Ultra Electronics Holdings plc

Interim Report and Accounts **2003**

Ultra Electronics is a group of specialist businesses designing, manufacturing and supporting electronic and electromechanical systems, sub-systems and products for aircraft, ships, submarines, armoured vehicles, airports and transport systems worldwide.

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 in 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.

THE QUEEN'S AWARDS FOR ENTERPRISE: INNOVATION 2000

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

THE QUEEN'S AWARDS FOR ENTERPRISE: INTERNATIONAL TRADE 2003

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

Chairman's Statement

Financial Results

Ultra's performance in the first half of 2003 was very encouraging with record sales and profits and strong cash generation.

Sales increased by 8.0% to £135.7m, compared to £125.6m in the same period last year. Organic sales increased by 1% in local currencies compared to the first half of 2002, offset by a 3% reduction in sterling terms for the US dollar translation effect. This growth reflected a strong performance in the Aircraft & Vehicle Systems division, with increased sales of HiPPAG and equipment for armoured vehicles. The Group's Information & Power Systems businesses also performed well, reflecting higher defence spending in the Battlespace IT sector. Tactical Communication Systems, acquired in September 2002, boosted the performance of Ultra's Tactical & Sonar Systems division.

Operating profit before goodwill amortisation was 11.4% higher at £17.4m (2002: £15.6m). The operating margin improved to 12.8% (2002: 12.4%) which was due mainly to an increased level of higher margin aerospace spares and repairs activity. The interest charge dropped by £0.3m and profit before tax and amortisation rose to £15.8m, a 14.9% increase when compared to last year's result of £13.8m. Earnings per share before amortisation of goodwill grew by 14.8% to 17.6p (2002:15.3p).

Ultra achieved excellent operating cash generation in the period of £18.4m (2002: £11.9m) after capital expenditure, a conversion rate from operating profit of 106%. After non-operating payments including interest, taxation and dividends of £13.0m (2002: £8.2m), net debt was £33.9m at the period end, a reduction of £5.4m since the beginning of the year. The strength of the Group's balance sheet is demonstrated by a first half interest cover of approximately eleven times.

An interim dividend of 4.1p (2002: 3.7p) will be paid on 26 September 2003 to those shareholders on the register at the close of business on 29 August 2003.

Markets

Equipment that provides mobility and the rapid and secure management of vital information remains a key focus in all of Ultra's main defence markets. There has been particular emphasis on Battlespace IT systems that facilitate the exchange, networking and interoperability of data. In the USA, which accounts for around 35% of Ultra's sales, defence and related budgets continue to increase significantly. Real budget growth has been less rapid in the UK, although expenditure is rising on specific equipment programmes in which Ultra is involved. Worldwide, budgeted levels of expenditure on Anti-Submarine Warfare (ASW) equipment are reducing, as anticipated, although a number of new ASW aircraft are currently under development. Demand for longer life distributed sensor systems, using sonobuoy-like technology, is rising.

The civil aerospace sector remains soft and build rates for new aircraft are flat at best. There has, however, in recent months been some evidence of a recovery in demand for after-market products and services. Infrastructure investment at selected airports around the world has continued in anticipation of a medium-term increase in passenger traffic. There is an increased focus on systems, including IT, that can make travel easier whilst maintaining an appropriate level of security and control.

Operational Review

Aircraft & Vehicle Systems

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

Total sales increased by 12.3% to £40.6m (2002: £36.2m) and the operating profit before goodwill amortisation was £7.1m compared with £6.1m last year, an increase of 16.0%. The order book reduced by 3.2% to £80.1m (December 2002: £82.8m) mainly reflecting the sales made against multi-year Eurofighter contracts.

The sales growth resulted from a significant increase in sales of the HiPPAG airborne compressor, additional sales of equipment for armoured vehicles and some recovery in the civil aerospace after market. In the period, HiPPAG, according to the US Navy, “significantly enhanced the combat readiness and deployability” of the F/A-18 aircraft during military operations in Iraq. Ultra has received a contract to adapt HiPPAG to meet the requirements of the F-35 Joint Strike Fighter. The Group has also continued to win contracts for hand controls for unmanned aerial vehicles, particularly in the USA. Sales of cockpit equipment for the Eurofighter programme increased in the first half as did activity levels associated with the development of the electronics systems for the UK Army’s Engineer Tank System. Also in the period, Ultra achieved further sales of its innovative Internet-based shared working environment to the UK Defence Procurement Agency.

Tactical & Sonar Systems

Includes secure tactical line-of-sight radio systems, multiplexers and switches; tactical datalinks; cryptographic equipment; active, passive and multi-static sonobuoys; sonobuoy receivers and processors; distributed surveillance sensor arrays; ship’s sonar systems and ship’s torpedo defence systems.

Total sales increased by 7.8% to £53.3m (2002: £49.4m) and operating profit before goodwill amortisation was £5.4m (2002: £5.3m). The order book at the end of the period reduced by 2.5% to £192.0m (December 2002: £196.8m) reflecting sales made against the long-term contracts in this division.

The anticipated reduction in the level of sales of Ultra’s Anti-Submarine Warfare (ASW) equipment affected turnover in the period although the Group has continued to win orders for sonobuoys in the international market. However, the large development programmes for naval systems, including the Type 45 sonar and the Royal Navy’s new torpedo defence system, are on schedule. Tactical Communication Systems in Canada, acquired in September 2002, has been integrated into the Group and is performing ahead of budget; the next tranches of orders for its tactical radio communication systems from the armies of the USA and South Korea were received in the period.

Information & Power Systems

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

Information & Power Systems recorded a good performance in the first half, with sales growth of 4.4% to £41.8m (2002: £40.0m) and a 15.0% increase in operating profit before goodwill amortisation to £4.8m (2002: £4.2m). Encouragingly, the order book increased by 27.2% to £87.1m (December 2002: £68.4m).

This result reflected the continuing growth in the Group’s Battlespace IT activities, with sales of the ADSI real-time command and control system up almost 10% on the equivalent period in 2002. In the UK, Ultra has started to supply equipment relating to the Army’s Bowman digitisation programme. In Airport IT, Ultra is now benefiting from having won contracts to integrate IT systems at airports such as Toronto and Kansas City, and at the new fifth terminal at London Heathrow. In addition, the Group was selected to install its UltraTrak baggage reconciliation system at Terminals 1, 2 and 3 at Heathrow. Market acceptance of Ultra’s expanded range of ID card printers has been good during the first half. Finally, in the period, the first installation took place of Ultra equipment to support the upgrade of the power supply for Network Rail’s southern region.

Chairman’s Statement

Pensions

Changes have been made to the Group’s UK defined benefit pension scheme to reduce the long-term uncertainty, and therefore risk, that previously existed. The £0.4m increase in pension contributions this year, that was mentioned in the 2002 preliminary results announcement, has been implemented. Additionally, employees’ contributions will increase by 2.0% by April 2004, equivalent to an extra £0.5m in a full year. The scheme has now also been closed to new members who will be offered a new defined contribution arrangement.

Prospects

The Group’s order book stood at £359m at the end of June (December 2002: £348m) representing approximately 15 months of future sales. This reflects the continuing supply of equipment on existing platforms for which there are firm contracts as well as new programmes won.

The infrastructure investment programmes for airports and airlines in which Ultra is involved will continue, as will Network Rail’s investment programme for the southern region power supply. Whilst no increase in the rate of build of new aircraft in civil aerospace is assumed before the end of 2004, it is anticipated that the partial recovery in the after-market will be sustained.

Additional ASW platforms are being developed, incorporating Ultra equipment, which are expected to drive a longer-term increase in sonobuoy usage. New longer life sensor systems, utilising technology derived from sonobuoys, are also in development. However, sales of sonobuoys are expected to reduce further in 2004 despite an initial contribution from advanced new sonobuoy systems entering development.

Strong growth in expenditure on defence equipment in the USA is forecast to continue and Ultra is well positioned to benefit from this. There will be a continuing focus on equipment to improve the connectivity of systems and to increase the tempo of battle and these are areas where Ultra has distinct expertise.

The broad spread of Ultra’s activities, mostly within the defence sector, its strong order book and proven ability to execute programmes successfully give an excellent basis for continued progress in the medium term. Two acquisitions have been made since the period end, SML Technologies and Radamec Defence Systems, for a combined cost of £12.5m. Both businesses are involved in Battlespace IT activities and will be part of the Group’s Information & Power Systems division. They will strengthen Ultra by complementing the high technology products and services that the Group provides to its customers.

The Board expects Ultra’s results for the full year to be broadly in line with current market expectations with growth continuing in the medium term.

Peter Macfarlane **Chairman**
4 August 2003

Ultra Electronics Holdings plc

Consolidated Profit & Loss Account

	Note	**Six months to 30 June 2003** £000	Six months to 30 June 2002 £000	Year to 31 December 2002 £000
Turnover				
– existing operations	1, 2	**135,669**	125,597	260,352
Operating profit before goodwill amortisation				
– existing operations		**17,365**	15,588	33,453
Goodwill amortisation				
– existing operations		**(2,320)**	(1,809)	(3,875)
Operating profit				
– existing operations		**15,045**	13,779	29,578
Net interest payable		**(1,518)**	(1,794)	(3,533)
Profit before taxation		**13,527**	11,985	26,045
Taxation	3	**(4,231)**	(3,724)	(8,099)
Profit after taxation		**9,296**	8,261	17,946
Dividends	4	**(2,731)**	(2,438)	(7,385)
Retained profit		**6,565**	5,823	10,561
Earnings per share (pence)				
After goodwill amortisation				
– Basic	5	**14.1**	12.6	27.3
– Diluted	5	**14.0**	12.5	27.3
Before goodwill amortisation				
– Basic	5	**17.6**	15.3	33.2

Consolidated Balance Sheet

	Note	**At 30 June 2003** £000	At 30 June 2002 £000	At 31 December 2002 £000
Fixed assets				
Tangible assets		**16,829**	14,484	15,180
Intangible assets – patents and trademarks		**582**	628	605
Intangible assets – goodwill		**78,630**	62,603	80,871
Investments		**1,527**	1,346	1,050
		97,568	79,061	97,706
Current assets				
Stocks		**21,004**	26,130	23,834
Debtors		**58,636**	53,384	57,579
Cash at bank and in hand		**13,104**	9,503	8,132
		92,744	89,017	89,545
Creditors: Amounts falling due within one year		**(73,633)**	(89,602)	(80,622)
Net current assets/(liabilities)		**19,111**	(585)	8,923
Total assets less current liabilities		**116,679**	78,476	106,629
Creditors: Amounts falling due after more than one year		**(50,377)**	(25,060)	(46,126)
Provisions for liabilities and charges		**(5,589)**	(3,246)	(4,822)
Net assets		**60,713**	50,170	55,681
Capital and reserves				
Called-up share capital		**3,312**	3,294	3,302
Share premium account		**27,626**	26,225	26,891
Profit and loss account	6	**29,775**	20,651	25,488
Shareholders' funds		**60,713**	50,170	55,681

Ultra Electronics Holdings plc

Consolidated Cash Flow Statement

	Note	**Six months to 30 June 2003**	Six months to 30 June 2002	Year to 31 December 2002
		£000	£000	£000
Net cash inflow from operating activities	7	**22,636**	13,878	42,765
Returns on investments and servicing of finance		**(1,586)**	(1,527)	(3,414)
Taxation		**(4,750)**	(3,122)	(7,279)
Capital expenditure and financial investment		**(4,203)**	(1,934)	(4,076)
Acquisitions		**(79)**	(50)	(21,996)
Equity dividends paid		**(4,959)**	(4,606)	(7,045)
Cash inflow/(outflow) before use of liquid resources and financing		**7,059**	2,639	(1,045)
Financing		**(2,685)**	(9,015)	(6,381)
Increase/(decrease) in cash in the period		**4,374**	(6,376)	(7,426)
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT				
Increase/(decrease) in cash in the period		**4,374**	(6,376)	(7,426)
Cash outflow from decrease in debt and lease financing		**3,453**	9,458	7,369
Change in net debt resulting from cash flows		**7,827**	3,082	(57)
Amortisation of finance costs of debt		**(49)**	(190)	(196)
Translation difference		**(2,377)**	733	1,559
Decrease in net debt in the period		**5,401**	3,625	1,306
Net debt at start of period		**(39,256)**	(40,562)	(40,562)
Net debt at end of period		**(33,855)**	(36,937)	(39,256)
ANALYSIS OF NET DEBT				
Cash at bank and in hand		**13,104**	9,503	8,132
Debt due within one year		**126**	(25,345)	(1,219)
Debt due after one year		**(47,085)**	(21,000)	(46,126)
Finance leases		**-**	(95)	(43)
		(33,855)	(36,937)	(39,256)

Consolidated Statement of Total Recognised Gains and Losses

	Six months to 30 June 2003	Six months to 30 June 2002	Year to 31 December 2002
	£000	£000	£000
Group profit for the period	**9,296**	8,261	17,946
(Loss)/gain on foreign currency translation	**(2,278)**	240	474
Adjustment in respect of the adoption of FRS 19 for prior years	**-**	1,162	1,162
Total recognised gains and losses relating to the period	**7,018**	9,663	19,582

Notes to the Interim Statement

1. Divisional analysis

	Six months to 30 June 2003	Six months to 30 June 2002	Year to 31 December 2002
	£000	£000	£000
Turnover			
Aircraft & Vehicle Systems	**40,620**	36,178	76,427
Information & Power Systems	**41,769**	39,999	82,859
Tactical & Sonar Systems	**53,280**	49,420	101,066
	135,669	125,597	260,352
Profit			
Aircraft & Vehicle Systems	**7,125**	6,143	12,495
Information & Power Systems	**4,796**	4,172	10,989
Tactical & Sonar Systems	**5,444**	5,273	9,969
	17,365	15,588	33,453
Goodwill amortisation	**(2,320)**	(1,809)	(3,875)
Operating profit	**15,045**	13,779	29,578

2. Turnover by geographical destination

	Six months to 30 June 2003	Six months to 30 June 2002	Year to 31 December 2002
	£000	£000	£000
United Kingdom	**55,916**	55,023	110,547
Continental Europe	**17,384**	15,947	33,700
North America	**49,261**	49,513	100,549
Rest of World	**13,108**	5,114	15,556
	135,669	125,597	260,352

3. Taxation

	Six months to 30 June 2003	Six months to 30 June 2002	Year to 31 December 2002
	£000	£000	£000
United Kingdom			
– Corporation tax	**3,096**	3,015	6,662
– Deferred tax	**268**	180	482
	3,364	3,195	7,144
Overseas			
– Corporation tax	**1,098**	578	895
– Deferred tax	**(231)**	(49)	60
	867	529	955
Total tax on profit on ordinary activities	**4,231**	3,724	8,099

The tax charge for the six months to 30 June 2003 has been based on an estimated effective rate, before amortisation of goodwill, for the year to 31 December 2003 of 26.7% (30 June 2002: 27.0%).

4. The proposed interim dividend of 4.1p per ordinary share (30 June 2002: 3.7p) will be paid on 26 September 2003 to shareholders on the register on 29 August 2003.

5. Earnings per share

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

	Six months to 30 June 2003	Six months to 30 June 2002	Year to 31 December 2002
	No. of shares	No. of shares	No. of shares
Number of shares used for basic EPS	**66,005,283**	65,706,837	65,647,904
Number of shares deemed to be issued at nil consideration following exercise of share options	**180,770**	285,826	174,036
Number of shares used for fully diluted EPS	**66,186,053**	65,992,663	65,821,940

5. Earnings per share (continued)

Earnings attributable to ordinary shareholders:

	Six months to 30 June 2003	Six months to 30 June 2002	Year to 31 December 2002
	£000	£000	£000
After goodwill amortisation	**9,296**	8,261	17,946
Before goodwill amortisation	**11,616**	10,070	21,821

6. Profit and loss account

Goodwill, representing the excess of the fair value of consideration given over the fair value of separable net assets acquired, is capitalised as an intangible asset and is amortised over a period of 20 years, being the Directors' assessment of its likely future value. Provision is made for any impairment. For acquisitions made prior to 30 December 1997, goodwill was considered separately for each acquisition and was written off immediately to the goodwill reserve, reflecting the Directors' assessment of its likely future value to the Group. This reserve, amounting to £33,294,000 at 30 June 2003, 31 December 2002 and at 30 June 2002, has since been offset against the profit and loss account.

7. Cash flow information

Reconciliation of operating profit to operating cash flow

	Six months to 30 June 2003	Six months to 30 June 2002	Year to 31 December 2002
	£000	£000	£000
Operating profit	**15,045**	13,779	29,578
Depreciation and amounts written off tangible fixed assets	**2,032**	1,948	3,771
Amortisation of goodwill	**2,320**	1,809	3,875
Amortisation of patents and trademarks	**23**	22	45
Provision against investments	**359**	272	604
Loss/(profit) on disposal of tangible fixed assets	**14**	(7)	(11)
Decrease/(increase) in stocks	**3,466**	(4,435)	623
(Increase)/decrease in debtors	**(409)**	1,445	(3,240)
(Decrease)/increase in creditors	**(404)**	(876)	6,161
Increase/(decrease) in provisions	**323**	(76)	1,410
Other	**(133)**	(3)	(51)
Net cash inflow from operating activities	**22,636**	13,878	42,765

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

The unaudited accounts for the half years ended 30th June 2003 and 30th June 2002 have been prepared on a basis consistent with the statutory accounts for the year ended 31st December 2002. Those statutory accounts received an unqualified auditor's report and have been filed with the Registrar of Companies. A copy of this interim statement is being sent to all shareholders, and will shortly be available on Ultra's web site: www.ultra-electronics.com. Further copies may be obtained from Ultra's registered office: 417 Bridport Road, Greenford, Middlesex, UB6 8UA.

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