The gain on derivative financial instruments included in the Group's consolidated income statement for the period was £11,983,000 (2016: loss £19,103,000).

The net notional or net contracted amounts of foreign currency related forward sales contracts, classified by year of maturity are shown below.

	Not exceeding 1 year £'000	Between 1 year and 5 years £'000	Over 5 years £'000	**Total £'000**
2017				
US Dollars/Sterling	**(139,103)**	**57,182**	**-**	**(81,921)**
Euro/other currencies	**1,407**	**(9,806)**	**(589)**	**(8,988)**
Total	**(137,696)**	**47,376**	**(589)**	**(90,909)**
2016				
US Dollars/Sterling	58,196	80,510	-	138,706
Euro/other currencies	3,553	5,198	872	9,623
Total	61,749	85,708	872	148,329

In 2017, the Group's foreign exchange derivatives included forward contracts to sell £191.9m and receive USD$250.0m in 2018 in connection with the proposed Sparton Corporation acquisition. The table above includes these forwards.

Net investment hedges

At the year end, the Group had net investments in US companies where the associated foreign currency translation risk was hedged by external borrowings in US Dollars. The value of the borrowings does not exceed the net investments, meeting the conditions required to qualify as effective hedges. The value of the net investment hedge was US$265m (2016: US$295m).

Interest rate risk

The Group holds interest rate swaps to manage its exposure to interest rate movements on its bank borrowings. The interest rate swaps, denominated in US dollars, have been entered into to achieve an appropriate mix of fixed and floating rate exposure reflecting the Group's policy. The swaps mature in July 2019 and have a fixed swap rate, including the bank margin, of 1.232%. The floating rates are US Dollar LIBOR. At the year end, the nominal amounts of the interest rate swaps were US$60m (2016: US$90m). The hedging contracts fix US$60m of borrowings to 30 December 2017, reducing to US$45m by December 2018 and nil by July 2019.

22 Financial instruments and financial risk management (continued)

The interest rate swaps were designated effective cash flow hedges and the change in fair value is charged to equity. At 31 December 2017, the net fair value of interest rate swaps was £434,000 (2016: £315,000). The amount recycled from the income statement during the year was £27,000 and has been charged to interest cost in the year (2016: £495,000).

The fair value will be realised in the income statement on a quarterly basis over the next 1.5 years. The Group also has US$70m of fixed rate debt with Pricoa at an interest rate of 3.60%, with US$10m due for repayment in July 2018 and the remainder due for repayment in January 2019.

The interest rate swaps and fixed rate Pricoa debt were entered into to achieve an appropriate mix of fixed and floating rate exposure reflecting the Group's policy.

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

	Effective interest rate	Total £'000	Within 1 year £'000	1 to 2 years £'000	2 to 5 years £'000	5+ years £'000
2017						
Cash and cash equivalents	**0.55%**	**149,522**	**149,522**	**-**	**-**	**-**
Loan notes	**3.60%**	**51,752**	**7,393**	**44,359**	**-**	**-**
Unsecured bank loans	**2.56%**	**164,734**	**44,359**	**120,375**	**-**	**-**
Government loans	**4.43%**	**7,493**	**-**	**-**	**-**	**7,493**
2016						
Cash and cash equivalents	0.36%	74,625	74,625	-	-	-
Loan notes	3.60%	56,897	-	8,128	48,769	-
Unsecured bank loans	2.09%	268,120	-	48,769	219,351	-
Government loans	4.43%	6,308	-	-	-	6,308

Market risk sensitivity analysis

Interest rate risk

During 2017 the Group's net borrowings were predominantly at floating interest rates. The Group has estimated the impact on the income statement of a 1% increase in market interest rates, from the average rates applicable during 2017. There is no significant difference between the amount recharged to the income statement and equity in the year.

	Profit before tax £'000
2017	**1% change**
Interest rate sensitivity	**(1,700)**
2016	
Interest rate sensitivity	(2,455)

Currency risks

The Group has estimated the impact on the income statement and equity of a 10% and 25% strengthening or weakening of average actual and transactional currency rates applicable during the year and a 10% and 25% change in the foreign exchange rates applicable for valuing foreign exchange derivative instruments.

	10% weakening of GBP		10% strengthening of GBP		25% weakening of GBP		25% strengthening of GBP	
	Profit before tax £'000	Equity £'000	Profit before tax £'000	Equity £'000	Profit before tax £'000	Equity £'000	Profit before tax £'000	Equity £'000
2017								
Transaction	**6,689**	**6,689**	**(6,689)**	**(6,689)**	**20,067**	**20,067**	**(20,067)**	**(20,067)**
P&L translation	**5,177**	**4,686**	**(5,177)**	**(4,685)**	**12,942**	**11,713**	**(12,942)**	**(11,713)**
Foreign exchange derivatives	**10,885**	**10,885**	**(9,294)**	**(9,294)**	**32,948**	**32,948**	**(20,245)**	**(20,245)**
Total foreign exchange	**22,751**	**22,260**	**(21,160)**	**(20,668)**	**65,957**	**64,728**	**(53,254)**	**(52,025)**
2016								
Transaction	6,355	6,355	(6,355)	(6,355)	15,888	15,888	(15,888)	(15,888)
P&L translation	1,177	1,091	(1,177)	(1,091)	2,943	2,728	(2,943)	(2,728)
Foreign exchange derivatives	(15,822)	(15,822)	15,475	15,475	(44,843)	(44,843)	37,759	37,759
Total foreign exchange	(8,290)	(8,376)	7,943	8,029	(26,012)	(26,227)	18,928	19,143

In 2017, the Group's foreign exchange derivatives include forward contracts to sell £191.9m and receive USD$250.0m in 2018 in connection with the proposed Sparton Corporation acquisition. The table above includes these forwards.

23 Government grants and loans

The Group through its Canadian subsidiaries Ultra Electronics Tactical Communication Systems (TCS) and Ultra Electronics Maritime Systems (UEMS) participates in three Canadian programmes that provide government support in relation to the development of certain of its products.

Under the Strategic Aerospace and Defence Initiative (SADI), the Canadian Federal Government provides a long-term funding arrangement in respect of certain eligible research and development project costs. Under this arrangement, up to C$32m will be provided to TCS and reimbursed at favourable rates of interest. Up to C$8m will be provided to UEMS and reimbursed at favourable rates of interest over the period 2020 to 2033. The benefit of the below-market rate of interest has been calculated as the difference between the proceeds received and the fair value of the loans and has been credited to profit in the year. Following delays on some of the TCS programme, a two-year extension of the project completion date to December 2017 and related repayments to 2032 has been agreed with Industry Canada.

The fair value of the loans has been calculated using a market interest rate for a similar instrument. The valuation used the discounted cash flow method and considered the value of expected payments using a risk-adjusted discount rate; the discount rate used was 18% for TCS and 15% for UEMS. For TCS, the amount repayable depends on future revenue growth of the TCS business to 2032 and will be between zero and x1.5 of the amounts received up to a maximum of C$47.6m. For UEMS, the amount repayable depends on future revenue growth of the UEMS business from 2020 to 2033 and will be between x1.0 and x1.5 of the amounts received up until the end of the funding period in 2019. As at 31 December 2017, C$2.5m had been received by UEMS.

The significant unobservable inputs for this Level 3 financial instrument are (i) whether, and by how much, TCS/UEMS revenues will grow during the periods to 2032/2033, and (ii) the specific years in which revenue will grow. There are significant inherent uncertainties in management's ability to forecast revenue over the following 16 years, particularly in later years. For TCS, if the compound annual revenue growth rate over the period from 2017 to 2032 was 2.5% higher than assumed in the valuation model, then the net present value of the liability as at 31 December 2017 would increase by C$2.3m (£1.4m). If the forecast revenue growth occurs in earlier years than envisaged, then the net present value of the liability will increase; if the revenue growth increases were to occur one year earlier than assumed in the valuation model, then the net present value of the liability as at 31 December 2017 would increase by C$0.8m (£0.5m).

TCS also participates in the Investissement Quebec (IQ) research and development programme, whereby IQ shares in the cost of research and development of certain specified new products. Under this arrangement, IQ will finance up to C$14m of eligible costs associated with these specified projects. This funding is repayable under a royalty arrangement over the period 2014 to 2021, if these products are successfully brought to market. Royalties only become payable when sales of these products are made. As there is no minimum repayment, funding received in respect of the IQ programme has been included in the income statement.

Amounts recognised in the financial statements in respect of these programmes were as follows:

	2017 £'000	2016 £'000
Fair value of SADI loan brought forward	6,308	4,289
Contributions	214	262
Interest charged to finance costs	1,133	837
Foreign exchange differences	(162)	920
Fair value of SADI loan carried forward	7,493	6,308

Government grants credited to profit in the year

	2017 £'000	2016 £'000
SADI	2,010	1,663
Other†	19	-
	2,029	1,663

†In 2017, Ultra Electronics Limited received a £13,000 grant from the UK Government and a £6,000 grant from the Technology Strategy Board.

24 Deferred tax

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

	Accelerated† tax depreciation £'000	Employee share options costs £'000	Derivatives £'000	Retirement benefit obligations £'000	Goodwill £'000	Other £'000	**Total £'000**
At 1 January 2016	(15,059)	571	959	15,370	(7,735)	4,661	(1,233)
Credit/(charge) to income	10,977	(134)	3,238	(4,037)	(5,715)	1,214	5,543
Credit to other comprehensive income	-	-	-	9,973	-	-	9,973
Credit direct to equity	-	167	-	-	-	-	167
Exchange differences	(703)	-	-	-	(1,373)	313	(1,763)
Effect of change in UK tax rate	1,189	(15)	(143)	(1,789)	42	699	(17)
Arising on acquisition	-	-	-	-	2,152	-	2,152
At 1 January 2017	**(3,596)**	**589**	**4,054**	**19,517**	**(12,629)**	**6,887**	**14,822**
Credit/(charge) to income	1,087	(470)	(4,291)	(1,271)	(3,926)	3,272	(5,599)
Charge to other comprehensive income	-	-	-	(4,113)	-	(74)	(4,187)
Charge direct to equity	-	(124)	-	-	-	-	(124)
Exchange differences	462	5	-	-	(315)	(704)	(552)
Effect of change in US tax rate	(2,285)	-	-	-	5,268	(3,021)	(38)
Reclassification	346	-	-	-	-	(346)	-
At 31 December 2017	**(3,986)**	**-**	**(237)**	**14,133**	**(11,602)**	**6,014**	**4,322**

	2017 £'000	2016 £'000
Non-current assets	**15,659**	21,377
Non-current liabilities	**(11,337)**	(6,555)
	4,322	14,822

†Relates to property, plant and equipment and intangible assets.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to do so.

Unrecognised deferred tax assets

Deferred tax assets, in excess of offsetting tax liabilities, are recognised for loss carry forwards and deductible temporary differences to the extent that the utilisation against future taxable profits is probable. UK deferred tax assets of £1.2m and a US deferred tax asset of £0.7m (2016: Nil) have not been recognised as their recovery is uncertain. Canadian deferred tax assets of £2.5m previously unrecognised (2016: £12.0m) have been recognised in this accounting period as their recovery is now considered probable due to forecast profits for the future periods.

25 Provisions

	Warranties £'000	**Contract related provisions £'000**	**Other £'000**	**Total £'000**
At 1 January 2017	4,444	6,739	10,919	22,102
Created	1,983	1,223	815	4,021
Reversed	(300)	(1,471)	(193)	(1,964)
Utilised	(1,300)	(3,192)	(4,662)	(9,154)
Exchange differences	(161)	(168)	(458)	(787)
At 31 December 2017	**4,666**	**3,131**	**6,421**	**14,218**
Included in current liabilities	2,608	2,301	3,756	8,665
Included in non-current liabilities	2,058	830	2,665	5,553
	4,666	**3,131**	**6,421**	**14,218**

Warranty provisions are based on an assessment of future claims with reference to past experience. Such costs are generally incurred within two years after delivery. Contract related provisions, for example including provisions for liquidated damages or agent fees, are utilised over the period as stated in the contract to which the specific provision relates. Other provisions include re-organisation costs, deferred consideration, dilapidation costs and provisions associated with the Oman Airport IT contract termination which were fully utilised during 2017. Dilapidations will be payable at the end of the contracted life, which is up to fifteen years. Contingent consideration is payable when earnings targets are met.

26 Share capital and share options

	2017 No.	2017 £'000	2016 No.	2016 £'000
Authorised:				
5p ordinary shares	**90,000,000**	**4,500**	90,000,000	4,500
Allotted, called-up and fully paid:				
5p ordinary shares	**77,731,224**	**3,887**	70,463,092	3,523

On 7 July 2017 a total of 7,047,168 ordinary shares of 5 pence were placed, representing 9.9% of Ultra's issued ordinary share capital prior to the placing. Net proceeds received, after attributable expenses, were £133.5m.

220,964 ordinary shares having a nominal value of £11,048 were allotted during the year under the terms of the Group's various share option schemes. The aggregate consideration received was £3,708,000.

Share options

During the year to 31 December 2017, the Group operated the following equity-settled share option schemes:

1. Savings-Related Share Option Schemes

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

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

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

At 31 December 2017, share options outstanding under the Savings-Related Share Option Schemes were as follows:

Options granted	Number of shares 2017	Number of shares 2016	Option price (£)	Exercise dates
2014 – US scheme	-	19,156	15.94	September 2016 - December 2016
2015 – US scheme	-	44,306	14.85	September 2017 - December 2017
2016 – US scheme	**45,528**	48,843	15.98	September 2018 - December 2018
2017 – US scheme	**46,381**	-	15.89	September 2019 - December 2019
2013 – Canadian scheme	-	2,723	16.80	October 2016 - April 2017
2014 – Canadian scheme	**6,526**	7,195	16.13	October 2017 - April 2018
2015 – Canadian scheme	**9,971**	10,884	16.12	December 2018 - June 2019
2016 – Canadian scheme	**6,905**	8,047	15.98	December 2019 - June 2020
2017 – Canadian scheme	**8,659**	-	16.55	December 2020 - June 2021
2011 – UK 5 year scheme	-	3,831	13.33	December 2016 - June 2017
2012 – UK 5 year scheme	**20,826**	24,613	13.85	December 2017 - June 2018
2013 – UK 3 year scheme	-	9,456	16.80	December 2016 - June 2017
2013 – UK 5 year scheme	**11,323**	13,267	16.80	December 2018 - June 2019
2014 – UK 3 year scheme	**10,515**	13,217	16.13	December 2017 - June 2018
2014 – UK 5 year scheme	**5,924**	8,517	16.13	December 2019 - June 2020
2015 – UK 3 year scheme	**11,879**	13,551	16.12	December 2018 - June 2019
2015 – UK 5 year scheme	**6,189**	7,025	16.12	December 2020 - June 2021
2016 – UK 3 year scheme	**55,431**	64,479	15.10	December 2019 - June 2020
2016 – UK 5 year scheme	**34,764**	38,415	15.10	December 2021 - June 2022
2017 – UK 3 year scheme	**31,273**	-	16.55	December 2020 - June 2021
2017 – UK 5 year scheme	**14,682**	-	16.55	December 2022 - June 2023

26 Share capital and share options (continued)

2. Company Share Option Plan

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

At 31 December 2017, share options outstanding under the Company Share Option Plan were as follows:

Options granted	Number of shares 2017	2016	Option price (£)	Exercise dates
2010	**3,054**	3,054	14.83	March 2013 - March 2020
2011	**3,673**	5,902	16.97	March 2014 - March 2021
2012	**4,022**	5,042	17.10	March 2015 - March 2022
2013	**10,715**	20,621	17.18	March 2016 - March 2023
2014	**13,108**	23,546	18.29	March 2017 - March 2024
2015	**10,758**	14,674	17.31	March 2018 - March 2025
2016	**27,206**	30,623	17.90	March 2019 - March 2026
2017	**18,674**	-	21.91	March 2020 - March 2027

3. Executive Share Option Scheme

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

At 31 December 2017, share options outstanding under the Executive Share Option Scheme were as follows:

Options granted	Number of shares 2017	2016	Option price (£)	Exercise dates
2010	**-**	11,037	14.83	March 2013 - March 2017
2011	**16,276**	33,880	16.97	March 2014 - March 2018
2012	**22,549**	46,209	17.10	March 2015 - March 2019
2013	**41,186**	82,431	17.18	March 2016 - March 2020
2014	**61,942**	129,536	18.29	March 2017 - March 2021
2015	**101,014**	126,657	17.31	March 2018 - March 2022
2016	**111,662**	130,448	17.90	March 2019 - March 2023
2017	**109,420**	-	21.91	March 2020 - March 2024

4. Long-Term Incentive Plan

Details in relation to the Ultra Electronics Long-Term Incentive Plan 2007 awards to Executive Directors are included in the Directors' Remuneration report on pages **78**-**91**. In April 2017, LTIPs were awarded to nominated employees. The awards will vest in March 2020 upon achievement of certain performance targets and are conditional upon continued employment.

5. All Share Based Payment Arrangements

The number and weighted average exercise price of share options for all share-based payment arrangements (including LTIP) are as follows:

	Weighted average exercise price (£) 2017	Number of options 2017	Weighted average exercise price (£) 2016	Number of options 2016
Beginning of year	**11.64**	**1,450,545**	12.45	1,553,412
Granted during the year	**10.40**	**468,851**	10.53	524,772
Forfeited during the year	**15.91**	**(83,566)**	12.57	(260,477)
Expired during the year	**7.79**	**(176,792)**	9.56	(188,553)
Exercised during the year	**17.39**	**(205,868)**	16.27	(178,609)
Outstanding at the end of the year	**10.65**	**1,453,170**	11.64	1,450,545
Exercisable at the end of the year	**17.10**	**214,392**	16.82	243,342

The Group recognised total expenses of £682,000 (2016: £984,000) in relation to equity-settled share-based payment transactions. Expected volatility was determined by calculating the historical volatility of the Group's share price.

Share options were exercised on a regular basis throughout the year. The weighted average share price during the year was £18.75. The fair value of options granted during the year that are expected to vest was £4,283,912 (2016: £2,969,796).

26 Share capital and share options (continued)

5. All Share Based Payment Arrangements (continued)

The Group's equity-settled share-based payments are measured at fair value at the date of the grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. The fair value for all schemes other than the 2013, 2014, 2015 and 2016 March LTIP schemes are measured by use of the Black-Scholes option pricing model using the following assumptions:

	Share save*	CSOP*	ESOS*	LTIP*†
				2017
Weighted average share price (£)	17.49	17.61	17.47	18.86
Weighted average exercise price (£)	15.71	17.66	17.46	n/a
Expected volatility %	20.4	23.2	23.9	19.0
Expected option life (years)	3.8	6.0	5.0	3.0
Risk-free interest rate %	0.6	1.4	1.5	0.5
Expected dividends %	2.6	2.4	2.3	0.0

	Share save*	CSOP*	ESOS*	LTIP*
				2016
Weighted average share price (£)	17.25	17.34	16.99	17.56
Weighted average exercise price (£)	15.51	17.39	16.96	n/a
Expected volatility %	21.3	23.3	24.4	18.4
Expected option life (years)	3.6	6.0	5.0	3.0
Risk-free interest rate %	0.7	1.5	1.7	0.6
Expected dividends %	2.5	2.4	2.3	0.0

*Figures in the above table show an average across the invested schemes at year end.
†April 2017 LTIP.

For the 2013, 2014, 2015 and 2016 March LTIP awards, the stochastic model has been used to calculate the fair value of the awards at the grant date as this is the most accurate way of modelling the TSR performance condition. The fair value of these schemes has been calculated using the following assumptions:

	2017	2016
Exercise price (£)	**n/a**	n/a
Share price at grant (£)	**19.05**	17.63
Expected option life (years)	**3.0**	3.0
Expected volatility %	**19.2**	20.5
Risk-free interest rate %	**0.4**	0.6

Figures in the above table show an average across the schemes.

The weighted average fair value of options granted during the year was £11.88 (2016: £6.81).

The weighted average remaining contractual life of share options was 4.2 years (2016: 4.6 years).

27 Equity

	Share capital £'000	Share premium account £'000	Reserve for own shares £'000	Hedging reserve £'000	Translation reserve £'000	Retained earnings £'000	Non controlling interests £'000	Total equity £'000
Balance at 1 January 2016	3,514	61,052	(2,581)	(25,908)	42,038	238,728	-	316,843
Total comprehensive income for the year	-	-	-	(43,078)	97,454	18,933	(2)	73,307
Non-controlling interest's investment made in subsidiary	-	-	-	-	-	1,929	71	2,000
Equity-settled employee share scheme	9	2,968	-	-	-	1,027	-	4,004
Dividends to shareholders	-	-	-	-	-	(32,583)	-	(32,583)
Balance at 1 January 2017	3,523	64,020	(2,581)	(68,986)	139,492	228,034	69	363,571
Total comprehensive income for the year	**-**	**-**	**-**	**20,927**	**(44,089)**	**68,978**	**(30)**	**45,786**
Issue of share capital	**352**	**133,195**	**-**	**-**	**-**	**-**	**-**	**133,547**
Equity-settled employee share scheme	**12**	**3,696**	**-**	**-**	**-**	**682**	**-**	**4,390**
Tax on share based payments	**-**	**-**	**-**	**-**	**-**	**(124)**	**-**	**(124)**
Dividends to shareholders	**-**	**-**	**-**	**-**	**-**	**(34,959)**	**-**	**(34,959)**
Balance at 31 December 2017	**3,887**	**200,911**	**(2,581)**	**(48,059)**	**95,403**	**262,611**	**39**	**512,211**

The share premium account represents the premium arising on the issue of equity shares.

The "own shares reserve" represents the cost of shares in Ultra Electronics Holdings plc purchased in the market and held by the Ultra Electronics Employee Trust to satisfy options under the Group's Long-Term Incentive Plan ("LTIP") share schemes. At 31 December 2017, the number of own shares held was 235,245 (2016: 235,245).

28 Notes to the cash flow statement

	2017 £'000	2016 £'000
Operating profit	**61,484**	89,725
Adjustments for:		
Depreciation of property, plant and equipment	**10,166**	11,499
Amortisation of intangible assets	**31,995**	38,034
Impairment charge of intangible assets	**1,608**	-
Cost of equity-settled employee share schemes	**682**	984
Adjustment for pension funding	**(8,964)**	(8,468)
Loss on disposal of property, plant and equipment	**565**	291
Decrease in provisions	**(7,086)**	(8,975)
Operating cash flow before movements in working capital	**90,450**	123,090
(Increase)/decrease in inventories	**(2,093)**	8,295
Increase in receivables	**(15,367)**	(339)
Increase/(decrease) in payables	**24,442**	(19,044)
Cash generated by operations	**97,432**	112,002
Income taxes paid	**(10,324)**	(9,012)
Interest paid	**(9,543)**	(10,156)
Net cash from operating activities	**77,565**	92,834

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

	2017 £'000	2016 £'000
Net increase in cash and cash equivalents	**80,118**	20,766
Cash inflow from movement in debt and finance leasing	**85,482**	54,419
Change in net debt arising from cash flows	**165,600**	75,185
Loan syndication costs	**2,040**	-
Amortisation of finance costs of debt	**(1,281)**	(848)
Translation differences	**15,884**	(35,465)
Movement in net debt in the year	**182,243**	38,872
Net debt at start of year	**(256,700)**	(295,572)
Net debt at end of year	**(74,457)**	(256,700)

Net debt comprised the following:

	2017 £'000	2016 £'000
Cash and cash equivalents	**149,522**	74,625
Borrowings	**(223,979)**	(331,325)
	(74,457)	(256,700)

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

Reconciliation of changes in financing liabilities.

	2017 £'000	2016 £'000
Borrowings at start of year	**(331,325)**	(341,046)
Repayments of borrowings	**168,975**	114,419
Proceeds from borrowings	**(83,493)**	(60,000)
Loan syndication costs	**2,040**	-
Amortisation of finance costs of debt	**(1,281)**	(848)
Translation differences	**21,105**	(43,850)
Borrowings at end of year	**(223,979)**	(331,325)

29 Other financial commitments

a) Capital commitments

At the end of the year capital commitments were:

	2017 £'000	2016 £'000
Contracted but not provided	696	430

b) Lease commitments

At 31 December 2017, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2017 £'000	2016 £'000
Within one year	11,557	13,360
Between one and five years	24,402	34,154
After five years	5,961	10,576
	41,920	58,090

30 Retirement benefit schemes

Some UK employees of the Group are members of the Ultra Electronics Limited defined benefit scheme which was established on 1 March 1994. The scheme was closed to new members in 2003. The scheme is a final salary scheme with the majority of members accruing 1/60th of their final pensionable earnings for each year of pensionable service, however the scheme was closed to future benefit accrual from 5 April 2016. A defined contribution plan was introduced for other employees and new joiners in the UK. The latest full actuarial valuation of the defined benefit scheme was carried out as at 6 April 2016. The Group also operates two defined contribution schemes for overseas employees. In addition to these schemes, the Group's Tactical Communication Systems business based in Montreal, Canada, has three defined benefit schemes and the Swiss business of the Forensic Technology group has a defined benefit scheme.

Defined contribution schemes

The total cost charged to income in respect of the defined contribution schemes was £9,848,000 (2016: £8,837,000).

Defined benefit schemes

All the defined benefit schemes were actuarially assessed at 31 December 2017 using the "projected unit" method.

In the UK, Ultra Electronics Limited sponsors the Ultra Electronics Pension Scheme, a funded defined benefit pension scheme. The scheme is administered within a trust which is legally separate from the Company. Trustees are appointed by both the Company and the scheme's membership and act in the interests of the scheme and all relevant stakeholders, including the members and the Company. The Trustees are also responsible for the investment of the scheme's assets.

This scheme provides pensions and lump sums to members on retirement and to their dependants on death.

The Trustees are required to use prudent assumptions to value the liabilities and costs of the scheme whereas the accounting assumptions must be best estimates.

Responsibility for making good any deficit within the scheme lies with the Company and this introduces a number of risks for the Company. The major risks are: interest rate risk, inflation risk, investment risk and longevity risk. The Company and Trustees are aware of these risks and manage them through appropriate investment and funding strategies. The Trustees manage governance and operational risks through a number of internal controls policies, including a risk register.

Investment Strategy

The investment strategy is set by the Trustee of the Scheme. The current strategy is broadly split into growth and matching portfolios. The growth portfolio is primarily invested in equities, property, diversified growth funds, private equity and private credit. The matching portfolio is invested primarily in bonds, through the "absolute return bonds" holding, and liability driven investment ("LDI") funds. Part of the investment objective of the Scheme is to minimise fluctuations in the Scheme's funding levels due to changes in the value of the liabilities. This is primarily achieved through the use of the LDI funds that aim to hedge movements in the liabilities due to changes in interest rate and inflation expectations. Currently, the Scheme targets hedging of around 65% on the technical provisions funding measure to both interest rate and inflation expectation changes. LDI primarily involves the use of government bonds and derivatives such as interest rate and inflation swaps. The main risk is that the investments held move differently to the liability exposures; this risk is managed by the Trustee, its advisers and the Scheme's LDI manager, who regularly assess the position.

The assets held are also well diversified, across asset classes and investment managers. This reduces the risk of drops in the value of individual asset classes, or a particular manager underperforming its investment objectives, having a negative impact on the funding position of the Scheme. The investment performance and liability experience are regularly reviewed by the Trustee, and the Trustee will consult with the Company over any changes to the investment strategy.

Rather than holding the underlying assets directly, the Scheme invests in pooled investment vehicles managed by professional external investment managers, whom the Trustee has appointed with the help of its investment advisors. The equity and diversified growth fund valuations are based on quoted market prices, while the property, private equity, private credit, absolute return bonds and LDI are primarily unquoted. All valuations are provided by the respective investment manager.

30 Retirement benefit schemes (continued)

Valuation

The scheme is subject to regular actuarial valuations, which are usually carried out every three years. The last actuarial valuation of the scheme was on 6 April 2016. The next actuarial valuation is due to be carried out with an effective date of 6 April 2019. These actuarial valuations are carried out in accordance with the requirements of the Pensions Act 2004 and so include deliberate margins for prudence. This contrasts with these accounting disclosures, which are determined using best estimate assumptions.

The results of the 6 April 2016 valuation have been projected to 31 December 2017 by a qualified, independent actuary. The figures in the following disclosure were measured using the Projected Unit Method.

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

	UK 2017	Canada 2017	Switzerland 2017	UK 2016	Canada 2016	Switzerland 2016
Discount rate	2.50%	3.50%	0.65%	2.55%	3.50%	0.35%
Inflation rate – RPI	3.20%	3.20%	1.00%	3.30%	3.30%	0.80%
Inflation rate – CPI	2.20%	2.20%	1.00%	2.30%	2.30%	0.80%
Expected rate of salary increases	n/a	3.45%	1.00%	n/a	3.55%	1.00%
Future pension increases (pre 6/4/08)	2.95%	n/a	n/a	3.05%	n/a	n/a
Future pension increases (post 6/4/08)	1.95%	n/a	n/a	1.95%	n/a	n/a

For each of these assumptions there is a range of possible values. Relatively small changes in some of these variables can have a significant impact on the level of the total obligation. For the UK scheme, a 0.1% increase in the inflation assumption to 3.30% and a 0.1% decrease in the discount rate to 2.40% would increase the scheme's liabilities by 1.6% and 1.9% respectively. If the members' life expectancy were to increase by 1 year, the scheme liabilities would increase by 4.0%. The average duration of the scheme liabilities is 19 years (2016: 20 years).

The assumptions used are provided by Willis Towers Watson as Company advisors, and also by reference to the Bank of England Gilt curve at a duration appropriate to the Scheme's liabilities of 19 years. At 31 December 2017 this was 1.8% and one month later it was 1.9%; this variation of 0.1% has been used in the sensitivity analysis presented above.

The key demographic assumption used was in relation to the mortality rates of current and future pensioners. Due to the size of the scheme the mortality rates were based on standard tables, namely:

Current pensioners	100% SAPS S2PMA_L/84% SAPS S2PFA_L c2007 CMI 2016 1.25% imps from 2007 (UK only)
Future pensioners	100% SAPS S2PMA_L/84% SAPS S2PFA_L c2007 CMI 2016 1.25% imps from 2007 (UK only)

The mortality assumptions used in the valuation of the UK scheme make appropriate allowance for future improvements in longevity and are set out below:

	2017	2016
Current pensioners (at 65) – males	23 years	23 years
Current pensioners (at 65) – females	26 years	26 years
Future pensioners (at 65) – males	25 years	25 years
Future pensioners (at 65) – females	27 years	28 years

Amounts recognised in the income statement in respect of the Group's defined benefit schemes were as follows:

	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m
Current service cost	-	0.1	0.3	0.4	1.3	0.1	0.2	1.6
Administration expenses	0.9	0.1	-	1.0	0.6	0.2	-	0.8
Interest on pension scheme liabilities	9.6	0.3	0.1	10.0	11.4	0.3	0.1	11.8
Curtailment gain	-	-	-	-	(15.5)	-	-	(15.5)
Expected return on pension scheme assets	(7.0)	(0.3)	-	(7.3)	(8.4)	(0.4)	-	(8.8)
Charge/(credit)	3.5	0.2	0.4	4.1	(10.6)	0.2	0.3	(10.1)

Of the current service cost for the year, £nil (2016: £1.0 million) has been included in cost of sales, and £0.4 million (2016: £0.6 million) has been included in administrative expenses.

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

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

	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m
Fair value of scheme assets	289.8	10.6	5.9	306.3	271.2	10.4	5.7	287.3
Present value of scheme liabilities	(371.3)	(10.7)	(7.0)	(389.0)	(382.4)	(11.1)	(7.0)	(400.5)
Scheme deficit	(81.5)	(0.1)	(1.1)	(82.7)	(111.2)	(0.7)	(1.3)	(113.2)
Related deferred tax asset	13.9	-	0.2	14.1	19.1	0.1	0.3	19.5
Net pension liability	(67.6)	(0.1)	(0.9)	(68.6)	(92.1)	(0.6)	(1.0)	(93.7)

30 Retirement benefit schemes (continued)

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

	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m
Present value of obligation at 1 January	(382.4)	(11.1)	(7.0)	(400.5)	(307.7)	(9.3)	(5.4)	(322.4)
Current service cost	-	(0.1)	(0.3)	(0.4)	(1.3)	(0.1)	(0.2)	(1.6)
Interest cost	(9.6)	(0.3)	(0.1)	(10.0)	(11.4)	(0.3)	(0.1)	(11.8)
Actuarial gains and losses	9.0	(0.2)	-	8.8	(89.2)	(0.3)	(0.5)	(90.0)
Exchange difference	-	0.3	0.3	0.6	-	(2.2)	(1.0)	(3.2)
Curtailment gain	-	-	-	-	15.5	-	-	15.5
Benefits paid	11.7	0.7	0.1	12.5	11.7	1.1	0.2	13.0
Present value of obligation at 31 December	(371.3)	(10.7)	(7.0)	(389.0)	(382.4)	(11.1)	(7.0)	(400.5)

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

	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m
Fair value at 1 January	271.2	10.4	5.7	287.3	224.5	8.6	4.5	237.6
Expected return on scheme assets	7.0	0.3	-	7.3	8.4	0.4	-	8.8
Actuarial gains and losses	14.7	0.4	0.2	15.3	40.3	0.2	0.2	40.7
Exchange differences	0.1	(0.3)	(0.3)	(0.5)	-	2.0	0.8	2.8
Employer contributions	9.4	0.6	0.4	10.4	10.3	0.5	0.4	11.2
Administration expenses	(0.9)	(0.1)	-	(1.0)	(0.6)	(0.2)	-	(0.8)
Benefits paid	(11.7)	(0.7)	(0.1)	(12.5)	(11.7)	(1.1)	(0.2)	(13.0)
Fair value at 31 December	289.8	10.6	5.9	306.3	271.2	10.4	5.7	287.3

Scheme assets were as follows:

	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m
Fair value:								
Equities	95.1	3.5	2.1	100.7	87.0	3.4	1.8	92.2
Bonds	-	6.5	1.7	8.2	-	6.4	2.4	8.8
Property	16.6	-	0.8	17.4	16.4	-	0.6	17.0
Other assets	1.5	0.6	1.0	3.1	38.4	0.5	0.9	39.8
Other investment funds:								
Absolute return	78.4	-	0.3	78.7	43.1	0.1	-	43.2
LDI	75.5	-	-	75.5	62.0	-	-	62.0
Multi-asset credit	22.7	-	-	22.7	24.3	-	-	24.3
	289.8	10.6	5.9	306.3	271.2	10.4	5.7	287.3

The analysis of the actuarial loss in the consolidated statement of comprehensive income was as follows:

	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m
Actual return less expected return on pension scheme assets	14.7	0.4	0.2	15.3	40.3	0.2	0.2	40.7
Experience gains arising on scheme liabilities	(0.3)	(0.2)	(0.3)	(0.8)	4.0	0.2	(0.2)	4.0
Changes in assumptions underlying the present value of the scheme liabilities	9.3	-	0.3	9.6	(93.2)	(0.5)	(0.3)	(94.0)
	23.7	0.2	0.2	24.1	(48.9)	(0.1)	(0.3)	(49.3)

Cumulative actuarial losses, net of deferred tax, recognised in the consolidated statement of comprehensive income at 31 December 2017 were £73.5 million (2016: £93.5 million).

30 Retirement benefit schemes (continued)

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

	2017 £m	2016 £m	2015 £m	2014 £m	2013 £m
Present value of defined benefit obligations	**(389.0)**	(400.5)	(322.4)	(321.7)	(280.4)
Fair value of scheme assets	**306.3**	287.3	237.6	234.4	194.3
Scheme deficit	**(82.7)**	(113.2)	(84.8)	(87.3)	(86.1)
Experience adjustments on scheme liabilities	**(0.8)**	4.0	-	(2.5)	2.3
Percentage of scheme liabilities	**(0.2%)**	1.0%	-	0.8%	(0.8%)
Experience adjustment on scheme assets	**15.3**	40.7	(7.9)	21.8	21.2
Percentage of scheme assets	**5.0%**	14.2%	(3.3%)	9.3%	10.9%

The amount of contributions expected to be paid to defined benefit schemes during the 2018 financial year is £10.3m. For the UK scheme this includes an additional deficit payment of £10.0m agreed with the Trustee. This will be followed by £10.5m in 2019 and £11.0m per annum for the following five years.

31 Acquisitions and disposals

On 7 July 2017, Ultra announced that it had entered into a conditional agreement to acquire Sparton Corporation ("Sparton"), its 50/50 partner in the long-standing ERAPSCO joint venture, which supplies sonobuoys to the US Navy. The transaction was subject to the approval of the United States Department of Justice ('DOJ') under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ('HSR'). Following recent discussions with the DOJ, and competition concerns raised by it, Ultra and Sparton mutually decided to terminate the merger agreement in March 2018. See page **19** for further details.

Acquisitions

In aggregate, cash consideration of £6.5m was paid in respect of retention payments for the prior period 3 Phoenix acquisition (2016: £5.2m on final payments and deferred consideration for acquisitions made in prior years).

Disposals

The Communications & Security division disposed of its ID business in August 2016 and its remaining legal intercept assets, from the former SOTECH business, in December 2016; both were in the C2ISR CGU group. Cash proceeds of £22m were received in 2016. Further proceeds may be received over the 24 month period after the disposal, based on agreed targets; any such proceeds will be accounted for in the year of receipt. The net loss on disposal was £4,076,000.

32 Related party transactions

Remuneration of key management personnel

The remuneration of key management personnel, which includes the Directors of the Group, is set out below in aggregate for each of the categories specified in IAS 24: Related Party Disclosures. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report on pages **78**-**91**.

	2017 £'000	2016 £'000
Short-term employee benefits	**3,428**	4,628
Post-employment benefits	**425**	410
Share-based payments	**2,592**	1,042
	6,445	6,080

33 Non-controlling interests

In November 2016, the Group sold a 5% share of its Corvid Holdings Limited subsidiary for cash consideration of £2,000,000. Before any intra-group eliminations, the consolidated revenue of the subsidiary in the year/prior period was £4,211,000 (2016: £1,214,000), the loss was £578,000 (2016: £40,000 loss) and the net assets were £2,892,000 (2016: £3,466,000). Sales to Group companies were £2,418,000 (2016: £496,000).

34 Contingent liabilities

The Group has entered into a number of guarantee and performance bond arrangements in the normal course of business totalling £42.8m (2016: £40.3m).

The nature of much of the contracting work performed by the Group means that there are occasional contractual issues, variations and renegotiations that arise. In addition, the Group is, from time to time, party to legal proceedings and claims which arise in the ordinary course of business. In particular, the Oman Airport IT contract was terminated in February 2015. This has given rise to significant uncertainty regarding the likely outcome of proceedings in respect of this termination event, and it is not possible to reliably estimate the outcome.

35 Additional information as required by Listing Rules Requirement 9.8.4

- Long-term incentive schemes – *see Directors' remuneration report*
- Allocation of equity securities for cash – *see note 26*
- Election of independent directors – *see Corporate Governance Report on page 66*
- Contractual arrangements – *see Directors' Report on page 93*
- Details of independent directors – *see Corporate Governance Report on page 58*
- Substantial shareholders – *see Directors' Report on page 93*

No profit forecasts are issued by the Group and no Directors have waived any current or future emoluments. No shareholders have waived or agreed to waive dividends. None of the shareholders is considered to be a Controlling Shareholder (as defined in Listing Rules 6.1.2A).

36 Related undertakings

The Company owns either directly or indirectly the ordinary share capital of the following undertakings:

Company name	Country incorporated	% owned	Direct/Indirect (Group interest)
3 Phoenix Inc.	United States	100%	Indirect (Group interest)
3e Technologies International Inc.	United States	100%	Indirect (Group interest)
AEP Networks Asia Pacific SDN BHD	Malaysia	100%	Indirect (Group interest)
AEP Networks Australia Pty Limited	Australia	100%	Indirect (Group interest)
AEP Networks Inc.	United States	100%	Indirect (Group interest)
AEP Networks Limited	Ireland	100%	Direct
AEP Networks Limited	United Kingdom	100%	Indirect (Group interest)
CORVID Holdings Limited	Guernsey	95%	Direct
CORVID Paygate Limited	Guernsey	95%	Indirect (Group interest)
CORVID Protect Holdings Limited	Guernsey	95%	Indirect (Group interest)
Dascam Consulting Limited	Cyprus	100%	Direct
DF Group Limited	United Kingdom	100%	Direct
EMS Development Corporation	United States	100%	Indirect (Group interest)
ERAPSCO	United States	50%	Indirect (Group interest)
EW Simulation Technology Limited	United Kingdom	100%	Indirect (Group interest)
Flightline Electronics Inc.	United States	100%	Indirect (Group interest)
Forensic Technology (Europe) Limited	Ireland	100%	Direct
Forensic Technology AEC Thailand Limited	Thailand	100%	Direct
Forensic Technology Inc.	United States	100%	Direct
Forensic Technology Mexico S. de RL. de C.V	Mexico	100%	Indirect (Group interest)
Forensic Technology-Tecnologia Forense Ltda	Brazil	100%	Indirect (Group interest)
Furnace Parts LLC	United States	100%	Indirect (Group interest)
Giga Communications Limited	United Kingdom	100%	Direct
GIGASAT, INC.	United States	100%	Direct
Gigasat. Asia Pacific Pty Limited	Australia	100%	Indirect (Group interest)
Herley Industries Inc.	United States	100%	Indirect (Group interest)
Herley-CTI Inc.	United States	100%	Indirect (Group interest)
Projectina AG	Switzerland	100%	Direct
Prologic Inc.	United States	100%	Indirect (Group interest)
Special Operations Technology Inc. (SOTECH)	United States	100%	Indirect (Group interest)
Ultra Electronics (USA) Group Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Advanced Tactical Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Airport Systems (South Africa) (Proprietary) Limited	South Africa	100%	Direct
Ultra Electronics Airport Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Australia Pty Limited	Australia	100%	Direct
Ultra Electronics Avalon Systems Pty Limited	Australia	100%	Indirect (Group interest)

36 Related undertakings (continued)

Company name	Country incorporated	% owned	Direct/Indirect (Group interest)
Ultra Electronics Canada Inc.	Canada	100%	Direct
Ultra Electronics Connecticut LLC	United States	100%	Indirect (Group interest)
Ultra Electronics Defense Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics DNE Technologies Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Enterprises (USA) LLC	United States	100%	Indirect (Group interest)
Ultra Electronics Finance Switzerland A.G.	Switzerland	100%	Indirect (Group interest)
Ultra Electronics Forensic Technology Inc./Les Technologies Ultra Electronics Forensic Inc.	Canada	100%	Direct
Ultra Electronics Hong Kong Holdings Limited 傲創電子香港控股有限公司	Hong Kong	100%	Direct
Ultra Electronics ICE, Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics in collaboration with Oman Investment Corporation LLC (in liquidation)	Oman	70%	Direct
Ultra Electronics Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Investments (USA) LLC	United States	100%	Indirect (Group interest)
Ultra Electronics Limited	United Kingdom	100%	Direct
Ultra Electronics Maritime Systems Inc.	Canada	100%	Indirect (Group interest)
Ultra Electronics Measurement Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics (Netherlands) Limited	United Kingdom	100%	Indirect (Group interest)
Ultra Electronics Ocean Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Pension Trustee Company Limited	United Kingdom	100%	Indirect (Group interest)
Ultra Electronics Precision Air and Land Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Secure Intelligence Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Swiss Holdings Company Limited	United Kingdom	100%	Indirect (Group interest)
Ultra Electronics TCS Inc.	Canada	100%	Indirect (Group interest)
Ultra Electronics Technology (Beijing) Co Limited	China	100%	Direct
Ultra Electronics Tisys	France	100%	Direct
Ultra Electronics TopScientific Aerospace Limited	Hong Kong	50%	Direct
UnderSea Sensor Systems Inc.	United States	100%	Indirect (Group interest)
Vados Systems Limited	United Kingdom	100%	Indirect (Group interest)
Weed Instrument Company Inc.	United States	100%	Indirect (Group interest)

The principal activity of the trading subsidiary undertakings is the design, development and manufacture of electronic systems for the international defence and aerospace markets.

Registered Office: Ultra Electronics Holdings plc, 417 Bridport Road,Greenford, Middlesex UB6 8UA, England.

37 IFRS 15 – Revenue from contracts with customers

IFRS 15 Revenue from contracts with customers – is effective from 1 January 2018. A detailed project has been undertaken to determine the impact of IFRS 15. The project has assessed revenue and contract terms from across all the Group's business units and contracting types. There is no impact to the timing of the Group's cash flows nor to the timing of revenue recognition on the majority of the Group's contracts. The table below sets out the impact to the 2017 income statement and balance sheet if IFRS 15 had been applied during the year:

	2017 as presented £m	Adjustment £m	2017 if presented under IFRS 15 £m
Income Statement impact			
Revenue	775.4	(7.1)	768.3
Cost of sales	(545.2)	4.7	(540.5)
Gross profit	230.2	(2.4)	227.8
Underlying operating profit	120.1	(2.4)	117.7
Statutory operating profit	61.5	(2.4)	59.1
Statutory profit before tax	60.6	(2.4)	58.2
Tax	(11.7)	0.7	(11.0)
Statutory profit after tax	48.9	(1.7)	47.2

	2017 as presented £m	Adjustment £m	2017 if presented under IFRS 15 £m
Balance Sheet impact			
Inventories	76.6	1.2	77.8
Amounts receivable from contract customers	116.7	(10.5)	106.2
Amounts due to contract customers	(58.7)	(2.8)	(61.5)
Tax liabilities	(13.6)	0.7	(12.9)
Net assets	512.2	(11.4)	500.8
Adjustment to retained earnings	262.6	(11.4)	251.2

The most significant changes relative to current accounting treatments arise in the following areas:

(i) the accounting for multiple elements of long term contracts approved at different times, for example contracts involving product design, followed by subsequent production orders;

(ii) allocation of the contract price to performance obligations for long term contracts containing multiple deliverables;

(iii) the accounting for certain transactions currently treated as long term contracts that may need to be treated as sales of goods; and

(iv) the accounting for certain licences that are determined to provide separately identifiable benefits to the customer.

The revenue for the substantial majority of contracts that are currently recognised using contract accounting will continue to be accounted for over the life of the contract, however the method by which performance obligations are determined will change on certain contracts including the identification of material rights. A small number of contracts no longer qualify to be contract-accounted and revenue will instead be recorded at the point at which control of the goods transfers to the customer. The timing of revenue recognised on the substantial majority of sale-of-goods contracts is not significantly affected with revenue continuing to be recognised as control of goods is passed to the customer.

The project determined that 2016 consolidated group revenue would have been £1.6m higher at £787.4m, and 2016 underlying operating profit would have been £0.2m lower at £130.9m if IFRS 15 had been applied. As set out in the table above, 2017 consolidated group revenue would have been £7.1m lower at £768.3m, and 2017 underlying operating profit would have been £2.4m lower at £117.7m if IFRS 15 had been applied. The 1 January 2018 order book increases by £17.0m to £914.4m.

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

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

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"). The financial statements have also been prepared in accordance with IFRSs adopted by the European Union and therefore comply with Article 4 of the EU IAS regulations.

The consolidated financial information has been prepared on the historical cost basis except for certain assets and liabilities which are measured at fair value, see note 23.

Adoption of new and revised Standards

The following IFRIC interpretations, amendments to existing standards and new standards have been adopted in the current year but have not impacted the reported results or the financial position:

- IAS 12 Income Taxes – Amendments regarding the recognition of deferred tax assets for unrealised losses.
- Annual Improvements to IFRS 2014-2016 Cycle

The following standards were also adopted in the current year and have had the impact as set out below.

- None

At the date of authorisation of these financial statements, the following standards and interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

- IFRS 9 Financial Instruments
- IFRS 15 Revenue from contracts with customers
- IFRS 16 Leases

The Directors anticipate that the adoption of these standards and interpretations in future periods will have no material impact on the financial statements of the Group, except for:

- IFRS 9 Financial Instruments – this will introduce a number of changes in the presentation of financial instruments.
- IFRS 15 Revenue from contracts with customers – is effective from 1 January 2018. A detailed project has been undertaken to determine the impact of IFRS 15. The key findings and determination of impact are set out in note 37. The Group will recognise the cumulative effect of applying IFRS 15 at the 1 January 2018 transitional date. The prior period will not be restated.
- IFRS 16 Leases – The new standard requires all leases to be recognised on the balance sheet with the exception of short-term and immaterial leases. The Group is assessing the impact of the new standard on its financial statements. IFRS 16 is effective from 1 January 2019.

Beyond the information above, it is not practicable to provide a reasonable estimate of the effect of these standards until a detailed review has been completed.

Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Group has adequate resources to continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Strategic Report on page **45**.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved when the Company:

- has the power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statements of profit or loss and other comprehensive income from the date the Company gains control until the date when the Company ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income are attributed to the owners of the Company and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Company.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), and liabilities of the subsidiary and any non-controlling interests. Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred directly to retained earnings) in the same manner as would be required if the relevant assets or liabilities were disposed of. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 Financial Instruments: Recognition and Measurement or, when applicable, the cost on initial recognition of an investment in an associate or jointly controlled entity.

Critical accounting judgements and key sources of estimation uncertainty
In the application of the Group's accounting policies, the Directors are required to make judgements (other than those involving estimations) that have a significant impact on the amounts recognised and to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgements in applying the Group's accounting policies
The following are the critical judgements, apart from those involving estimations (which are dealt with separately below), that the Directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in financial statements.

OMAN AIRPORT IT CONTRACT
The Oman Airport IT contract was terminated in February 2015. On 4 March 2015, 'Ithra' ("Ultra Electronics in collaboration with Oman Investment Corporation LLC"), the legal entity established with the sole purpose of delivering the Oman Airport IT contract, was placed into voluntary liquidation. A liquidator was appointed to pursue claims against the customer on behalf of the interested parties.

There remains significant uncertainty regarding the likely outcome of proceedings with the Sultanate of Oman, Ministry of Transport & Communications. Material items have been disclosed separately within the financial statements. In accordance with IAS 37, it is management's judgement that no provision is required at the balance sheet date.

Critical accounting estimates and assumptions
The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting period, that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

CONTRACT REVENUE AND PROFIT RECOGNITION
A significant proportion of the Group's activities are conducted under long-term contract arrangements and are accounted for in accordance with IAS 11 Construction Contracts. This revenue is derived from a large number of individual contracts across the Group.

Revenue and profit on such contracts are recognised according to the stage of completion of the contract activity at the balance sheet date of the particular contract and are calculated by reference to reliable estimates of contract revenue and expected costs. When the contract outcome cannot be reliably estimated, revenue is recognised to match costs until such time as this can be reliably estimated. Expected costs are calculated after taking account of the perceived contract risks related to performance not yet proven.

Owing to the complexity of some of the contracts undertaken by the Group, the cost estimation process is carried out using the experience of the Group's engineers, project managers and finance and commercial professionals. Cost estimates are reviewed and updated on a regular basis using the Group's established project management processes. Some of the factors that will impact upon cost estimates include the availability of suitably qualified labour, the nature and complexity of the work to be performed, the availability of materials, the impact of change orders and the performance of sub-contractors.

RETIREMENT BENEFIT PLANS
The Group accounts for its post-retirement pension plans in accordance with IAS 19 Employee Benefits.

The main assumptions used in determining the defined benefit post-retirement obligation include the discount rate used in discounting scheme liabilities, the inflation rate, the expected rate of future pension increases, expected returns on scheme assets and future mortality assumptions. For each of these assumptions, there is a range of possible values. Relatively small changes in some of these variables can have a significant impact on the level of the total obligation.

The valuation of pension scheme assets and liabilities at a specific point in time rather than over a period of time can lead to significant annual movements in the pension scheme deficit as calculated under IAS 19, but it has no impact on short-term cash contributions since these are based upon separate independent actuarial valuations.

Details of the pension scheme estimates, assumptions and obligations at 31 December 2017 are provided in note 30.

IMPAIRMENT TESTING
Each year, the Group carries out impairment tests of its goodwill balances which requires estimates to be made of the value-in-use of its cash generating units (CGUs). These value-in-use calculations, particularly with respect to the Infrastructure CGU grouping, are dependent on estimates of future cash flows and long-term growth rates of the CGUs. Further details on these estimates are provided in note 14.

Proxy Board
Certain Group companies in the US undertake work of importance to US national security; consequently activities are conducted under foreign ownership regulations which require operation under a Proxy Agreement. The regulations are intended to insulate these activities from undue foreign influence as a result of foreign ownership. The entities that are operated under the management of a Proxy Board are ProLogic Inc. ("ProLogic") and Ultra Electronics Advanced Tactical Systems Inc. ("ATS").

The Directors consider that the Group has control over the operating and financial policies and results of these entities and therefore they are consolidated in the Group consolidated accounts in accordance with IFRS 10 Consolidated Financial Statements.

Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interest issued by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and assets or liabilities related to employee benefit arrangements are recognised and measured in accordance with IAS 12 Income Taxes and IAS 19 Employee Benefits respectively; and
- assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations are measured in accordance with that standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

When the consideration transferred by the Group in a business combination includes an asset or liability resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the "measurement period" (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with IAS 39, or IAS 37 Provisions, Contingent Liabilities and Contingent Assets, as appropriate, with the corresponding gain or loss being recognised in profit or loss.

When a business combination is achieved in stages, the Group's previously held interests in the acquired entity is remeasured to its acquisition date fair value and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

Goodwill

Goodwill is initially recognised and measured as set out above. Goodwill is not amortised but is reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units or groups of cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

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

Revenue recognition

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Sales of goods are normally recognised when substantially all of the risks and rewards of ownership have transferred to the customer.

Revenue from contracts to provide services is recognised by reference to the stage of completion of the contracts in the same way as for long-term contracts. This is normally measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion.

Revenue from long-term contracts is recognised in accordance with the Group's accounting policy on long-term contracts *(see below)*.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

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

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

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

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

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

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

Other intangible assets
Costs associated with producing or maintaining computer software programmes for sale are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, that will generate economic benefits exceeding costs beyond one year and that can be measured reliably, are recognised as intangible assets. Capitalised software development expenditure is stated at cost less accumulated amortisation and impairment losses. Amortisation is provided on a straight line basis over the estimated useful life of the related asset (see note 15).

Acquired computer software licences for use within the Group are capitalised as intangible assets on the basis of the costs incurred to acquire and bring to use the specific software.

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

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

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

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

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

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

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

Freehold buildings	40 to 50 years
Short leasehold improvements	over remaining period of lease
Plant and machinery	3 to 20 years

Freehold land and assets under construction are not depreciated.

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

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

Rentals under operating leases, where the Group acts as either lessee or lessor, are charged on a straight line basis over the lease term, even if the payments are not made on such a basis. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight line basis over the lease term.

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

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

Trade receivables
Trade receivables are initially measured at fair value then subsequently remeasured at amortised cost less any impairment. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired.

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

Assets held for sale
Assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

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

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

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

Borrowing costs
Borrowing costs are recognised in profit or loss in the period in which they are incurred, except where they relate to qualifying assets, in which case they are capitalised.

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

Government assistance provided in the form of below-market rate of interest loans are treated as government grants. The benefit of the below-market rate of interest is calculated as the difference between the proceeds received and the fair value of the loan and is matched against the related expenditure. The fair value of the loan is calculated using prevailing market interest rates.

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

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

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight line basis over the average period until the benefits become vested.

Curtailment gains or losses are recognised immediately in the income statement.

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

Payments to defined contribution retirement schemes are charged as an expense as they fall due.

Trade payables
Trade payables are initially measured at fair value then subsequently remeasured at amortised cost.

Loans and overdrafts
Interest-bearing loans and overdrafts are recorded at the proceeds received, net of direct issue costs where there is a facility commitment. In these circumstances, issue costs are deducted from the value of the loan and amortised over the life of the commitment. Where there is no facility commitment, issue costs are written off as incurred. Finance charges including premiums payable on settlement or redemption are accounted for on an accruals basis in profit or loss using the effective interest rate method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Share-based payments
The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest and adjusted for the effect of non-market-related conditions.

Fair value is measured by use of a Black-Scholes model for the share option plans and a stochastic model for awards made under the 2007 Long-Term Incentive Plan.

The credits in respect of equity-settled amounts are included in equity.

Provisions
Provisions, including property-related and contract-related provisions, are recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and where it is probable that an outflow of economic benefits will be required to settle the obligation.

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

Equity instruments
Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

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

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

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

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

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

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

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

Derivative financial instruments
Ultra uses derivative financial instruments, principally forward foreign currency contracts and interest rate swaps, to reduce its exposure to exchange rate and interest rate movements. Ultra does not hold or issue derivatives for speculative or trading purposes.

Derivative financial instruments are recognised as assets and liabilities and measured at their fair values at the balance sheet date. Changes in their fair values are recognised in the income statement and this is likely to cause volatility in situations where the carrying value of the hedged item is not adjusted to reflect fair value changes arising from the hedged risk. Provided the conditions specified by IAS 39 are met, hedge accounting may be used to mitigate this income statement volatility. Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Hedge accounting will not generally be applied to transactional hedging relationships, such as hedges of forecast or committed transactions. However, hedge accounting will be applied to translational hedging relationships where it is permissible under IAS 39. When hedge accounting is used, the relevant hedging relationships will be classified as fair value hedges, cash flow hedges or net investment hedges.

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

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

Income statement
Additional line items are disclosed in the consolidated income statement when such presentation is relevant to an understanding of the Group's financial performance.

Operating profit
Operating profit is stated after charging restructuring costs but before investment income and finance costs.

Exceptional items
When items of income or expense are material and they are relevant to an understanding of the entity's financial performance, they are disclosed separately within the financial statements. Such exceptional items include material costs or reversals arising from a restructuring of the Group's operations, material creation or reversals of provisions, and material litigation settlements.

Non-statutory and underlying performance measures
In the analysis of the Group's operating results, earnings per share and cash flows, information is presented to provide readers and stakeholders with additional performance indicators that are prepared on a non-statutory basis. This 'underlying' presentation is regularly reviewed by management to identify items that are unusual and other items relevant to an understanding of the Group's performance and long-term trends with reference to their materiality and nature. The non-statutory performance measures are consistent with how business performance is planned and reported within the internal management reporting to the Divisional management teams, Executive Committee and to the Board. Some of the measures are used for setting remuneration targets. The Group also uses 'organic' performance measures for the order book, order intake and the income statement. Explanations of how they are determined, and how they reconcile to IFRS statutory measures are set out below. This additional non-statutory information is not uniformly defined by all Companies and may not be comparable with similarly titled measures and disclosures by other organisations.

The non-statutory disclosures should not be viewed in isolation or as an alternative to the equivalent statutory measure. Information for separate presentation is considered as follows:

- Contract losses arising in the ordinary course of trading are not separately presented; however, losses (and subsequent reversals) are separately disclosed in situations of a material dispute which are expected to lead to arbitration or legal proceedings.
- One-off curtailment gain arising on closure of defined benefit pension scheme.
- Material costs or reversals arising from a significant restructuring of the Group's operations, such as the S3 programme, are presented separately.
- Disposals of entities or investments in associates or joint ventures, or impairments of related assets are presented separately.
- The amortisation of intangible assets arising on acquisitions and impairment of goodwill or intangible assets are presented separately.
- Other matters arising due to the Group's acquisitions such as adjustments to contingent consideration, payment of retention bonuses, acquisition and disposal costs and fair value adjustments for acquired inventory made in accordance with IFRS 13 are separately disclosed in aggregate.
- Furthermore, IAS 37 requires the Group to discount provisions using a pre-tax discount rate that reflects the current assessment of the time value of money and the risks specific to the liability. This discount unwind is presented separately when the provision relates to acquisition contingent consideration.
- Derivative instruments used to manage the Group's foreign exchange exposures are "fair valued" in accordance with IAS 39. This creates volatility in the valuation of the outstanding instruments as exchange rates move over time. This has minimal impact on profit over the full term of the instruments, but can cause significant volatility on particular balance sheet dates. Consequently, the gain or loss is presented separately.
- The defined benefit pension net interest charge arising in accordance with IAS 19 is presented separately.
- The related tax effects of the above items are reflected when determining underlying earnings per share, as set out in note 13.
- The Group is cash-generative and reinvests funds to support the continuing growth of the business. It seeks to use an accurate and appropriate measure of the funds generated internally while sustaining this growth. For this, the Group uses operating cash flow, rather than cash generated by operations, as its preferred indicator of cash generated and available to cover non-operating expenses such as tax and interest payments. Management believes that using cash generated by operations, with the exclusion of net expenditure on property, plant and equipment and outflows for capitalised product development and other intangibles, would result in an under-reporting of the true cash cost of sustaining a growing business.
- EBITDA is the underlying operating profit before depreciation charges and before amortisation arising on internally-generated intangible assets and on other, non-acquired, intangible assets. The figure is adjusted to remove the EBITDA generated by businesses up to the date of their disposal in the period.
- Net debt comprises loans and overdrafts less cash and cash equivalents. The determination of net debt is set out in note 28.
- Total shareholder return is annual shareholder return (capital growth plus dividends paid, assuming dividends reinvested) over a rolling five year period.

ORGANIC MEASURES:
The Divisional management teams, the Executive Team and the Board review and compare current and prior year group and divisional revenue and underlying operating profit at constant exchange rates and exclude the impact of acquisitions and disposals from these organic performance measures. The order intake and order book are also reviewed and compared in the same way.

The constant exchange comparison retranslates the prior year reported results from the prior year's average exchange rates into the current year's average exchange rates, and in the case of underlying operating profit adjusts for the impact of exchange rate movements on prior year-end USD net assets held in GBP functional currency entities.

The impact of business acquisitions is excluded for the first 12 months of ownership, from the date of completion of purchase. For disposals, comparative figures are adjusted to reflect the comparable period of ownership. The ID business was disposed of in late August 2016; references to 'organic' performance, have excluded the revenue and underlying operating profit for those eight months of 2016 ownership.

Company balance sheet
31 December 2017

	Note	2017 £'000	2016 £'000
Fixed assets			
Property, plant and equipment	38	**511**	1,038
Investments	39	**815,144**	939,943
		815,655	940,981
Current assets			
Debtors: Amounts falling due within one year	40	**11,352**	16,678
		11,352	16,678
Creditors: Amounts falling due within one year	42	**(191,081)**	(180,722)
Net current liabilities		**(179,729)**	(164,044)
Total assets less current liabilities		**635,926**	776,937
Creditors: Amounts falling due after more than one year	43	**(164,734)**	(325,017)
Net assets		**471,192**	451,920
Capital and reserves			
Share capital	45	**3,887**	3,523
Share premium account	46	**200,911**	64,020
Retained earnings brought forward	46	**352,681**	345,971
Profit and loss for year	46	**(83,706)**	40,987
Own shares	46	**(2,581)**	(2,581)
Shareholders' funds		**471,192**	451,920

The financial statements of Ultra Electronics Holdings plc, registered number 02830397, were approved by the Board of Directors and authorised for issue on 5 March 2018.

On behalf of the Board
D. Caster, Executive Chairman
A. Sharma, Group Finance Director

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

Company statement of changes in equity
31 December 2017

	Share capital £'000	Share premium account £'000	Profit and loss account £'000	Own shares £'000	Total £'000
Balance at 1 January 2016	3,514	61,052	377,570	(2,581)	439,555
Retained profit for the year	-	-	40,987	-	40,987
Total comprehensive income for the year	-	-	40,987	-	40,987
Issue of share capital	9	2,968	-	-	2,977
Equity-settled employee share schemes	-	-	984	-	984
Dividends paid	-	-	(32,583)	-	(32,583)
Balance at 31 December 2016	**3,523**	**64,020**	**386,958**	**(2,581)**	**451,920**
Balance at 1 January 2017	3,523	64,020	386,958	(2,581)	**451,920**
Retained profit for the year	-	-	(83,706)	-	**(83,706)**
Total comprehensive income for the year	-	-	(83,706)	-	**(83,706)**
Issue of share capital	352	133,195	-	-	**133,547**
Equity-settled employee share schemes	12	3,696	682	-	**4,390**
Dividends paid	-	-	(34,959)	-	**(34,959)**
Balance at 31 December 2017	**3,887**	**200,911**	**268,975**	**(2,581)**	**471,192**

Notes to accounts – Company
31 December 2017

38 Property, plant and equipment

	Plant and machinery £'000
Cost	
At 1 January 2016	2,039
Additions	534
At 1 January 2017	2,573
Disposals	(518)
At 31 December 2017	**2,055**
Accumulated depreciation	
At 1 January 2016	1,468
Charge	67
At 1 January 2017	1,535
Charge	9
At 31 December 2016	**1,544**
Net book value	
At 31 December 2017	**511**
At 31 December 2016	1,038

39 Investments

a) Principal subsidiary undertakings

The Company owns either directly or indirectly 100% of the ordinary share capital of a number of subsidiary undertakings as set out in note 36.

b) Investment in subsidiary undertakings

	Total £'000
At 1 January 2017	**939,943**
Impairments	**(124,799)**
At 31 December 2017	**815,144**

The impairments arose following review of the recoverability of investments within the corporate Company structure.

40 Debtors

	2017 £'000	2016 £'000
Amounts falling due within one year:		
Amounts due from subsidiary undertakings	**8,785**	15,199
Deferred tax assets	**505**	30
Other receivables	**1,747**	1,146
Prepayments and accrued income	**315**	303
	11,352	16,678

41 Deferred tax

Movements in the deferred tax asset were as follows:

	2017 £'000	2016 £'000
Beginning of year	**30**	37
Credit/(charge) to the profit and loss account	**475**	(7)
End of year	**505**	30

41 Deferred tax (continued)

The deferred tax balances are analysed as follows:

	2017 £'000	2016 £'000
Other temporary differences relating to current assets and liabilities	**505**	30
Deferred tax asset	**505**	30

These balances are shown as follows:

	2017 £'000	2016 £'000
Debtors: Amounts falling due within one year	**505**	30

At the balance sheet date the Company had nil unprovided deferred tax (2016: nil).

42 Creditors: amounts falling due within one year

	2017 £'000	2016 £'000
Bank loans and overdraft	**72,283**	52,025
Amounts owed to subsidiary undertakings	**112,208**	119,116
Other payables	**1,089**	4,062
Accruals and deferred income	**5,501**	5,519
	191,081	180,722

The bank loans are unsecured. Interest was predominantly charged at 1.20% (2016: 1.35%) over base or contracted rate.

43 Creditors: amounts falling due after more than one year

	2017 £'000	2016 £'000
Borrowings	**164,734**	325,017
	164,734	325,017

The financial risk management objectives and policies of the Company are managed at a Group level; further information is set out in note 23.

44 Borrowings

Borrowings fall due as analysed below:

	2017 £'000	2016 £'000
Bank loans and overdraft		
In one year or less, or on demand	**72,283**	52,025
	72,283	52,025
Less: included in creditors: amounts falling due within one year	**(72,283)**	(52,025)
Amounts due after more than one year		
Bank loans	**120,375**	268,120
Unsecured loan notes	**44,359**	56,897
	164,734	325,017

The loan notes are unsecured and due for repayment in 2018 and 2019. Interest was charged at 3.60% (2016: 3.60%).

45 Called-up share capital

The movements are disclosed in note 26.

46 Equity reserve

The profit and loss account includes £65,400,000 (2016: £175,157,000) which is not distributable. A net foreign exchange gain of £23,707,000 was taken to reserves in the year. Further details in respect of dividends are presented in note 12 and in respect of share-based payments in note 26.

The Company holds 235,245 own shares (2016: 235,245).

47 Related parties

Transactions with Corvid Holdings Limited are set out in note 33.

Statement of accounting policies
for the Company accounts

A summary of the Company's principal accounting policies, all of which have been applied consistently throughout the year and preceding year in the separate financial information presented for the Company, are set out below:

Basis of accounting

The Company accounts have been prepared under the historical cost convention and in accordance with FRS 101 Reduced Disclosure Framework. No profit and loss account is presented for the Company, as permitted by section 408 of the Companies Act 2006. As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share-based payments, financial instruments, capital management, presentation of a cash-flow statement and certain related-party transactions. The Company's retained profit for the year is disclosed in note 46.

Fixed assets and depreciation

Property, plant and equipment are shown at original historical cost, net of depreciation and any provision for impairment. Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows:

Plant and machinery	3 to 20 years

Taxation

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future, or a right to pay less tax in the future, have occurred at the balance sheet date. Temporary differences are differences between the Company's taxable profits and its results as stated in the financial statements. These arise from including gains and losses in tax assessments in different periods from those recognised in the financial statements. A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is not discounted.

Retirement benefit costs

The Company participates in a defined benefit plan that shares risks between entities under common control. The details of this UK scheme, for which Ultra Electronics Limited is the sponsoring employer, are set out in note 30. There is no contractual agreement or stated policy for charging the net benefit cost to Ultra Electronics Holdings plc.

Investments

Fixed asset investments are shown at cost less provision for impairment. Assessment of impairments requires estimates to be made of the value-in-use of the underlying investments. These value-in-use calculations are dependent on estimates of future cash flows and long-term growth rates. The criteria used in this assessment are consistent with those set out in note 14 and the critical accounting estimates and assumptions as set out below.

Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Group has adequate resources to continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Strategic Report on page **45**.

Foreign currency

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

Share-based payments

The Company issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of the grant. The fair value determined at the grant date is expensed on a straight line basis over the vesting period, based on the Company's estimate of shares that will eventually vest. Further disclosure in relation to share-based payments is given in note 26.

Related parties

The Remuneration of the Directors, who are considered to be the key management personnel of the Company, is disclosed in the audited part of the Directors' Remuneration Report on pages **85-90**.

Loans and overdrafts

Interest-bearing loans and overdrafts are recorded at the proceeds received, net of direct issue costs where there is a facility commitment. In these circumstances, issue costs are deducted from the value of the loan and amortised over the life of the commitment. Where there is no facility commitment, issue costs are written off as incurred. Finance charges including premiums payable on settlement or redemption are accounted for on an accruals basis in profit or loss using the effective interest rate method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Critical accounting judgements and key sources of estimation uncertainty
In the application of the Company's accounting policies, the Directors are required to make judgements (other than those involving estimates) that have a significant impact on the accounts recognised and to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumption are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical accounting judgements in applying the Company's accounting policies
There were no critical accounting judgements that would have a significant effect on the amounts recognised in the Parent Company financial statements.

Critical accounting estimation and assumptions
IMPAIRMENTS TO INVESTMENTS IN SUBSIDIARY UNDERTAKINGS
Following the review of the recoverability of investments within the corporate company structure, an impairment was identified due to the calculated value-in-use being in excess of the book value of certain investments. The value-in-use is calculated by discounting the forecast cash flows of each investment to present value. The Directors consider the investments in the US business and Giga Communications Limited to be most sensitive to the achievement of the forecast cash flows and to the discount rate applied in calculating the present value of the future cash flows. A 0.1% increase in the discount rate would increase the impairment charge by £4.3m, and a 1% reduction in forecast future cash flows would increase the impairment charge by £6.8m.

Five-year review

Financial highlights

	2013 £m	2014 £m	2015 £m	2016 £m	**2017 £m**
Revenue					
Aerospace & Infrastructure	230.4	198.6	193.2	204.7	**203.2**
Communications & Security	237.7	224.4	239.3	259.0	**242.7**
Maritime & Land	277.1	290.7	293.8	322.1	**329.5**
Total revenue	745.2	713.7	726.3	785.8	**775.4**
Underlying operating profit[1]					
Aerospace & Infrastructure	46.2	29.6	28.7	32.4	**32.6**
Communications & Security	27.5	37.0	40.4	39.7	**28.2**
Maritime & Land	48.0	51.5	50.9	59.0	**59.3**
Total underlying operating profit[1]	121.7	118.1	120.0	131.1	**120.1**
Margin[1]	16.3%	16.5%	16.5%	16.7%	**15.5%**
Profit before tax	49.3	21.5	34.8	67.6	**60.6**
Profit after tax	38.2	6.5	25.0	58.3	**49.4**
Operating cash flow[2]	79.0	83.1	81.3	120.4	**116.5**
Free cash flow before dividend payments, acquisitions and financing[3]	46.7	52.8	48.4	86.0	**65.3**
Net debt at year-end[4]	(42.2)	(129.5)	(295.6)	(256.7)	**(74.5)**
Underlying earnings per share (p)[5]	127.1	123.1	123.9	134.6	**116.7**
Dividend per share (p)	42.2	44.3	46.1	47.8	**49.6**
Average employee numbers	4,274	4,787	4,843	4,466	**4,172**

[1] Before adjustments to contingent consideration net of acquisition and disposal-related costs, amortisation of intangibles arising on acquisition, the S3 programme, impairment charges and Oman contract termination and liquidation related costs.

[2] Cash generated by operations and dividends from associates, less net capital expenditure, R&D, LTIP share purchases and excluding cash outflows from the S3 programme, acquisition and disposal related payments and the Oman related cash flow in 2016 and 2017.

[3] Free cash flow before dividends paid, acquisitions and financing has been adjusted to include the purchase of LTIP shares, which are included in financing activities. Prior periods have been re-stated to include dividend receipts from equity-accounted investments.

[4] Loans and overdrafts less cash and cash equivalents.

[5] Before adjustments to contingent consideration net of acquisition and disposal-related costs, amortisation of intangibles arising on acquisition, the S3 programme, impairment charges, fair value movement on derivative financial instruments, defined benefit pension interest charges and unwinding of discount on provisions.

Footnote

A reconciliation is set out in note 2 between operating profit and underlying operating profit, between profit before tax and underlying profit before tax and between cash generated by operations and underlying operating cash flow. The calculation for underlying earnings per share is set out in note 13.

Further detail on non-statutory performance measures is set out on page **143**.

underlying operating profit before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, Oman contract termination related costs and adjustments to contingent consideration net of acquisition and disposal related costs. IFRS operating profit was £61.5m (2016: £89.7m).

organic growth (of revenue or profit) is the annual rate of increase in revenue or profit that was achieved at constant currencies, assuming that acquisitions made during the prior year were only included for the same proportion of the current year, and adjusted for disposals made during the prior year to reflect the comparable period of ownership.

underlying operating margin is the underlying operating profit as a percentage of revenue.

net finance charges exclude fair value movements on derivatives, defined benefit pension interest charges and discount on provisions.

underlying profit before tax before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, Oman contract termination related costs, fair value movements on derivatives, unwinding of discount on provisions, defined benefit pension interest charges and curtailment gain and adjustments to contingent consideration net of acquisition and disposal related costs. Basic EPS 66.2p (2016: 82.8p).

underlying tax is the tax charge on underlying profit before tax. The underlying tax rate is underlying tax expressed as a percentage of underlying profit before tax.

underlying operating cash flow is cash generated by operations and dividends from associates, less net capital expenditure, R&D, LTIP share purchases and excluding the cash outflows from the S3 programme, acquisition and disposal related payments and the Oman performance bond/contract termination related costs.

operating cash conversion is underlying operating cash flow as a percentage of underlying operating profit.

total shareholder return is annual shareholder return (capital growth plus dividends paid, assuming dividends reinvested) over a rolling five year period.

net debt comprises loans and overdrafts less cash and cash equivalents.

bank interest cover is the ratio of underlying operating profit to finance costs associated with borrowings.

underlying order book growth excludes the impact of foreign exchange and the order book arising on acquisition.

underlying order intake includes orders from acquisitions since acquisition date.

underlying earnings per share is before acquisition and disposal related costs, amortisation of intangibles arising on acquisition, the S3 programme, impairment charges, fair value movement on derivative financial instruments, defined benefit pension interest charges and curtailment gain and unwinding of discount on provisions.

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