

meeting our commitments

2002



ULTRA ELECTRONICS IS A GROUP OF SPECIALIST BUSINESSES DESIGNING, MANUFACTURING AND SUPPORTING ELECTRONIC AND ELECTROMECHANICAL SYSTEMS, SUB-SYSTEMS AND PRODUCTS FOR INTERNATIONAL DEFENCE AND AEROSPACE MARKETS.

THE GROUP CONCENTRATES ON OBTAINING A TECHNOLOGICAL EDGE IN NICHE MARKETS, WITH MANY OF ITS PRODUCTS AND TECHNOLOGIES BEING MARKET LEADERS IN THEIR FIELD.

ULTRA, WHICH EMPLOYS 2,600 PEOPLE IN THE UK AND NORTH AMERICA, FOCUSES ON HIGH INTEGRITY SENSING, CONTROL, COMMUNICATION AND DISPLAY SYSTEMS WITH AN EMPHASIS ON INTEGRATED INFORMATION TECHNOLOGY SOLUTIONS.

ULTRA HAS AN INCREASING ROLE OF SUPPORTING PRIME CONTRACTORS BY UNDERTAKING SPECIALIST SYSTEM AND SUB-SYSTEM INTEGRATION USING THE COMBINED EXPERTISE OF THE GROUP BUSINESSES.

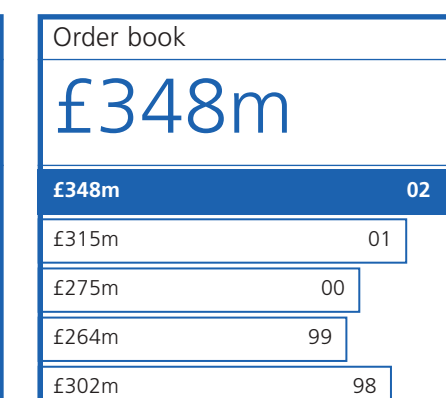
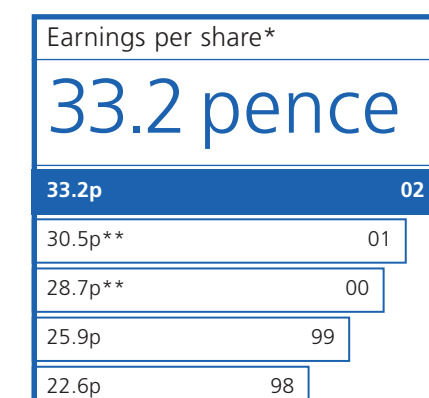
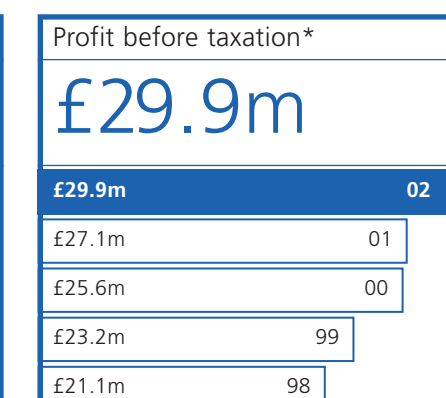
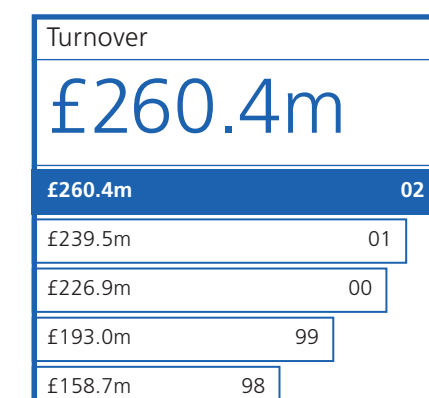
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THE QUEEN'S AWARD
FOR ENTERPRISE 2000
FOR THE
MAGICARD PRINTER
AT MANUFACTURING
& CARD SYSTEMS

Financial Highlights

	2002 £m	2001 £m	Growth
Turnover	260.4	239.5	+8.7%
Profit before taxation*	29.9	27.1	+10.6%
Earnings per share*	33.2p	30.5p**	+9.1%
Equity shareholders' funds	55.7	43.7**	
Operating profit margin*	12.9%	13.2%	
Employees (average number)	2,395	2,376	



* Before amortisation of goodwill.
In 2002 this amounted to £3.9m

** 2000 and 2001 tax restated for FRS 19

capability

ULTRA ELECTRONICS SPECIALISES IN THE DESIGN, MANUFACTURE AND SUPPORT OF ELECTRONIC AND ELECTROMECHANICAL SYSTEMS, SUB-SYSTEMS AND PRODUCTS FOR AIRCRAFT, SHIPS, SUBMARINES, ARMoured VEHICLES, AIRPORTS AND TRANSPORT SYSTEMS.



TACTICAL



SONAR



AIRCRAFT & VEHICLES



INFORMATION



POWER



ADVANCED PROGRAMMING CONCEPTS ▲
Battlespace IT solutions. Software based data fusion and display systems for applications in military command, control, communications, computers, intelligence, surveillance and reconnaissance (C⁴ISR) systems.



COMMAND & CONTROL SYSTEMS ■
Battlespace IT solutions. Geographical information management systems. Data link communication systems. Multifunction console systems with integrated application software and flat panel displays for command and control. Weapon interface electronics.



CONTROLS DIVISION ■
Landing gear control systems. Propeller de-icing, balancing and control systems. Supervisory engine controls.



DATTEL DEFENCE ■
High integrity systems including safety critical software, Internet-based shared working environments and secure communication networks.



ELECTRICS DIVISION ■
Specialised control handles, high integrity switches and indicators, lighting systems. Ruggedised cable harnesses. Data management and vision control systems for armoured vehicles.



EMS ▲
Specialised power supplies and demagnetising systems for the electromagnetic silencing of naval vessels.



FASL ■
Airport IT system integration. IT services and solutions for airlines and airports: central database (UltraDB); flight information (UltraFIDS); management information (UltraMIS); passenger bag matching (UltraTrak); resource management (UltraResource); data acquisition and control (UltraControl).



FLIGHTLINE SYSTEMS ▲
Sonobuoy telemetry receivers for maritime patrol aircraft and helicopters. Mechanical gyroscopes.



MANUFACTURING & CARD SYSTEMS ■▲
High integrity contract manufacturing. The Magicard range of identity card printers.



MARITIME SYSTEMS ▲
Passive sonobuoys and bathythermal buoys. Towed array sonars. High power sonar transducers.



MEASUREMENT SYSTEMS INC ▲
Displacement and force joysticks, hand grip controls, trackballs, encoders and simulation equipment.



NOISE & VIBRATION SYSTEMS ■
Civil and military aircraft cabin quieting systems using active noise and vibration control technology.



PMES ■
High power solid state power conversion and control equipment. Naval data processing and distribution systems. Transit system power conversion and control.



PRECISION AIR SYSTEMS ■▲
High pressure pure air generators (HiPPAG) for cooling thermal imagers and infra red sensors, and for pneumatic ejection of aircraft munitions. Sidewinder missile overhaul and repair.



SIGNATURE MANAGEMENT SYSTEMS ■
Multi-influence measurement ranges for measuring complex signatures of naval vessels. Magnetic sensors, instruments and ship demagnetising systems.



SONAR & COMMUNICATION SYSTEMS ■
Active and passive sonobuoys. Sonobuoy receivers and acoustic processors for maritime patrol aircraft and helicopters. Ship sonar systems. Torpedo defence systems and countermeasures. Data link communication systems. Cryptographic equipment.



TACTICAL COMMUNICATION SYSTEMS ▲
High capacity, multi-channel line-of-sight radios. Electronic counter-counter measure radio systems. Multiplexers and switches.



UNDERSEA SENSOR SYSTEMS INC ▲
Active and passive sonobuoys. Advanced autonomous sensor systems for coastal surveillance. Hydrophones.

■ Businesses in the UNITED KINGDOM
▲ Businesses in NORTH AMERICA



Peter Macfarlane, Chairman

THE ORDER BOOK IS AT A NEW HIGH REFLECTING THE CONTINUING GROWTH IN THE BUSINESS AND MAJOR ORDERS WON IN 2002.

I am pleased to report that Ultra has enjoyed an excellent year with record sales and profit. The order book is at a new high reflecting the continuing growth in the business and major orders won in 2002. Importantly, Ultra has continued to meet its commitments across the range of its major defence programmes. Ultra's strategic objectives remain to concentrate on growth in its niche aerospace and defence markets and to make acquisitions of complementary businesses.

Sales were 8.7% higher at £260.4m despite the softness in the civil aircraft market. This strong sales growth reflected Ultra's focus on the expanding defence electronics sector and, in total, military sales now represent over 80% of turnover. Profit before tax and amortisation of goodwill grew by 10.6% to £29.9m whilst earnings per share before goodwill amortisation increased by 9.1% to 33.2p in 2002.

The continued international development of Ultra is demonstrated by the growing importance of North America as a market, now representing almost 40% of Group sales.

Once again, I am delighted to report a very strong cash performance, and especially pleasing is the cash conversion ratio of 116%. Net debt at £39.3m leaves Ultra with ample resources from which to make further targeted acquisitions. New syndicated banking facilities established during the year have reinforced the Group's financial strength.

Based on this year's profit performance, the Board is recommending a dividend increase of 7.7% to give a total dividend of 11.2p per share.

In 2002, Ultra made a substantial acquisition, Tactical Communication Systems (TCS), a manufacturer of military radios based in Montreal, Canada, for £21.5m before expenses. With a similar customer base to other Ultra companies and with many opportunities to win business internationally, TCS is an excellent complementary fit for Ultra.

The Group had considerable success during 2002 in winning large orders in its core business areas. This reflects the excellent long-term relationships that Ultra has with its key customers worldwide. The largest contract secured by Ultra to date was a programme to develop, supply and support a system to protect Royal Navy surface ships from attack by torpedoes. This contract utilises the combined strength of several Ultra businesses. Additionally, the Group won a contract from BAE Systems to supply bow sonars for the Royal Navy's new Type 45 destroyer. Ultra has supplied the UK MoD with its sonobuoys for many years and this position is now being reinforced by negotiations for a ten-year partnership agreement with MoD to develop and supply sonobuoys exclusively.

The outlook for civil aerospace remains dull and a recovery in demand for new aircraft is not expected in the next twelve months.

There are, however, a number of airport investment programmes underway, some reflecting the requirement for enhanced security. Ultra is winning orders for electronic systems in these areas. Demand for defence electronics is growing strongly, particularly in the USA, and Battlespace IT equipment remains a high priority for military expenditure. Ultra's expertise in supplying electrical power conversion equipment for rapid transit rail systems in the United Kingdom also holds significant potential.

With an order book at the year-end of £348m and with headroom for further acquisitions, the Board is confident of the outlook for the current year and beyond.

Finally, I would like to thank all Ultra employees for their continuing commitment and for their contribution to the success of the Group.

Peter Macfarlane Chairman

total commitment to our customers and our shareholders



Julian Blogh, Chief Executive

Successful strategy

Increased shareholder value through organic growth in niche markets and strategic acquisitions

+9%

Sales
Reflecting increased demand for Battlespace IT systems, growth in sales of Anti-Submarine Warfare equipment and higher production of HiPPAG

ULTRA ELECTRONICS AGAIN PRODUCED EXCELLENT RESULTS IN 2002, ACHIEVING RECORD LEVELS OF SALES, PROFIT AND ORDER INTAKE. CONFIRMING THE QUALITY OF EARNINGS, THE CONVERSION OF OPERATING PROFIT TO OPERATING CASH FLOW WAS 116%.†

Successes in the year included the award of the largest contract received by the Group to date and the signing of a partnership intent memorandum on sonobuoys with the Defence Procurement Agency of the UK Ministry of Defence (MoD).

Group strategy

The Group continues to focus its strategy on being a niche supplier of electronic systems and products in defence and aerospace markets. In order to strengthen its niche positions, the Group continued its high level of investment in the application of advanced technology to create new products in its chosen markets, coupled with the acquisition of complementary businesses. Ultra's 2002 results show the success of this strategy through both the operating results reported and the Group's record order book at the year-end.

Acquisition

In accordance with its strategy, in September 2002 Ultra completed the acquisition of MilComm, now renamed Tactical Communication Systems (TCS), for C\$53m (£21.5m) before expenses. TCS, based in

Montreal, Canada, designs and manufactures military high bandwidth line-of-sight radios, a critical part of command and control systems. Major customers include the US Department of Defense (DoD), the UK MoD and the Korean armed forces. TCS strengthens Ultra's position in Battlespace IT, an area of increasing military expenditure, and complements its existing data link activities.

Group results

Sales increased to £260.4m, (2001: £239.5m), a rise of 8.7%, of which 5.8% was organic. This encouraging sales increase was achieved despite the translation impact of the weaker US dollar without which growth would have been 2% higher. Sales growth was driven primarily by a rising demand for Battlespace IT systems, an increase in the delivery of anti-submarine warfare equipment and higher production of the HiPPAG missile cooling product. Sales of civil aerospace products declined in line with both the reduction of Airbus aircraft deliveries and reduced demand for spares and repairs from airlines as they attempted to move back into profit. However, Ultra's civil aerospace business, including the

airport IT activity, represented less than 12% of the Group's 2002 sales.

The operating margin, before the amortisation of goodwill, was 12.9%, slightly below that recorded in 2001. This margin reduction resulted mainly from the lower level of civil aerospace spares and repairs activity during the period. Operating profit, before the amortisation of goodwill, increased by 5.6%, while profit before tax and amortisation rose by 10.6% to £29.9m (2001: £27.1m). The effective tax rate for the Group was 1% higher at 27.1%. As a result, earnings per share before goodwill amortisation were 9.1% higher at 33.2p (2001: 30.5p, as restated following the adoption of FRS 19).

Operating cash flow was very strong at £38.7m (2001: £35.2m) after capital expenditure, with an operating profit to operating cash flow conversion of 116%.† This brings the average conversion ratio over the past five years to 85%. Despite the acquisition of TCS for £21.5m (before expenses), net debt during the year decreased by £1.3m to £39.3m (2001: £40.6m).

The Group's order book at the year-end stood at a record level of £348m, an increase of 10% compared to the same point last year (2001: £315m). This represents the equivalent of approximately 15 months of future sales.

Air & Land Systems

Air & Land Systems, with the addition of TCS, comprises eleven businesses in the UK and North America that supply advanced technology products for military aircraft and land vehicles, the anti-submarine warfare market and the civil aerospace market.

Sales growth in the division was 7.5% to £177.5m (2001: £165.1m). Organic growth was 3.4%. Operating profit before goodwill amortisation was £22.5m (2001: £24.1m). Reduced civil aerospace spares and repair activity, combined with the completion of deliveries to the US Navy of sonobuoys on older low margin contracts, contributed to the reduction in operating margin to 12.7% (2001: 14.6%). The effect was somewhat mitigated, however, by the excellent growth of HiPPAG deliveries for both the US Navy and the Eurofighter programme.

The year produced a number of notable successes. In March, Ultra was awarded a £20m contract to develop and deliver the bow sonar for the Royal Navy's Type 45 destroyer. This was Ultra's first major ship sonar contract and was achieved in collaboration with our US partner, EDO Corporation. Further success in an associated field came with the award of the main part of the Surface Ship Torpedo Defence contract in July, bringing the total contract value to £54m, Ultra's largest single contract to date.

In anti-submarine warfare, where Ultra is the

world's largest supplier of sonobuoys, the Group continued to increase its market share of new orders with major contracts being won in the US, the UK, Canada, France and Australia. Ultra's traditional dominance of the export market for passive sonobuoys is now being complemented by its ability to win major active sonobuoy awards with a competitive new design which recently entered production.

In recognition of Ultra's record in meeting its commitments as a supplier of sonobuoys to the MoD, a memorandum of intent to partner has been signed between Ultra and the MoD. The final agreement, when signed, will bind Ultra and the MoD together, with Ultra being the developer and supplier of all sonobuoys and derivative products to the MoD for a period of at least ten years.

During the year, Ultra's commitments were met on the Nimrod, Eurofighter and Engineer Tank System programmes, with development milestones being achieved and deliveries being made in a timely manner.

+11%

Profits
Profit before tax and amortisation increased by 11% to £29.9m (2001: £27.1m)

† see definition on page 6

£348m

Order book
The order book of £348m, an increase of 10%, represents the equivalent of about 15 months of future sales

116%[†]

Cash performance
Cash flow was very strong at £38.7m (2001: £35.2m) with an operating profit to operating cash conversion of 116%

£54m

Largest ever contract received
Successes in the year included the award of the largest contract received by Ultra to date, valued at £54m

+9%

Earnings per share
Earnings per share were 9% higher at 33.2p (2001: 30.5p)

THE OUTLOOK FOR THE GROUP REMAINS STRONG, WITH RECENT IMPORTANT CONTRACT WINS IN THE UK AND IN EXPORT MARKETS LAYING THE FOUNDATIONS FOR FURTHER BUSINESS GROWTH.

Orders

Ultra increased its share of the sonobuoy market with orders from the US, the UK, Canada, France and Australia

Completed

Strategic acquisition
The acquisition of TCS strengthens Ultra's position in Battlespace IT

Partnership

with MoD
An intent to act in partnership has been signed between Ultra and the MoD for future sonobuoy supplies

Information & Sea Systems

Information & Sea Systems consists of seven businesses in the UK and North America that supply information management and power products for defence, commercial and airport applications worldwide.

Divisional turnover was £82.9m (2001: £74.4m), an increase of 11.3%, all of which was organic. Operating profit, before the amortisation of goodwill, rose by 43.9% to £11.0m (2001: £7.6m). The operating margin before amortisation was 13.3%, up from 10.3% in 2001. This resulted from increased Battlespace IT activity, improved profitability at the airport information systems business and the completion of a number of Astute equipment development programmes allowing higher margins to be taken.

The division benefited from a rise in government expenditure on Battlespace IT. There was significant growth in Ultra's US activity in this area as efforts are made to improve the situational awareness of operating forces. Progress was also made in the UK with the first order from the MoD for the Group's Air Defense Systems Integrator. In a related area, BAE Systems ordered command systems equipment for the third contract of the Korean KDX destroyer programme.

Ultra provides power systems for naval and rail transit applications and, in October, initial contracts were placed with the Group by Network Rail to provide trackside power

equipment as part of the rail infrastructure upgrade for the south of England. This is expected to lead to an increasing involvement by Ultra in this high investment sector.

While civil aerospace continues to operate in a difficult environment, the need for long-term investment in airport infrastructure remains, supplemented by security concerns. Ultra's work defining the IT infrastructure for London Heathrow's new fifth terminal continued throughout the year. In addition, there was an upturn in demand for Ultra's baggage reconciliation system, and equipment was installed for British Airways and Virgin Atlantic in their North American terminals.

Finally, Ultra again met its commitments by delivering on time initial equipment for the Astute class submarine, and equipment for the US Virginia class submarine and Air Defense Systems Integrators for the DoD.

[†] Operating cash conversion is defined as being operating cash flow less capital expenditure and financial investment, as a percentage of operating profit before goodwill amortisation.

Reporting in 2003

Ultra has expanded in capability, in products and in the number of operating businesses since its flotation in 1996. Ultra's two-divisional reporting structure therefore no longer adequately presents the Group in a format related to its activities, neither does it provide sufficient detail. From the beginning of 2003, the Group will report on the basis of three divisions, with the objective of making Ultra easier to understand. The new reporting structure is explained in more detail on page 22.

Prospects

Increasing concerns about the activities of rogue states and terrorist organisations is driving an increase in defence expenditure in many countries. In the US, the defence procurement budget for 2003 has risen by 11%, while in the UK defence procurement is also growing in real terms. Expenditure is being concentrated on Battlespace IT, unmanned vehicles for air, land and sea and highly mobile systems. Through its continuing investments, Ultra is well positioned to benefit from this activity.

Major UK opportunities include: control electronics for the UK's submarine fleet; a new active search sonobuoy system; electronics for new armoured vehicles and Network Rail trackside power equipment. In the US, new opportunities for Ultra are presented through: the F-35 Joint Strike Fighter programme; the Small Diameter Bomb programme and Battlespace IT activity.

The civil aerospace market is not expected to recover for at least the next twelve months with Ultra's sales in this market likely to remain static over this period. However, with this sector representing less than 12% of Ultra's total sales, this will not have a major impact on performance. Overall, non-military activity is expected to rise in absolute terms as rail transit, airport IT and security product sales increase.

The outlook for the Group remains strong, recent important contract wins in the UK and in export markets laying the foundations for further business growth. With interest cover before goodwill amortisation of 9.5 times in 2002, Ultra enters 2003 with the capacity to continue its strategy of organic growth and acquisition of complementary businesses in order to strengthen its market niches. These factors, coupled with the record closing order book, give the Board confidence in the performance of the Group in 2003.

Julian Blogh, Chief Executive

Outlook

With an order book at the year-end of £348m and the headroom for further acquisitions, the Board is confident of the outlook for the current year and beyond

effective communication systems

ULTRA IS COMMITTED TO BEING A WORLD-LEADING SUPPLIER OF MILITARY TACTICAL COMMUNICATION EQUIPMENT THAT PROVIDES ENHANCED CAPACITY FOR VOICE, DATA AND VIDEO IMAGES.

15,000

Ultra has over 15,000 line-of-sight tactical radio systems in use worldwide – more than any other supplier

The success of military operations is dependent upon having secure and robust communications. A key element of military tactical communication systems is the wide area network for voice and data transmission between the various command levels in land forces. An essential component of this network is the microwave trunk radio which provides the highway for the traffic between the system nodes. Ultra's advanced radio products serve as the backbone of modern tactical line-of-sight networks. They provide secure battlefield trunk telephone and high capacity data telecommunication services to link battlefield theatre commanders and their combat forces.

To satisfy the high mobility needs of the tactical environment, users are demanding ever-greater transmission distances, increased reliability and low error performance of the link. Systems must also make efficient use of the available radio spectrum. In satisfying all of these requirements, Ultra has become a

world-leading supplier of high-capacity, line-of-sight radio systems.

In a trend that mirrors the digitisation of the commercial business environment, the capabilities of the tactical communication system must now accommodate an increasing need for data-based communications, including e-mail and near-real-time video transmissions, in addition to the usual voice communications. This supports the increasing data content of modern command and control systems which depend on the high bandwidth wide area communications system.

To be tactically useful, communication needs to be secure. Attempts will constantly be made to intercept radio traffic or to jam transmissions. The need for security can be met through techniques such as frequency hopping and encryption. By transmitting data at different frequencies, the system can reduce its susceptibility to enemy interference or jamming. In addition, several levels of data encryption can be provided

dependent on the nature of the information being transmitted.

Ultra's radio systems are state of the art and have been designed to meet user requirements well into the 21st century.

In order to provide and maintain the most up-to-date battlefield picture, real-time video images of the battlespace and data from other specialised sensors are captured by surveillance equipment mounted in manned and unmanned aerial vehicles. These various data sources must be linked together and the information passed to the battlespace network. Ultra specialises in the supply of data links to allow ground-based operators to control multiple remotely piloted aircraft simultaneously. In addition, Ultra's data links are used to transmit digital battlespace information from aircraft to ground based centres in real-time using secure and robust communications.



Ultra's advanced data link equipment for unmanned aircraft



Specialist cryptography equipment for secure communications



Ultra supplies secure battlefield radio communication systems



enhanced sonar capability



170,000

Ultra supplied over 170,000 sonobuoys in 2002 to a total of 15 countries around the world

Submarines pose an enormous threat to ships in wartime. Small, highly capable diesel electric submarines are difficult to detect especially when the underwater battlespace is noisy, cluttered, shallow coastal waters. Increasingly, though, this is where navies are having to operate. The threat of torpedo attack is ever present and, in times of war, mines may litter the coastal waters.

Ultra is the world leader at designing and supplying advanced sonobuoys, the highly sensitive acoustic sensors that are dropped from maritime patrol aircraft and helicopters. Ultra supplies more than half of the western world's sonobuoys. Dropping an array of active and passive sonobuoys into the sea allows even the quietest target submarine to be tracked and, if necessary, attacked. The signal from the sonobuoy, carrying acoustic information about the target, is relayed back to an aircraft overhead where Ultra's highly sensitive acoustic receivers and processors are used to evaluate the data. In the year,

ULTRA IS COMMITTED TO DEVELOPING WORLD-CLASS UNDERWATER BATTLESPACE EQUIPMENT TO MEET THE CHALLENGE OF TORPEDO ATTACK FROM MODERN, STEALTHY SUBMARINES.

Ultra upgraded the mission equipment on the UK's existing fleet of Nimrod MR2 aircraft and continued to supply systems for the new MRA4 Nimrod.

In this underwater battlespace, Ultra's commitment to providing ever more capable, cost-effective solutions has been rewarded in 2002. Ultra won all UK sonobuoy requirements, half of the contracts in the USA and Canada and important export contracts from France, Australia and Sweden. In late 2002, Ultra signed an intent to act in partnership with the UK MoD covering the development and procurement of future sonobuoy and derivative systems.

Modern warships are equipped with sensitive bow-mounted sonar equipment, a key element of the ship's own defences, which can detect submarines in the area or mines that are capable of disabling the ship if triggered. Ultra was awarded a major contract in the year to supply the UK's new Type 45 destroyer with its bow sonar system.

As a further layer of defence against torpedo attack, ships can be equipped with a torpedo defence system such as the Surface Ship Torpedo Defence (SSTD) system. In 2002, Ultra received the main contract to supply SSTD to the Royal Navy. The system detects and locates incoming torpedoes and provides the means to decoy or jam their homing mechanisms. It also gives the captain of the ship tactical advice on ship manoeuvres. Ultra has already successfully demonstrated the in-water performance of key elements of the SSTD system.

An even higher level of protection from attack can be provided around harbour entrances or in critical shipping lanes. Here, Ultra's expertise in expendable sonobuoys, data fusion and in-buoy processing is being used to develop long-life multi-sensor tactical surveillance systems.



Ultra is developing the bow sonar for the Type 45 destroyer



Ultra is the world-leading supplier of sonobuoy systems



The Nimrod MR2's mission system has been upgraded by Ultra

fulfilling the customer requirement

ULTRA PROVIDES A BROAD RANGE OF ADVANCED ELECTRONIC, ELECTROMECHANICAL AND MECHANICAL SOLUTIONS FOR THE MOST CHALLENGING OF CUSTOMER REQUIREMENTS.

Advanced

Ultra's advanced grips and hand controls are used on at least six different unmanned vehicle programmes

Ultra's products can be found on the world's latest aircraft, manned and unmanned, fixed and rotary wing. Ultra supports all stages of the customer programmes, from concept studies to in-service support.

The American F/A-18 E/F "Super Hornet" aircraft is flying extended missions over Afghanistan, fitted with Ultra's HiPPAG airborne compressor. HiPPAG provides a constant, controlled flow of high pressure pure air to cool the seekers of the aircraft's defensive missiles, keeping them ready for action. HiPPAG performs beyond the capability of the traditional solution, thereby meeting a vital operational requirement.

Ultra's HiPPAG controllable compressor is also part of Boeing's proposed new, high performance weapons ejection system for future smart munitions delivery systems. HiPPAG is also being developed for use on the new Lockheed Martin F-35 Joint Strike Fighter for smooth munitions ejection.

Ultra's advanced Human Computer Interface

(HCI) equipment is used not only in advanced cockpits such as that on Eurofighter but also in the control suite for unmanned aerial vehicles. In the USA, Ultra has accelerated the development and production of HCI equipment to support several such programmes. Ultra enhanced the scope of its supply of cockpit equipment on the EH101 helicopter to reduce Agusta Westland's total procurement cost.

Ultra is committed to supporting Pilatus in Switzerland with rapid development of the displays on the PC21 trainer aircraft so as to emulate the cockpit of the aircraft onto which the trainee pilot will graduate. This will be a key selling feature of the PC21 which had its first flight in mid-2002. Ultra also continued through the year managing the vital software upgrades of the weapons system of the Tornado aircraft. This is typical of the long-term support that Ultra offers to such programmes.

Ultra completed a highly successful demonstration of its unique active noise

cancellation equipment on a C130 aircraft. This trial improved the aircrew's working environment by reducing significantly the noise levels in the cockpit. Ultra also demonstrated its innovative active propeller balancing system on the powerplant for the existing fleets of C130 transport and P3 maritime surveillance aircraft.

Ultra frequently responds to urgent customer requirements. In the USA, Ultra met the need for rapidly prototyped driver's grips and handles for technology demonstrations to suit the Future Combat System armoured vehicle programme. In the UK, Ultra was selected to meet tight development timescales for the Alvis Vickers Engineer Tank System. The challenge has been met and consequently additions to the scope of the contract have been agreed. The Bowman programme in the UK upgrades the Army's communication system which will be incorporated on armoured vehicles. Ultra will be supplying equipment to help integrate Bowman with other advanced vehicle systems.



Ultra's landing gear controls will be on easyJet's Airbus aircraft



Advanced indirect vision systems for armoured vehicles



Ultra demonstrated cockpit noise reduction on C130 Hercules



improved information management

ULTRA SPECIALISES IN SYSTEMS THAT ENHANCE SAFETY, SECURITY AND THE EFFECTIVENESS OF CONTROL THROUGH THE PROVISION OF ACCURATE AND TIMELY DATA.

25 million

Ultra has sold printers and, in 2002, enough dye-film to create ID cards for over 25 million people

In the USA, the terrorist attacks of September 2001 highlighted the urgent need for an integrated real-time air picture, bringing together onto one display multiple radar plots and intelligence feeds. Ultra's Air Defense System Integrator (ADSI) product was ideally placed to act as the computing heart of this system and emergency funding was made available for the required development. Ultra's staff responded with enormous personal commitment to ensure that the need for enhanced security was met. The quality culture prevailing in the team was demonstrated when a 'right first time' pass was achieved after critical integration testing of an enhanced version of ADSI at a government test facility.

In the UK, Ultra responded to an urgent operational requirement by bidding, winning a contract, developing and delivering a mobile high technology multi-media communication system in less than twenty weeks. This equipment allows UK peace-

keeping forces to communicate effectively with the civilian population.

In the year, the Group made on-time deliveries of computers and display consoles for the UK Astute submarine programme. The equipment delivered to the integration facility included key elements of the weapons interfacing and combat management systems. Ultra is also supplying critical information processing and networking equipment as part of the command and control system for the Korean KDX range of destroyers. In 2002, Ultra won a contract to supply equipment for the second batch of three KDX-II ships.

Ultra's Olympus collaborative planning system allows real-time, highly mobile electronic sharing of geographic and tactical information. An upgrade to this innovative battlespace digitisation system was demonstrated that would enhance the command and control response to a major incident such as a chemical or biological terrorist attack.

Airports and airlines are able to improve the safety and security of commercial flights when a positive match is maintained between passengers and their baggage. The UltraTrak baggage reconciliation system is being supplied to both BA and Virgin in North America and to BAA plc for general use at London's Heathrow airport. In addition, through its airport IT business, the entire IT infrastructure at the new fifth terminal at Heathrow will be provided by Ultra. The relationship with BAA is built on trust with open collaborative working to meet a common goal including joint R&D activities.

At facilities such as airports, schools and similarly sensitive areas, access control is vital to minimise any risk to security. Ultra has expanded its range of ID card printers with holographic anti-counterfeiting technology. This has given Ultra a significant presence in this sector of the access control market.



Ultra's range of ID printers increases security of access control



Enhanced command and control for major incidents



Ultra's baggage tracking system used by both BA and Virgin

providing powerful solutions

ULTRA PROVIDES HIGHLY RELIABLE SOLID-STATE ELECTRICAL POWER SUPPLIES FOR USE WORLDWIDE IN MISSION-CRITICAL APPLICATIONS ON SHIPS, SUBMARINES AND MASS TRANSIT SYSTEMS.

Upgrade

Ultra will supply electrical sub-stations as part of Network Rail's upgrade programme for the Southern Region

Electrical power provides clean solutions. For naval vessels, solid-state electrical power supplies are more flexible and tolerant of battle damage than hydraulic systems, as well as being more reliable, smaller and lighter than rotary converters. For transport, electric rail systems are cleaner and more efficient than diesel trains or buses.

Rising populations and the concentration of those populations in relatively small areas have led to ever worsening traffic congestion and have emphasised the need for investment in advanced transportation systems. A key element of the solution is the provision or upgrade of mass transit systems. These usually require direct current electrical supplies and Ultra has powerful solutions to meet these customer requirements.

In the UK, Network Rail has embarked on a programme to upgrade the power supply for Southern Region trains serving London and the South East. Network Rail, aware that they are working to challenging timescales,

needed to build a strong team around them. They needed companies with the right technologies, skills and capacity and, above all, the right culture, attitude and will to succeed. In Ultra's PMES business, Network Rail found these attributes and, as a result, selected the division to play a key role in the solution to the Southern Region power supply challenge.

Ultra's record of meeting its commitments was reinforced during 2002 with the on-time design and delivery of modular sub-stations for installation at Fawkham Junction, to the south east of London.

Ultra's capability in transit power systems mirrors an equivalent capability for defence power systems. In the UK, the Astute class of submarine and the Type 45 destroyer are being developed and Ultra is providing critical power systems for both programmes.

For the Type 45 destroyer, Ultra is supplying a range of solid-state power supplies and associated control equipment. During the year

Ultra delivered power systems equipment for the first Astute submarine which included a range of specialist power supplies, all characterised by a need for the highest quality and integrity of supply. One example is the equipment that powers part of the submarine's nuclear reactor control system.

Ultra is also a world-leading supplier of equipment to sense and control the magnetic signature of naval vessels. These should be degaussed continuously to prevent them from triggering magnetic influence mines that may litter coastal waters in times of war. Ultra is providing this specialist equipment for modern day ships and submarines and, in 2002, was selected to supply the US Navy T-AKE class of cargo and ammunition ships.



Specialist power equipment for the USN Virginia submarines



Advanced signature management for the Type 45 destroyer

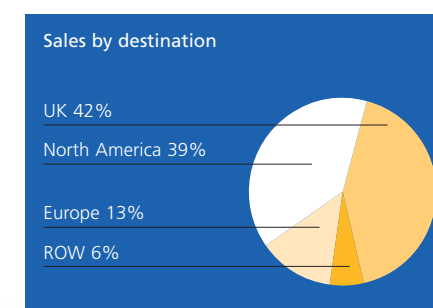
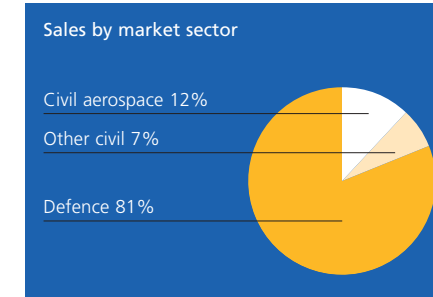


Magnetic signature management for USN T-AKE cargo ships

sales rose by 9% to £260.4m... a record level for the Group



David Jeffcoat, Finance Director and Company Secretary



Trading results

Sales rose by 9% to £260.4m, a new record level for the Group. Underlying organic growth was 6% with an additional contribution from Tactical Communication Systems (TCS), acquired in September. Operating profit before goodwill amortisation was 6% higher at £33.5m, giving an operating margin of 12.9% (2001: 13.2%). This encouraging result was achieved in spite of lower sales and further reorganisation costs in Ultra's civil aerospace businesses, negative currency translation effects and higher insurance premiums resulting from the 11 September 2001 terrorist attacks.

Ultra increased its sales in North America, where the share of total Group sales rose to 39% (2001: 35%). The rapid increase in Battlespace IT spending by the US DoD is a key driver of this trend and sonobuoy sales were also strong in 2002. Ultra reduced its dependence on the UK with sales dropping to 42% of turnover in the year (2001: 47%). Sales in Continental Europe remained at 13% of sales, with HiPPAG equipment for Eurofighter and Airbus landing gear computers the main elements.

2002 saw Ultra's defence sales rise above 80% of turnover. This was caused by a combination of lower civil aerospace sales, higher defence sales in the USA and the acquisition of TCS, which is solely a defence manufacturer. Civil aerospace activity, at 12% of Group turnover, formed the major part of Ultra's sales to the civil sector.

Group-funded R&D expenditure was £10.7m (2001: £10.0m). Including customer funding the total investment in new product development was £58.6m (2001: £50.1m), equivalent to 22% of turnover. The biggest development programmes were Ultra's Air Defense Systems Integrator in the USA, equipment for Astute and the important new Surface Ship Torpedo Defence system in the UK.

Interest and profit before taxation

Interest costs were significantly lower at £3.5m, compared to £4.6m in 2001. This was due partly to lower borrowings, as the Group benefited from its recent strong cash performance. In addition the interest rates that applied to Ultra's floating rate debt were lower than in 2001. This saving in interest costs increased profit before tax and goodwill amortisation to £29.9m, 11% more than in 2001 (£27.1m). The interest charge was covered 9.5 times by operating profit before goodwill amortisation. Amortisation of goodwill and intangibles increased to £3.9m (2001: £3.7m) with £0.26m being charged for the new acquisition, TCS.

Taxation

The effective tax rate on profit before amortisation was 27%. This is 1% higher than the 2001 rate, which was restated to reflect the adoption of the new accounting standard FRS 19 in 2002. The new standard has also led to the recognition of deferred tax assets, brought about mainly by timing

differences and tax deductible goodwill in the USA. The net deferred tax asset was £0.2m at the end of the year.

Earnings per share and dividends

Earnings per share before amortisation increased by 9% to 33.2p despite the higher tax rate. The proposed final dividend is 7.5p, bringing the total dividend to 11.2p (2001: 10.4p), an increase of 8%. The full year dividend is covered 3.0 times by earnings per share before amortisation, maintaining a policy of strong dividend cover.

Cash flow and borrowings

With its focus upon long-term contracts, Ultra regards cash performance as a key indicator of its financial strength. It is therefore encouraging that operating cash flow, after capital expenditure, was £38.7m in the year (2001: £35.2m). The ratio of operating cash to operating profit was 116%, bringing the average conversion ratio to 85% over the past five years. Investments in fixed assets were £3.3m, approximately £0.5m less than the depreciation charge and indicative of Ultra's low dependence on fixed capital investment. Operating working capital was reduced by £4.9m in spite of the 6% organic increase in turnover. As a result of this strong cash performance, free cash flow before dividends and acquisitions was £28.0m. Despite making the investment in TCS, net debt fell by £1.3m to close the year at £39.3m.

Acquisition

Ultra acquired TCS, based in Montreal, Canada, in September 2002 for a cash consideration of C\$53m (£21.5m). The net assets acquired have been valued provisionally at £1.6m. The balance of the acquisition cost will be capitalised as goodwill and amortised over twenty years, increasing the Group's annual amortisation charge by approximately £1.0m.

After initial reorganisation costs, TCS made a £0.5m operating profit before goodwill amortisation in its first three months under Ultra ownership. The business should make a positive contribution to profit after financing costs during the coming year.

Financial risk management

Ultra's financial instruments, other than derivatives, comprise borrowings, cash and trade funding consisting of debtors, creditors and customer advances. Group policy prohibits speculative transactions and no trading activity in financial instruments is undertaken. Treasury policies are determined by the Group Finance Director, based on forecast business requirements, and are reviewed regularly.

Financing

The Group finances its existing operations and new acquisitions through a mix of retained cash and bank borrowings. During 2002 Ultra established a new £80m three-year revolving credit facility with a small syndicate of banks, led by The Royal Bank of Scotland. There will be no interim repayments during the term of the facility. It is denominated in a range of currencies to meet balance sheet hedging and

operational needs. Both the Sterling and US Dollar elements of the facility will fund working capital requirements. The US and Canadian Dollar borrowings will provide hedges for assets denominated in those currencies. A further £10m overdraft is also available for working capital funding.

The new facility replaces a five-year term loan used to finance the acquisition of the DF Group in 2000. An interest rate swap that fixed the effective interest rate at 7.7% for the full term of the original loan will remain in place until April 2005, despite the refinancing. At 31 December 2002, 48% of total debt was at floating rates after taking account of the swap, which applied to the first £16.5m of debt.

Foreign currency exposure

Ultra's main translation exposure is to the US Dollar with lesser exposure to the Canadian Dollar. The average Sterling exchange rate against these currencies strengthened by 6% during the year, leading to a reduced contribution from Ultra's North American subsidiaries when their results were translated into Sterling. The impact upon Group sales and profits was a reduction of approximately 2% in both cases.

The principal currency transaction exposure is to the US Dollar as virtually all civil aerospace sales are denominated in US Dollars. Group policy is to hedge the net exposure on orders in hand using forward foreign exchange contracts, typically extending to 18-24 months. Exposure to the Canadian Dollar and the Euro is hedged in the same way. Any

exposure to other currencies is hedged as it arises on specific contracts.

Pensions

The retirement benefits of Ultra's UK workforce are funded by a combination of defined benefit and defined contribution pension schemes, with most staff participating in the Ultra Electronics Ltd. defined benefit scheme. This scheme was actuarially assessed in April 2001 when its solvency was 105%, or 115% on an MFR basis. As a result of stockmarket falls since then, the Company has committed to raise its contributions to the scheme from 10% to 13.5% of pensionable pay by 2003, a total increase of approximately £0.9m per annum. The scheme is relatively immature, with just 13% of retired members, and remains strongly cash positive. Ultra's US subsidiaries and Maritime Systems Inc. in Canada operate defined contribution schemes. Employees at TCS participate in a limited defined benefit scheme. Note 24 to these accounts contains additional disclosures on Ultra's defined benefit pension funding position in accordance with UK Financial Reporting Standard FRS 17 – Retirement Benefits. The FRS 17 valuation at the end of 2002 showed a deficit of £20.4m (2001: £7.1m), after deducting the associated deferred tax asset.

David Jeffcoat, Finance Director and Company Secretary



Peter Macfarlane* FCA FCT, Non-Executive Chairman, age 64, qualified as a Chartered Accountant with Touche Ross and, after three years with Coopers & Lybrand joined Kimberley Clark, managing their financial affairs in Europe, Africa and the Middle East. He joined Rolls Royce in 1979 as Group Treasurer and, after a period as Director of Corporate Development, was appointed Finance Director in 1989. Mr Macfarlane retired from the board of Allied Domecq plc in 1998 where he had been initially Finance Director and subsequently Chairman of two divisions. He was appointed to the board of Ultra in January 1995.

Julian Blogh CBE BA MSc PhD CEng MIEE, Chief Executive, age 59, has spent most of his working life in the electronics industry working with Ferranti Radar, Plessey Radar and Dowty Electronic Systems. He was Managing Director of Sonar & Communication Systems from 1987 to 1992, when he was appointed Managing Director of Dowty Avionics. He became Chief Executive of Ultra Electronics when it began trading in October 1993.

Douglas Caster BSc MIEE, Managing Director, Information & Power Systems, age 49, started as a Design Engineer with Racal in 1975, before moving to Schlumberger and then to Dowty as Engineering Director of Sonar & Communication Systems in 1988. In 1992, he became Managing Director of that division and joined the board of Ultra in October 1993. In 1999 he became Managing Director of Command & Control Systems with responsibility for Ocean Systems, PMES, and APC. In April 2000, he was appointed to his current position.

Andrew Hamment BA, Marketing Director, age 48, started his career with Hawker Siddeley before moving to Schlumberger in 1980, working in procurement and then marketing at Weston Aerospace before transferring to Solartron as Aerospace Business Manager. He joined Dowty in 1988 as Managing Director of the Controls business. He was appointed to his current position in July 2000 and joined the board at that time.

Sir Frank Holroyd* KBE CB MSc FEng CEng FRAeS FIEE CIMgt, Non-Executive Director, age 67, retired from the RAF in 1991 as Air Marshal after 35 years' service, latterly as Chief of Logistics and Chief Engineer; formerly Chief Engineer of Strike Command and Director General of Procurement (MoD) for Strategic Electronic Systems. He is Chairman of Composite Technology Ltd, Deputy Chairman of Military Aircraft Spares Ltd and Deputy Chairman of Council at Cranfield University. Sir Frank was appointed to the board of Ultra in March 1995.

Frank Hope BSc PhD CPhys MInstP, Managing Director, Aircraft & Vehicle Systems, age 48, started his career with Tecalemit as a design engineer working on robotics. He spent 13 years with Avimo Limited latterly as Managing Director, having previously held the positions of Technical Director and Operations Director. He joined Ultra in 1994 as Managing Director of the Electrics Division and was appointed to the board of Ultra in January 1999. In April 2000 he was appointed to his present position.

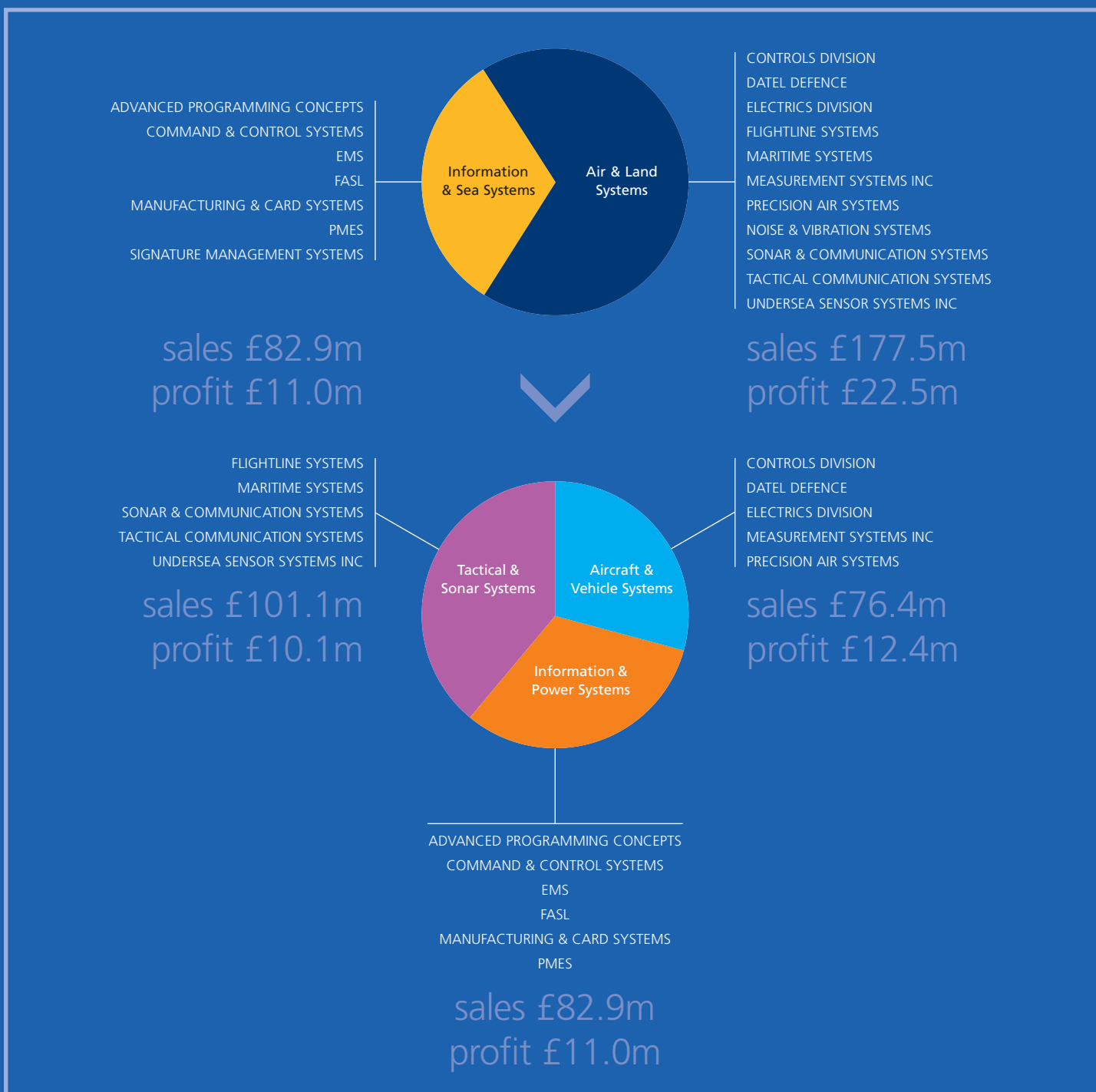
David Jeffcoat BA FCMA, Finance Director and Company Secretary, age 52, started his career in the motor industry as a Production Engineer. Since qualifying as an accountant he has held senior financial positions in several large corporations including GlaxoWellcome plc, where he was Finance Director of two subsidiaries. Before joining Ultra he was Group Financial Controller of Smiths Industries plc for three years. He was appointed to the board in July 2000.

Andrew Walker* MA CEng, Senior Non-Executive Director, age 51, was appointed to the board in June 1996. Joining the Dowty Group plc in 1978, he became an operating board member during 1991/92. Following TI Group's acquisition of Dowty, he became Managing Director of John Crane Polymer Engineering. He was Chief Executive of South Wales Electricity plc (SWALEC) from 1993 to 1996, and was Chief Executive of McKechnie plc from 1997 to 2001. In 2000, he successfully led the MBO of McKechnie plc. Mr Walker is also a non-executive director of Galileo Innovations plc and Bioganix Limited.

*Audit and Remuneration Committee members

evolution

ULTRA ELECTRONICS HAS EXPANDED SUBSTANTIALLY SINCE ITS FORMATION. FROM JANUARY 2003, THE GROUP WILL BE ORGANISED INTO THREE DIVISIONS AS SHOWN BELOW. THE NEW DIVISIONAL NAMES MORE ACCURATELY REFLECT THE ACTIVITIES OF THE BUSINESSES IN EACH DIVISION.



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