Ultra Electronics Holdings plc
Annual Report and Accounts 2016

Why Ultra?

We enjoy solving tough problems, beating our competitors and **making a difference** for our **customers**, **shareholders** and **employees.**

Financial highlights

Revenue

£785.8m **+8.2%**

(2015: **£726.3m**)

Underlying profit before tax*

£120.1m **+6.8%**

(2015: **£112.4m**)

Dividend per share

47.8p **+3.7%**

(2015: **46.1p**)

Underlying earnings per share*

134.6p **+8.6%**

(2015: **123.9p**)

Underlying operating profit*

£131.1m **+9.3%**

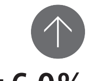
(2015: **£120.0m**)

IFRS operating profit

£89.7m **+35.1%**

(2015: **£66.4m**)

Group order book



£799.3m **+6.0%**

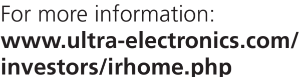
(2015: **£753.8m**)

Dividend

The proposed final dividend is **33.6p**, bringing the total dividend for the year to **47.8p** (2015: 46.1p). This represents an annual increase of **3.7%**, with the dividend being covered **2.8 times** (2015: 2.7 times) by underlying earnings per share. If approved at the Annual General Meeting, the dividend will be paid on 4 May 2017 to shareholders on the register on 7 April 2017.

Operational highlights

- The award of an $18m contract to provide Electronic Warfare equipment to a NATO country for use in unmanned surveillance aircraft.
- Securing a £16m programme for the continued support of our world-leading software-defined encryption device (ECU RP) for the UK Ministry of Defence (MoD).
- A $34.6m award for the critical infrastructure protection and cyber security for US naval bases.
- Securing a $27m contract with Lockheed Martin for development and production of an acoustic nose array for the US Navy Mark 48 (MK 48) torpedo programme.
- Successful delivery of a ship refit and modernisation upgrade of a Fatahillah-class corvette for the Indonesian Navy, and award of a contract for the restoration and sustainment of two Philippines Jacinto-class patrol vessels.
- A multi-year agreement for supply of Canadian sonobuoys to the South Korean P-3C maritime patrol aircraft, worth Canadian $14.9m.



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

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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 **144**

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.

Our vision

Why?
We enjoy solving tough problems, beating our competitors and making a difference for our customers, shareholders and employees.

How?
We innovate to disrupt market dynamics.

What?
We offer superior solutions in regulated markets.

Ultra has developed its vision using the Simon Sinek Inc. "Golden Circle".

Our business model

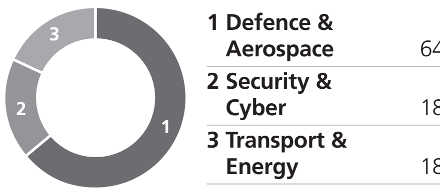
The value we create through our business model enables us to achieve our strategic objective.

See full details of Ultra's business model on pages **8** and **9**

How and where Ultra operates

2016 saw the embedding of Ultra's three new Divisions; Aerospace & Infrastructure, Communications & Security and Maritime & Land, through which it delivers and reports its performance. Ultra's Divisions deliver specialist capabilities to our key end markets of **Defence & Aerospace**, **Security & Cyber**, **Transport** and **Energy**. The Group addresses these end markets through eight distinct market segments, discussed on pages **14** to **21**.

Ultra's place in the market



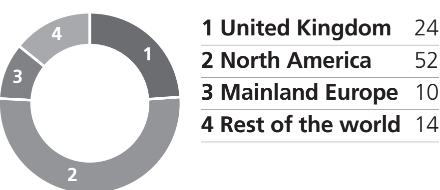
1 Defence & Aerospace	64
2 Security & Cyber	18
3 Transport & Energy	18

% of Group revenue **by market**

Ultra continues to focus on its main markets of **Defence & Aerospace**, **Security & Cyber**, **Transport** and **Energy**. To explain its wide portfolio of capabilities more effectively, the Group uses market segmentation. Each of the **eight segments** generate highly-differentiated, cost-effective and proven technologies at the system, sub-system and component level. These technologies are often fundamental to the performance, safety or mission success of the platforms in which they are incorporated, making Ultra a critical supplier on many complex platforms, enjoying long-term positions.

The segment structure allows Ultra to harness the capabilities of its **19 businesses** together, providing technical expertise and domain knowledge to deliver the adaptable, comprehensive and cost-effective solutions customers demand. Where required, the Group will seek partners with best-of-breed suppliers to offer a more complete solution and will seamlessly "lead or follow" as a non-threatening mid-tier company in order to satisfy customer needs. Equally, individual businesses continue to develop and supply the specific high-end technologies for which they are well known, providing the agility and responsiveness of a smaller, autonomous business unit. To maintain its position, the Group harnesses both internal and customer-funded research and development, tailoring its solutions to changing customer needs and budgets. This sustains the Group's reputation as an innovative supplier of enabling technology.

Where Ultra operates

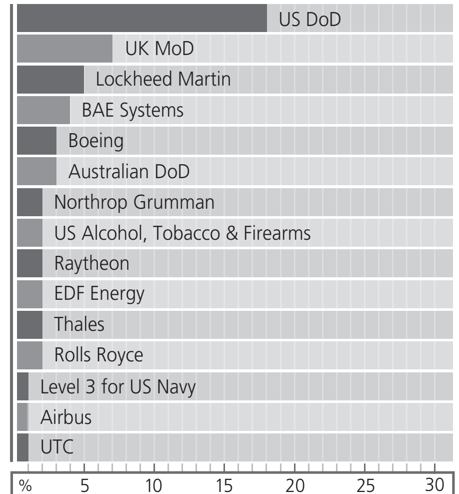


1 United Kingdom	24
2 North America	52
3 Mainland Europe	10
4 Rest of the world	14

% of Group revenue **by region**

Ultra's core markets remain North America and the United Kingdom. In mainland Europe the Group generally supplies technologies that are unavailable from indigenous suppliers, for example, sonobuoys. Given this relatively low exposure to mainland Europe, the UK decision to exit the EU (BREXIT) has not had a significant specific impact on the Group, global macroeconomic impacts aside. Elsewhere in the world, the Group has developed strategic positions in its target regions of Australia, the Middle East, India, and (for non-defence products) China, while continuing to pursue individual opportunities and business relationships in many other nations. Looking ahead, Japan is considered a promising market for Ultra. 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.

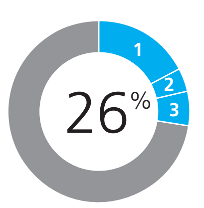
Ultra's customers



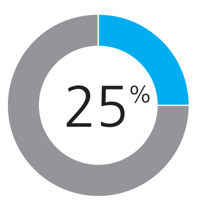
This market position, together with Ultra's independence, allows the Group to work closely with the world's prime contractors in our chosen markets. The chart above shows Ultra's major customers, including the US Department of Defense (DoD), the UK Ministry of Defence (MoD) and Lockheed Martin. The Group supplies to a wide range of project offices, integrated project teams and platform teams, having a larger number of different partners and customers than the chart might at first suggest, and executing against tens of thousands of contracts and production orders on an annual basis.

See Ultra's business model on pages **8** and **9**

Aerospace & Infrastructure



% of Group revenue



% of Group profit*

Market segments

1. Aerospace

2. Infrastructure

3. Nuclear

Revenue

£204.7m +6.0%

2015: **£193.2m**

Underlying operating profit*

£32.4m +12.9%

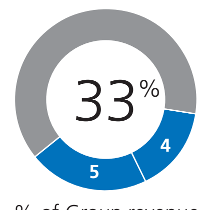
2015: **£28.7m**

Order book

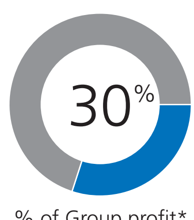
£267.8m +0.9%

2015: **£265.4m**

Communications & Security



% of Group revenue



% of Group profit*

Market segments

4. Communications

5. C2ISR+

Revenue

£259.0m +8.2%

2015: **£239.3m**

Underlying operating profit*

£39.7m -1.7%

2015: **£40.4m**

Order book

£227.0m +6.2%

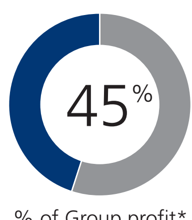
2015: **£213.7m**

+ **Command & Control, Intelligence, Surveillance and Reconnaissance**
Ultra's Cyber capabilities sit primarily in C2ISR and Communications, but run across all eight segments

Maritime & Land

41%

% of Group revenue



% of Group profit*

Market segments

6. Underwater warfare

7. Maritime

8. Land

Revenue

£322.1m +9.6%

2015: **£293.8m**

Underlying operating profit*

£59.0m +15.9%

2015: **£50.9m**

Order book

£304.5m +10.8%

2015: **£274.7m**

For more information on Ultra's Divisions see pages **30-35**

*see footnote on page **144**

Chief Executive's review

Rakesh Sharma
Chief Executive

A year of surprises and opportunities

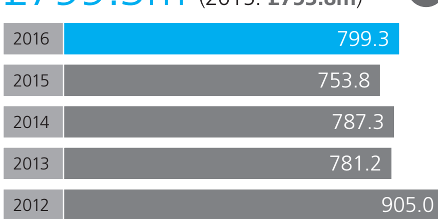
2016 will be remembered as a year of shocks and surprises. The UK electorate's surprise decision to exit the European Union (BREXIT) was a result that continues to cause UK businesses uncertainty. Despite having a less immediate impact on the national economy, concerns remain regarding long-term UK inflation and currency instability as the details of withdrawal emerge. Ultra is largely insulated from the direct impacts of BREXIT, with exports from the UK to mainland Europe contributing just 7% of Group revenue, and minimal dependency on the free movement of skilled staff. Indeed, our much greater exposure to the US should provide reassurance to our investors during a period of such uncertainty.

The US election provided the second major shock of the year with the full implications yet to be realised. However, there is now a strong expectation in the market of a return to growth of about 3% in the defence sector, fuelled by increased US defence spending. This will need to be enabled by the expected early repeal of the Budget Control Act and action to achieve an agreed defence budget for FY17. President Trump is also insistent that those allies living under a US defence umbrella "pay their way", implying increased defence expenditure in those nations. Initial signs of the new Administration's commitment to closer working with the UK, on both trade and defence, are also positive indicators for Ultra given that they represent Ultra's two largest markets.

Portfolio strength focused on **customer need**

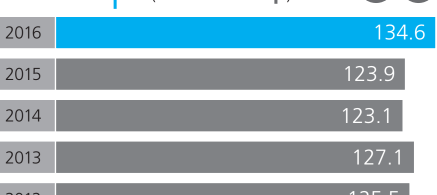
Group order book +6.0%

£799.3m (2015: **£753.8m**)



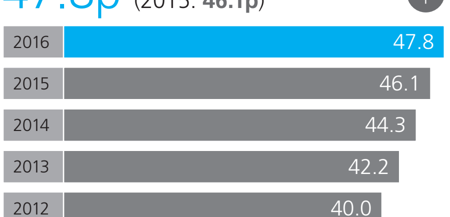
Underlying earnings per share* +8.6%

134.6p (2015: **123.9p**)



Dividend per share +3.7%

47.8p (2015: **46.1p**)



In the UK, major programmes are on a sounder footing after the comprehensive Strategic Defence and Security Review (SDSR) 2016, but budgets remain taut. This budgetary pressure can translate into cash flow constraints at the mid-tier of the supply chain as the Government and primes attempt to control spending. We have seen a growing trend of limited funding approvals and delays in programmes. That being said, our key positions on major platforms, such as the Joint Strike Fighter (JSF) and the "Dreadnought" submarine, underpin our longer-term performance.

Globally, the range of conflicts and tensions in Asia, Eastern Europe and the Middle East are expected to result in increased defence spending in these regions; more so as oil prices recover. Many nations are already upgrading their military and security capabilities, providing opportunities for Ultra in our areas of strength: communications, ISTAR** and cyber protection. Competition in these markets is fierce and procurement processes extended, so contract awards are less predictable than in our core markets. Extensive delays in order intake are not unusual and can disrupt short-term performance. To mitigate this uncertainty our efforts remain focused, selecting target programmes and in-country partners with great care. Currently, we see India, Australia, Japan, the Middle East, and (for non-defence products) China as important regions to prioritise marketing efforts.

Increasing efficiency

There is a general consensus that the commercial aerospace market has peaked in orders and is approaching a manufacturing highpoint. Ultra has already responded to this expected change by significantly reducing its investment in development of new capabilities, choosing instead to focus resources on production efficiency. Strong positions on many aircraft types, now stepping up production rates to meet existing orders, will underpin performance for several years. Where we are able to readily adapt our existing technologies for new opportunities, we will do so. China will become an increasingly important market for commercial aviation and our long-established joint venture partnership with Top-Scientific Inc. will allow us good access to these large commercial opportunities. The year saw some important decisions made on the future of the UK nuclear electricity generation programme: we continue to work with the UK Government and major industrial participants to demonstrate how Ultra can provide a significant, UK-based contribution to these long-term projects. Our relationship with EDF remains excellent, culminating in the award of EDF Energy's "UK Supplier of the Year" award. I am also very pleased by our partnership with NuScale, which will see Ultra responsible for developing the safety and sensor suites for the first Small Modular Reactors (SMRs) to seek regulatory approval.

> Our relationship with EDF remains excellent, culminating in the award of EDF Energy's "UK Supplier of the Year" award.

**Intelligence, Surveillance, Target Acquisition and Reconnaissance

*see footnote on page **144**

Chief Executive's review (continued)

> We will continue to retain a core of capability at **Tiers 3** and **4**, with most Ultra businesses reflecting this focus.

Delivering excellence
During our annual Business Leaders Conference, I sought my senior team's view on the core question of why we do what do, as more important than who we are and what we do. The "**Why**" we developed from our own discussions is set out on the front cover of this report and neatly captures Ultra's fundamental culture (see also page **1**). We are disruptors in the marketplace. Simply put, this means that Ultra is always looking for a new approach or a new method that utilises our technology to displace the incumbent supplier, through innovative and adaptive solutions.

Achieving this still depends upon the innovation and agility of our businesses, which stems from their autonomy. Ultra businesses retain great freedom to make decisions and react quickly to market opportunities, while meeting their budget goals. Over the past two years, we have enhanced this responsiveness by restructuring into three Divisions (pages **30-35**) which reflect the eight market segments we face. This structure has increased the level of collaboration across the Group, improving shared understanding of Ultra's capabilities and the market as a whole, resulting in greater opportunities to provide well-matched solutions to customer needs. This approach has led to some further consolidation, from 24 businesses in 2015 to the current 19, where businesses face a similar customer set and have complementary capabilities. An additional benefit to these selective consolidations is the generation of a small number of larger businesses that are capable of taking on larger opportunities at a **Tier 2** level (defined on page **8**), with the greater depth, experience and skill set that a larger-scale business allows us to attract into our management teams. We will continue to retain a core of capability at **Tiers 3** and **4**, with most Ultra businesses reflecting this focus.

In 2016 we made our first significant disposal, with the sale of the ID Card business for £22m. This important exercise of discipline demonstrates the greater attention we are paying to the development of our capability portfolio across the Group, as we reposition to achieve long-term growth. Acceleration of the integration of Herley and an excellent cash conversion rate has quickly reduced the Group's leverage to a point where we can actively consider our next significant acquisition.

Our Standardisation & Shared Services (**S3**) workstreams continue to make good progress (see pages **12-13**). Importantly, this programme does not reduce business autonomy but instead brings together non-differentiating activities (including HR, finance and IT) into a single hub and service provider. Individual businesses retain expert roles in order to support managerial decisions and to be "demanding customers" for **S3** services.

In 2016 I was delighted to welcome the return of Amitabh Sharma to the Head Office, where he succeeded Mary Waldner as Group Finance Director. When he was with Ultra previously, Amitabh was formative in the development of many of Ultra's financial control systems, so his transition into the lead financial role has been very swift. He brings an important insight, rigour and discipline to our financial processes and is leading the **S3** programme.

> In 2016 we made our first significant disposal.

Portfolio strength focused on customer need

Operational highlights

- The award of an **$18m** contract to provide Electronic Warfare equipment to a NATO country for use in unmanned surveillance aircraft.
- Securing a **£16m** programme for the continued support of our world-leading software-defined encryption device (ECU RP) for the UK Ministry of Defence (MoD).
- A **$34.6m** award for the critical infrastructure protection and cyber security for US naval bases.
- Securing a **$27m** contract with Lockheed Martin for the development and production of an acoustic nose array for the US Navy MK 48 torpedo programme.
- Successful delivery of a ship refit and modernisation upgrade of a Fatahillah-class corvette for the Indonesian Navy, and award of a contract for the restoration and sustainment of two Philippines Jacinto-class Patrol Vessels.
- A multi-year agreement for supply of Canadian sonobuoys to the South Korean P-3C maritime patrol aircraft, worth Canadian **$14.9m**.

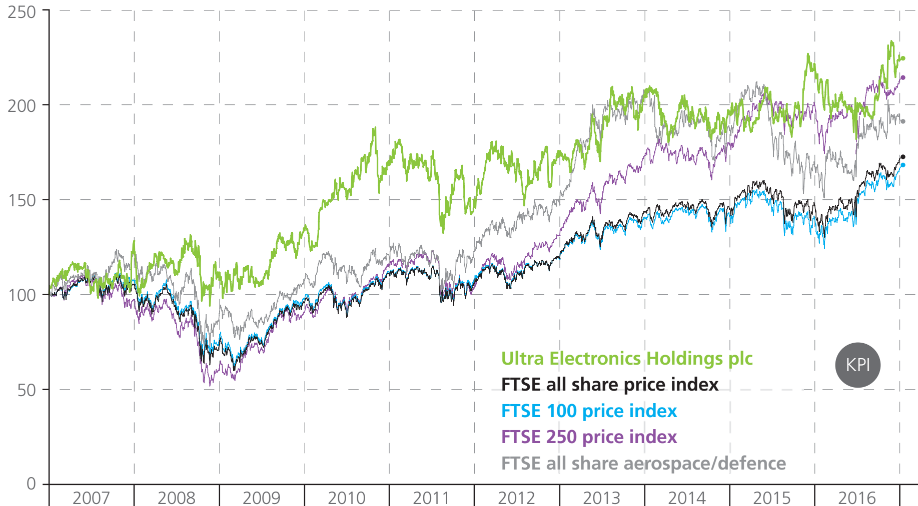
Return to growth

In such a turbulent year in terms of global surprises, I am pleased to report these sound results which reflect the disciplined approach we have taken to the restructuring of the Group and control of our costs. Through our focused approach to the market, continuing investment in developing highly-differentiated technology capabilities and further refinement of our portfolio, we are well prepared to exploit the challenges and opportunities in our markets and return Ultra to growth. In the prevailing markets the Executive Team will maintain a careful balance between performance during the year and investing and positioning for longer-term growth. Our recent restructuring provides us with a much better framework within which to make these judgements, while the **S3** programme and continuing discipline within businesses ensures we control our costs effectively.

None of this happens without immense effort from across the entire workforce. 2016 has been another challenging year for all our businesses and the positive results reflect a huge amount of hard work and commitment by every one of the Group's 4,466 employees. In all the disciplines of the Group – management, engineering, production, marketing, HR and finance – people continue to improvise, adapt and overcome. No one is standing still or taking their revenue or market for granted. It is that strength in people that gives me the confidence that we will return to growth and ensure the Group's continuing success for the future.

Rakesh Sharma
Chief Executive

Ultra's track record of delivering above-average shareholder returns (pence)



KPI = Key Performance Indicator, see pages **28-29** for details

Business model

The value Ultra creates through its **business model** enables it to achieve its primary objective: to **outperform the market in terms of annual increases in shareholder return.**

Ultra faces the market with **portfolio strength**

Eight distinct and wide-ranging market segments

Clearly defined market segments allow Ultra to provide more complex offerings from across the full range of the Group's capabilities, rather than only supplying individual products from single businesses. 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 and divestment to position in growth markets

Ultra invests in targeted acquisitions to further strengthen its portfolio and will dispose of capabilities that no longer fit within the portfolio. The Group invests in acquisitions that develop and apply domain expertise, capabilities and technical synergies in common end markets. Ultra's deep understanding of the users' domain, its enduring customer relationships, and its outward-facing nature inform the Group's investment decisions.

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, disruptive technological innovation – which are different from, and better than, those of the Group's competitors.

Ultra constantly innovates to meet **customer needs**

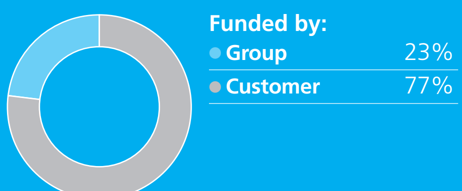
Focus on Tiers 2-4

Ultra has no strategic intent to be a **Tier 1**, top-level platform provider. Therefore, the Group is non-threatening to the **Tier 1** prime contractors, for example, BAE Systems or Boeing, and so counts them amongst its key customers. As such, **Tier 1** contractors can rely on Ultra to provide the specialist capabilities at which the Group is expert, rather than regarding us as a competitor.

Ultra's specialist capabilities are mainly at **Tiers 3** and **4**, supplying equipment and components to support **Tiers 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 aims to invest 5% of revenue in R&D to develop new offerings and its customers typically invest a further 15%

Ultra aims to maintain investment at 5% or more of its revenue on innovation, new products and business development. In addition, over 14% of Group revenue is customer-funded product development. In total over 18% of revenue spend is focused on enhancing the portfolio of capabilities and programme positions which underpin further growth.



Funded by:

Group	23%
Customer	77%

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 sub-system requirements.

Tier 1. Platform provider
Responsible for being the prime contractor of the platform in question, examples being a naval ship or a terminal at an airport.

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 the 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).

Portfolio strength focused on **customer need**

Form external partnerships to develop the best solutions for customers

Ultra has an established capability to partner and team (both internally and externally) in order to offer the best-of-breed technologies which meet its customers' requirements as closely as possible. The Group is agnostic as 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 which meet customer needs efficiently. By working together, Ultra businesses are able to win opportunities which would not be possible in isolation.

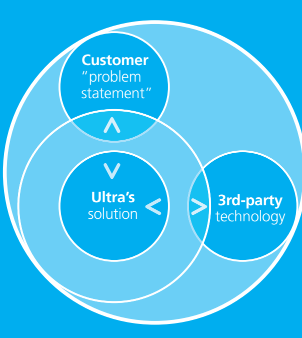
Ultra is continually evolving its approach in response to:

- changing customer demands
- anticipating the 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 which customers would like addressed.

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



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 delivers effective leadership and direction in achieving the key corporate objective of reliable and consistent growth in 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.

To ensure it provides the exceptionally agile and responsive support to customers and partners that is normally associated with a smaller business, Ultra's individual businesses have a high degree of operational autonomy. The agility of the individual businesses is enhanced by access to wider and complementary technologies and expertise that lie elsewhere in the Group (collaborative autonomy) and by Ultra's strong financial position.

Ultra's businesses are focused on helping customers identify their true needs while developing long-term relationships. This enables the Group to be an excellent 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, enables 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 the customers' extended enterprises, to mutual benefit.

Find out more about **LEAP** and **LAUNCH** on page **47**

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.

Ultra's business model is underpinned by:

Sustainability. Pages **44-45**

Ultra's people and culture. Pages **46-53**

Risk management. Pages **36-43**

Good governance. Pages **54-91**

Ultra's four strategies for growth

Ultra's objective is to add long-term shareholder value, as measured by market capitalisation and the Group's ranking in the FTSE index, more rapidly than other companies in order to outperform the market. This will be facilitated by an above-average rate of revenue growth. Ultra constantly strives to increase its share of the high-growth sectors of the markets in which it has positioned itself.

1

Increase the Group's portfolio of specialist capability areas

- Concentrate on providing customers with capabilities and systems
- Offer electronic and software solutions in niche markets
- Focus on developing specialist capabilities with demanding and critical requirements
- Provide specialist solutions, 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 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 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
- The US still spends more on defence each year than other nations combined
- Undertaken the majority of acquisitions in North America to achieve transatlantic capability
- Focus now is to gain competitive advantage through measured expansion into Australia, the Middle East, India and Asia-Pacific

Portfolio strength focused on **customer need**

Examples of how the Group is performing in each strategy can be found below:

1

- Precision Control Systems (PCS) received an order from the US DoD for CombatConnect, a new electronic soldier architecture Ultra had developed for the UK Army. This breakthrough order could lead to a significant opportunity utilising cutting-edge technology.
- Ultra Electronics signed a strategic memorandum of agreement with Northrop Grumman (NG) Corporation to deliver new Maritime Domain Awareness (MDA) and Anti-Submarine Warfare (ASW) capabilities for NG's family of autonomous vehicles and systems. This expands Ultra's specialist capability areas to include unmanned autonomous platforms to supplement our existing position on manned ASW platforms.
- 3eTI was contracted by the US Department of the Navy to continue providing cyber-secure critical infrastructure solutions. The contract will see 3eTI work with the Navy to design, develop, integrate and install a variety of cyber-secure systems for critical infrastructure control and monitoring.

2

- PCS has secured a position on the Saab Gripen NG aircraft for the supply of the HiPPAG stores management solution. This is the first time a dual-purpose HiPPAG system has been fielded, capable of providing stores ejection and seeker head cooling from the same unit. The Gripen aircraft is enjoying strong sales and has a long service future ahead of it. Production is expected to start ramping up in 2019 and continue for at least a decade.
- The US WIN-T Increment 1 Signal Modernization – Terrestrial Transmission Program was established as a DoD Program of Record enabling funding to be applied to the long-term procurement of TCS' Orion radios.

- Ocean Systems was contracted by Lockheed Martin to provide fully integrated Array Nose Assemblies to increase the US Navy's inventory of MK 48 torpedoes. This contract will provide Ultra with access to additional platforms because the MK 48 is used by all classes of US Navy submarines as well as by many western navies as their primary ASW and anti-surface warfare (ASuW) weapon. In addition, Ocean Systems plans to expand its acoustic sensor capability to include the MK 54 acoustic nose assemblies. The MK 54 is the primary ASW weapon for the airborne and seagoing ASW assets of many western navies.
- Following on from its success upgrading the first Indonesian Navy's Fatahillah Class corvette, Ultra continues to expand its geographic footprint as its Command & Sonar Systems business was awarded a contract from the Philippine Government for the restoration of their Jacinto Class Patrol Vessels. This two-year contract will include replacement of the electro-optic fire control system and navigation sensors and overhaul of the 25mm and 76mm guns on two ships of the Jacinto Class.

- Ultra's CIS business expanded its footprint in the Middle East region with the award of a major contract to provide an integrated security system to protect naval ports from underwater threats.
- In 2016, Flightline Electronics was successful in working with Airbus to secure development and production funding to implement Ultra's aircraft Health and Usage Monitoring System (HUMS) into the US Army's fleet of UH-72 Lakota light utility helicopters. Ultra's HUMS product is gaining global attention as the Aviation Industry Corporation of China (AVIC) has requested a demonstration prior to negotiating a supply agreement with Ultra, and the US State Department is interested in using this technology to upgrade its UH-1, CH-46 and UH-60 rotorcraft platforms.
- PCS is entering into a partnership with Nanjing Engineering Institute of Aircraft Systems (NEIAS) to supply the Nose Wheel Steering System for the MA700. This is Ultra's first partnership with a Chinese company for the provision of aerospace systems.

- NCS's acquisition Lab Impex is now fully integrated into the business and has facilitated engagement with new customers across markets that were previously not accessible, offering access to a much wider customer base and enabling totally new business to be won in 2016 at the Sequoia reactor in the US and EDF Heysham II reactor in UK.
- Herley was awarded a contract by a major US prime contractor to supply next-generation RF assemblies for the Surface Electronic Warfare Improvement Program (SEWIP), a substantial and long-term programme focused on electronic support capability improvements on US navy ships.
- Following a successful Integrated Ballistic Identification System (IBIS) trial installation in Beijing, Ultra's Forensic Technology business anticipates its first IBIS order from China in early 2017.
- Ultra successfully delivered the first of three Air Warfare Destroyer Integrated Sonar Suites to the Royal Australian Navy.

Standardisation & Shared Services (**S3**)

Challenging markets and a deflationary economy demand increasing efficiency. Ultra's move over the past two years to a Divisional structure aligned around **eight key market segments** is enabling its businesses to collaborate more easily in the marketplace, and address customer needs more efficiently.

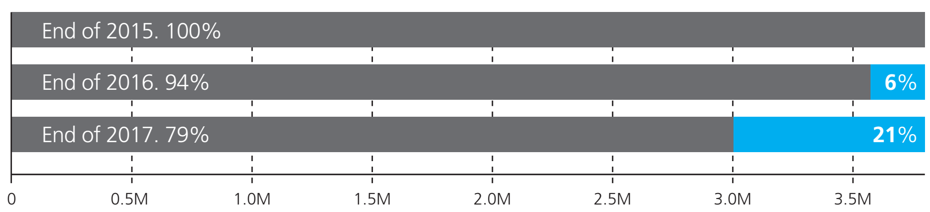
As Ultra has grown as a Group, through acquisition and organic success, each autonomous business has maintained its own enabling functions including finance, IT, HR, sourcing and property. After 20 years of growth, mergers and acquisitions, and the recent restructuring of market segments, the Group now has the size and infrastructure to streamline these functions thereby increasing efficiency and realising savings. The Standardisation & Shared Services programme, known as **S3** and established in late 2015, is focused on bringing together these enabling activities from across all the businesses under a Global Business Service (GBS) function. By adopting common, best practice solutions, Ultra will deliver these services to the businesses in more effective and efficient ways. An internal roadshow by the Chief Executive and the **S3** Managing Director is helping to explain and promote the initiative, and ensure each business understands the benefits **S3** will deliver to them and the Group as a whole.

For 2016, the **S3** programme was in a cost-neutral position realising savings of £6.9m. It is expected that by 2019, recurring annual savings from **S3** will total in excess of £20m. Ultra's continued commitment to realising savings is matched by its commitment to preserving and encouraging each individual business's autonomy, thereby allowing them to strive for excellence on a daily basis without being hampered by out-of-date or inefficient processes.

The **S3** programme is structured around eight individual workstreams, illustrated in the diagram. These are the key functional areas for **S3** to focus on redefining.

Portfolio strength focused on **customer need**

Global Property Footprint (ft²)



£6.9m

The **S3** programme generated savings of **£6.9**m in 2016.

Some **S3** Highlights to date:

Global Business Services (GBS)

The first stage of the **S3** programme centred around understanding the requirements of the individual businesses and ensuring that any changes did not detract from a business's autonomy or restrict their ability to outperform the market. Having identified potential areas to increase efficiency, the programme has now reached its second phase and is actively managing the implementation of the appropriate changes necessary to bring the service functions together. A key requirement for the programme is the setting up of two shared service centres, one in the UK and one in the US.

UK GBS, based in Dorset, opened on 1 June 2016 with the direct and indirect sourcing teams being the first functions on site. Following the successful pilot tests of GBS systems and processes, services will, business by business, be migrated into GBS. This includes payroll management, facilities management, and expenses processing and payment.

Continuous improvement techniques will be put in place within GBS to develop these services going forward. In most cases, this will involve the implementation and adoption of new systems and best practice processes. In turn, this will lead to Ultra businesses enjoying the benefits of an integral service partner and the efficiencies gained from consistent service and product contracts negotiated at a Group level as opposed to an individual business level.

An announcement made in February 2017 confirmed that the second GBS, supporting the US businesses, will be located in Rochester, New York and will mirror the same approach and services as the UK GBS centre.

Property

Greater attention is being paid to Ultra's property portfolio. By the end of 2016, the property footprint had reduced by 6%, a total of 218,967ft². A further 587,017ft² has been identified for 2017, to be achieved through a combination of exiting, subleasing and general consolidation of the estate. This represents a further 15% reduction. Following the development of a central database, managed by GBS, work is already underway to rigorously assess the future property requirements across the Ultra Group targeting a total reduction of 21% by the end of 2017.

Sourcing

With a forecast to achieve £7.6m of total savings from indirect and direct sourcing, work on increasing efficiencies has already helped to realise £0.5m of savings by the end of 2016 through changes to indirect sourcing, procurement and payment. The implementation of the Coupa system as the single Group-wide online system for sourcing, procurement and expenses is underway, with all UK businesses due to adopt the system in the first half of 2017. Similarly, changes in direct sourcing have delivered savings on a number of items by increased collaboration across the Group and new supplier sourcing as indicated in the following examples:

- By combining the requirements of three Ultra businesses, negotiations with a wire supplier resulted in an average combined price reduction of 7.1%
- Expanding an existing relationship with a freight supplier to cover more Ultra businesses for their truck freight service is forecast to realise full year savings of $230k
- Sourcing from lower-cost regions will see a reduction of 60% against costs on the industrial Thermowell line at NSPI.

Elsewhere in the Group, workshops have been held in collaboration with distributors. As a result new supply chain solutions are being established with the aim of tailoring the supply chain to better meet Ultra's needs. In one case, a forecast-driven "Reduced Lead Time" programme to decrease costs is now being piloted for a major project. It is expected that this pilot will also reduce working capital costs and supply chain risk, and improve overall operational excellence.

ERP

Additionally, some key **S3** enablers are being progressed, including a new ERP strategy which will deliver significant operational efficiencies over the next three years and transform businesses' ability to report and extract data in ways they have not been able to before. This will lead to efficiencies wider reaching than finance, providing transparency and agility in manufacturing and projects too, through automation and elimination of duplicate processes.

IT

The appointment of a Chief Information Officer in February 2017 is helping to streamline and encourage IT efficiency and compatibility across the Group. By building an internal capability through a specialised team, continuous improvement will be enabled across the Group, reducing IT support costs, and greatly improving long-term system robustness and alignment with best practice models.

7.1%

Price reduction through consolidation of wire suppliers.

> It is expected that by 2019, recurring annual savings from **S3** will total in excess of £20m.

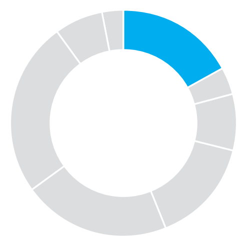
Aerospace

Across the civil and military aerospace sectors, demand for innovative technologies to reduce cost, improve efficiency and increase safety play well to Ultra's established strengths in controls systems and niche aviation technologies. This has allowed the Group to establish positions on a number of long-term aerospace programmes now ramping up production.

Revenue by segment

Aerospace

17%



Ultra's portfolio strength

Ultra's CORE capabilities include:

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

Market overview

Commercial aerospace remains a vibrant sector with predictions of worldwide passenger growth doubling over the next 15 years. Large aircraft manufacturers are buoyed by record order backlogs that exceed 13,000 aircraft, although new orders have probably reached a peak. This growth in platform numbers is driven by the demand for new aircraft in developing regions, while the more established markets need new aircraft to replace ageing fleets as well as to capture the greater efficiencies in fuel, emissions and system reliability. The military aerospace market continues to see growth driven predominantly by the production ramp-up of the existing major military aircraft programmes. There are few new military aircraft programmes, with the market focused on technology insertion and capability upgrades of existing airframes.

Market outlook

In the civil aerospace sector the twin-aisle market continues to grow, and will remain dominated by Airbus and Boeing for the foreseeable future. Ultra provides unique electrical wing ice protection systems and position sensing electronics to the Boeing 787 as well as providing specialist harnessing, landing gear service panels and a new electrical ground door opening system to the new Airbus A350. The single-aisle market is also in growth and, while currently dominated by Boeing and Airbus, is seeing new entrants from China and Canada. The regional aircraft market is highly competitive. Nonetheless, Ultra has secured content on the Japanese Mitsubishi Regional Jet and the new Chinese MA700 regional turboprop. Growth in the business jet market is focused on larger aircraft, where Ultra has secured business on the new Gulfstream G650, G600 and G500 as well as the Cessna Citation Longitude. In the rotary wing market the large reduction in energy prices is reducing orders from the oil and gas rig servicing businesses and key requirements in this market are minimising aircraft through-life costs. 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 F-135 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. The air transport market is seeing a number of competitors looking to fill the niches left by C-17 and C-130. In this sector Ultra has secured positions on the Embraer KC-390 and on the Airbus A400M. The UAV market remains an attractive but crowded sector.

1 2 4

Strategy in action

In 2016, Ultra's Flightline business in Victor, NY collaborated with Curtiss-Wright to provide a new compact and lightweight Cockpit Voice and Flight Data Recorder with integral HUMS capability designed for use on rotorcraft platforms.

Portfolio strength focused on **customer need**

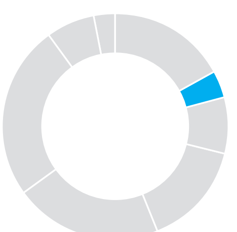
Infrastructure

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

Revenue by segment

Infrastructure

4%



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

Market overview

Transportation, including airport and rail systems, remains an area of strong investment worldwide. The increase in global air traffic and national prestige projects 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 China, India and the Middle East and North Africa regions, at least 50% of the global market for smart solutions lies in Europe and the US.

Market outlook

In the airport sector, the market for Airport Master Systems Integration continues to experience growth, especially in the demand for Tier 2 airport capabilities. This is particularly so in South America, the Middle East and Asia, where there are a number of key capital projects. The airport and airline information management market is also forecast to see investment grow, although many of the operational systems are becoming increasingly commoditised. There is growing polarisation between global offerings and those with more localised niche expertise, so Ultra has continued to focus upon market intimacy, customer relationships and comprehensive solutions over individual products. The rail transit power conversion and control market is also anticipated to see significant growth. 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. In 2015, Ultra launched a cyber-hardened critical infrastructure management system to improve site management and performance without the need to replace legacy equipment. This is now being fielded. 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.

2

Strategy in action

In response to the growing need for compact, power-dense solutions, Ultra supplied the London Underground Jubilee Line Upgrade project with compact transformer rectifier equipment.

Nuclear

Through its established relationships with Original Equipment Manufacturers (OEMs), the domain knowledge of its Suitably Qualified and Experienced Personnel (SQEP), and its broad range of qualified safety systems and sensors, Ultra is well positioned to support the growing market in the licensing, delivery and safe operation of reactors and associated systems via a full "defence in depth" approach.

Revenue by segment

Nuclear

8%

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

Market overview

There are over 430 commercial nuclear power reactors operating in 31 countries worldwide. They provide over 11% of the world's electricity as continuous, reliable, base-load power and 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 are over 70 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, with plants taking several years to come to completion, 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, which is 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 16 countries, plus another 32 reactors currently under construction. Furthermore, Ultra is uniquely qualified on eight new types (as well as many legacy plants), meaning that it is well positioned for the future.

Growth in the nuclear emergency management market continues, prompted by the Fukushima accident which caused a global reassessment of post-accident response and support needs. Plant safety is now increasingly reliant on secure data and, as such, cyber security is a key part of meeting the formal safety requirements. Security concerns around the proliferation of nuclear and the threat of terrorism are also driving the growth in new deployable security and surveillance systems for nuclear plants and enhanced border security. Ultra's domain knowledge, through its SQEP, coupled with its extensive security and surveillance capabilities (as described on page **18**), position Ultra well in this sector.

[2]

Strategy in action

EDF's ageing fleet of AGR reactors are undergoing life extension reviews to ensure their continued operational availability to end of station life. In 2016, NCS was awarded a £7.3m contract spanning 10 years to maintain design integrity and equipment reliability across the fleet via a structured management and risk-mitigation approach.

Portfolio strength focused on **customer need**

Communications

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

Revenue by segment

Communications

15%

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

Market overview

The communications market includes shipborne, ground-based, underwater, air-to-ground and airborne communications, and encompasses a wide and diverse range of capabilities. Within the military and security sector, there is continued demand for greater bandwidth and broader connectivity, coupled with a growing need for interoperability. The emphasis today on secure networked communications is spreading to all nations seeking to modernise their systems. The ability to deliver real-time voice and data with ad hoc mesh capabilities was becoming essential. This is driving investment in a market where proven designs, which can be integrated with existing equipment and are interoperable with allies, are preferred. Additionally, this is where commercial "off the shelf" technology is increasingly being applied to reduce costs and improve performance. In particular, there is a shift towards software-defined solutions that enable fast-cycle upgrades of capability and the use of open and commercial standards. Outside the military and security market, there is a growing reliance on Machine-to-Machine (M2M) communications and, with the rising prevalence of connected devices, increasing emphasis on the "Internet of Things" (IoT).

Market outlook

The trend towards greater connectivity and networking will persist, driving significant further investment in military communications. The emphasis will be on resilient networked communication capabilities enabling people to be connected anywhere, anytime, all the time. On the battlefield, this will drive the requirement for high-performance tactical communication systems such as the Ultra Orion multi-mission software-defined radio, one of the most versatile and advanced radios available today. It will also see military satellite systems moving towards higher frequency Ka band solutions and smaller, more portable earth stations that deliver higher bandwidth; developments that Ultra, in collaboration with a number of partners, is positioned to exploit. Similarly, in the data link market, in which Ultra remains well placed with its wide range of advanced data link and airborne gateway solutions, the demand for secure tactical and full-motion video links will continue to grow.

In the encryption market, the move to smaller form factor products and from link to Internet Protocol (IP)-based cryptographic solutions will continue. Additionally, there is a shift from paper-based key to electronic key distribution and management systems. Ultra has proven next-generation end-to-end cryptographic products and a strong position in both UK and US cryptographic programmes. This, allied to the Group's electronic key distribution and management solutions, ensures Ultra remains well positioned in this sector to pursue a variety of opportunities. Finally, with the increasing awareness of the vulnerabilities of M2M communications, and a growing recognition of the need for solutions to secure such systems, the secure M2M market will continue to grow. Ultra's proven certified security solutions, which are tailored to meet critical national infrastructure and industrial needs, position the Group well in this arena and have led to partnerships with OEMs in the building automation, energy/utilities, and oil and gas markets.

Strategy in action

In November, Ultra's TCS business was awarded a substantial contract to supply Ultra Orion radios, through a strategic collaboration with a major systems integrator for a large military communications programme in the Middle East.

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

21%

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
- Airborne surveillance and targeting
- Electronic Warfare solutions, Electronic Warfare simulators and radar test systems
- Document examination systems
- Ballistics and crime scene analysis

Market overview

C2ISR remains a priority capability within global defence budgets due, primarily, to the increased importance of these systems in modern warfare. C2ISR applications are used across a variety of platforms with air power, as the principal mechanism for early or urgent delivery of military effect, driving the demand for intelligence, surveillance, target acquisition and reconnaissance (ISTAR). Here, the growth in platforms, particularly unmanned platforms, fulfilling these roles continues unabated. The challenge, as ever, being the timely and secure dissemination of the associated data, typically video, around the battlespace. In the face of terrorism, organised crime, drug trafficking and illegal immigration, C2ISR capabilities are also growing in importance in the wider border security and Critical National Infrastructure (CNI) protection markets. Overall, there continues to be an increasing demand for interoperable and mobile networks that deliver a single integrated picture for timely situational awareness. With a growing number of devices capable of collecting sensor data operating across multiple communication networks, the complexity and scale of integrated surveillance systems also continues to increase. Solutions need to be tailored to customers' needs, comprehensive and able to draw on "best-of-breed", established and clearly differentiated technologies.

Market outlook

Global spending on C2ISR systems is expected to remain robust. In the military arena, there will be a continued emphasis on intelligence and surveillance assets, as well as the ability to fuse or correlate these data streams into a single real-time integrated picture that can be disseminated down to the lowest level. This will drive growth in real-time ISTAR (for both manned and unmanned platforms) and the connectivity between assets in the battlespace. Ultra's leading data fusion, situational awareness and visualisation systems play well to this growing need. Electronic Warfare (EW) is also gaining in prominence. The global EW market is forecast to grow significantly over the next few years driven by the increasing emphasis placed on information superiority and situational awareness. Ultra bolstered its capability in this area with the acquisition of Herley in 2015 and continues to grow its share of the EW market.

The border security and CNI protection markets are also projected to grow. The illegal movement of arms, narcotics and people will continue to drive growth, while the shift from labour-intensive security to high-tech networked solutions will continue. Ultra has all the necessary elements to deliver multiple applications into these markets and is focused on those opportunities where there is a growing need, the political impetus and the necessary funding. Growth in the CNI physical protection market will continue to be underpinned by the increasing adoption of video surveillance and wireless technologies for perimeter security. The rising awareness of cyber threats and government mandates will drive similar growth in the protection of industrial control systems. Drawing on its advanced secure communications and surveillance capabilities, Ultra remains well-positioned to provide complete cyber-physical security solutions to this growing market.

[2]

Strategy in action

In 2016, 3eTI was awarded a $34.6m contract by the US Navy to continue providing critical infrastructure protection solutions. Initial tasks of $13.9m are due to be completed by September 2017.

*Command & Control, Intelligence, Surveillance and Reconnaissance

Portfolio strength focused on customer need

Underwater warfare

Ultra's world-leading domain knowledge, acoustic technical expertise and ability to provide leading technology in Anti-Submarine Warfare (ASW) performance through rapidly delivered, modular, affordable and reliable solutions means that it is well positioned to exploit this large and growing market.

Revenue by segment

Underwater warfare

25%

Ultra's portfolio strength

Ultra's CORE capabilities include:

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

Strategy in action

The Royal Netherlands Navy received its second Multistatic Active Passive Sonar (MAPS) system from Ultra in 2016. It was installed and underwent successful harbour acceptance tests in October whilst the first system completed its operational evaluation trial with the Dutch Navy in November. The trials were so successful that the commander of the Dutch Navy tweeted "the MAPS system was a quantum leap in ASW capability". Lastly Ultra, through its joint venture ERAPSCO, commenced production of the next generation of High Altitude Anti-Submarine Warfare (HAASW) sonobuoys. These sensors have been designed to be deployed from P-8A Poseidon aircraft and will provide extended detection ranges on enemy submarines due to their coherent multistatic active capability.

Market overview

Submarines are strategic assets, able to fulfil a variety of missions from covert surveillance through to anti-surface warfare, stand-off land attack and ultimately, strategic deterrence. This multi-mission capability, combined with their innate characteristics of stealth and endurance, has made submarines highly attractive to nations wishing to exercise cost-effective power projection. Submarines pose more than just a military threat. These platforms can easily and effectively disrupt the sea lines of trade that sustain the global economy. As a consequence, there has been a substantial investment in submarine technology by Russia, China, North Korea, and Iran. Moreover, many smaller nations in Asia-Pacific are rapidly procuring submarines in an effort to protect their national interests. This growth in submarine capability is no longer offset by traditional western underwater technological superiority, which has eroded through years of neglect. Therefore, investment in ASW has become a top priority for nations.

Global financial pressures, coupled with increased capital platform costs, mean that nations can typically no longer afford platforms dedicated to a specific role. Instead, they are generally moving to the use of increased, smaller multi-role platforms, of frigate or offshore patrol vessel size. As a result, ASW solutions now need to be modular with reduced footprints to fit on these smaller vessels. Another key factor in this growing ASW market is the desire for increasingly short development times, requiring investment in advance of contract awards. Ultra has positioned itself well in both of these areas, with continued investment in ASW technologies including multistatic active systems and sonobuoys for use with Unmanned Aerial Vehicles (UAV). A key export market driver is the increasing requirement for indigenous technology transfer to overseas customers, another area where Ultra has a strong pedigree with recent export contracts.

Market outlook

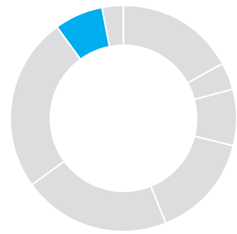
The US continues its strategic rebalancing of military assets and capability between the Atlantic and Pacific theatres. As a result, despite the wider US government funding pressures, ASW and submarines remain areas of preferential spend with increased budget allocation. Specifically, the US continues to build two Virginia Class SSNs per year, and has delivered more than 30 P-8A maritime patrol aircraft to the US Navy, as well as awarding contracts to upgrade both light and heavyweight torpedoes. Future funding is earmarked to further bolster the US Navy's ASW capability through the award of next generation torpedo countermeasures and torpedo defence systems. Elsewhere, several of the major Commonwealth countries have embarked on a major recapitalisation of their ASW frigates; the steel on the Royal Navy's first T-26 Global Combat Ship is due to be cut during the summer of 2017. Activity is well underway on Canada's Common Surface Combatant fleet with the initial contracts due to be released in 2018. Similarly, Australia's SEA5000 programme has started the competitive evaluation process and should go to contract in 2020. In all, more than 30 vessels will be constructed with a mission emphasis on ASW. More broadly in the addressable Asia-Pacific market, spend related to ASW systems, including towed torpedo defence solutions, is projected to rise to almost £0.5bn. Specifically, India intends to award three major ASW related programmes totalling in excess of £100m over the next five years. Ultra is well placed to address these needs based on its continued investment in integrated sonar systems and surface ship torpedo defence system technologies.

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 command and control systems for maritime platforms.

Revenue by segment
Maritime

7%



Ultra's portfolio strength

Ultra's CORE capabilities include:

- Magnetic and electric signature management for ships and submarines
- Specialist motor drives and power converters
- Power conversion and control management
- Nuclear rod control for submarines
- Stable positioning for precise electro-optic (EO) tracking on moving platforms
- Customised command, control and navigation systems for small ships

Market overview

Post the Afghanistan and Iraq land-based conflicts, many nations are now looking to rebalance their force structure and have a renewed focus on the procurement of maritime and air domain equipment. As a result, national military shipbuilding strategies are being developed by several Western nations with the objective to stimulate long-term, sustained new ship construction. In the US and the UK, the construction of new strategic deterrent submarine fleets has been approved and is now underway. In other parts of the world the requirement for increased maritime capability is clear, but fiscal constraints are driving life extensions of existing platforms through cost-effective capability upgrades. Consequently, the demand for system/sensor upgrades and technology insertion programmes on existing hulls is growing, particularly for navies in emerging nations. For the export market in general, maritime platform programmes are often dominated by the industrial politics of the nation concerned, especially if they have indigenous capabilities. As a result, technology transfer is an increasingly important factor enabling business in the export market.

Market outlook

The power products segment in the US market remains stable. The Virginia Class Submarine (VCS) production is well protected with manufacturing steady at two hulls per year for the foreseeable future. Longer-term growth opportunities for Ultra specialist power products will come with the new Columbia Class SSBN, projected to provide 12 new hulls beginning in 2021. The use of common sub-systems with VCS will help lower the cost-growth risk that currently exists on the Ohio Replacement Programme. The US Navy is investing in a technical refresh of Arleigh Burke Class guided missile destroyers (DDG-51), landing platform docks (LX-R) and replenishment naval vessels (T-AOX) which will provide further opportunities for growth of the Group's advanced power and signature management products.

The incumbent position on the UK Dreadnought SSBN development and qualification programme will ensure a high probability of production follow on for main static converters, electric cruise propulsion and signature management. Clean Power requirements of the US DoD and aerospace specifications will continue to drive the need for Ultra's speciality components such as power filters and multi-phase transformers. The Group's specialist signature management capabilities will see growth opportunities in the next five years through the US Navy's Columbia Class SSBN Programme, replacement auxiliary vessels, ongoing Littoral Combat Ship production and DDG-51 upgrades. There is also increased focus on electric field signature management due to the growing awareness of Influence mine threat.

With the protection of maritime resources rising in importance in areas such as the South China Sea, there are increasing requirements for submarines with extended patrol times. The advent of air-independent propulsion capability is expected to increase demand for power conversion and degaussing products.

More broadly, the continuing demand for surface platform system and sensor upgrades plays well to Ultra's strengths in naval combat systems and electro-optics and the Group's pedigree in partnering with local industry.

3 4

Strategy in action

Ultra Command & Sonar Systems was awarded a contract in September for the upgrade of the electro-optic fire control systems, navigation and gun systems on two Philippine Navy patrol vessels. This award leverages Ultra's established position on ship modernisation as highlighted through the Indonesian Fatahillah-class upgrade which underwent successful at-sea acceptance in December.

Portfolio strength focused on **customer need**

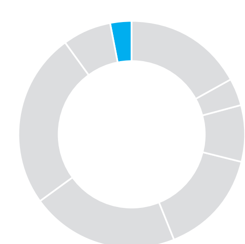
Land

Ultra is primed to exploit the growing market for capabilities and products that conform to the Open Architecture Standards. Niche electronic products enable Ultra to gain a foot in the door of most significant programmes. The land segment product range includes innovative, affordable and reliable solutions which meet current customer needs in power and electronics.

Revenue by segment

Land

3%



Ultra's portfolio strength

Ultra's CORE capabilities include:

- Power systems
- Information systems
- Control systems
- Mission systems
- Electronic architectures
- Soldier systems
- Operating base solutions
- Vehicle systems
- Fire control and weapon systems

Market overview

The market for armoured vehicles is stable although showing a slight decline in new vehicle programmes in Ultra's established markets. Asia-Pacific is predicted to be the area of major growth over the next ten years. Afghanistan, Australia, China, India, Malaysia, New Zealand, Pakistan, the Philippines, Singapore, South Korea, Taiwan and Thailand all have major armoured vehicle procurement programmes underway or in a planning phase.

There is a significant growth in the number of major capability enhancements and life-extension programmes for land platforms playing to Ultra's strengths in electronic vehicle architectures. Land platforms are now increasingly complex, with multiple sensors, weapons and communication systems; this suits our core product range. These complex electronics are driving the increased electrical generation capacity and management within the platform.

The dismounted soldier opportunities continue to grow and our offerings are generating significant interest.

Market outlook

In the UK and European markets, the reduction in the number of new vehicle programmes has been partially offset by a significant increase in the number of platform life-extension and technical insertion programmes. There is also an increase in upgrade programmes as a number of platforms, procured to meet urgent operational requirements over the last decade of operations, are now being absorbed back into core services. Ultra, as a provider of specialist capabilities, is well positioned to be able to support such upgrade programmes. In the UK, the Group has teamed with Morgan Advanced Materials to provide through life support to the Mastiff platforms.

In the US, despite the budgetary pressures that led to the cancellation of several large new vehicle programmes, the DoD has funds for a number of platform upgrades that present Ultra with new opportunities due to the Group's capabilities. More broadly, the export marketplace is growing with a number of prospective new vehicle and upgrade programmes being initiated. This includes the established markets of India and Australia and the emerging markets in the Middle and Far East. In the Middle East, Ultra is working in partnership with an indigenous platform provider to support the upgrade of the existing vehicle fleet. Combined, these potential programmes offer significant opportunities.

Military forces are looking at how they can integrate soldiers, and their associated systems, into the wider land battlespace and there are several active programmes in this area. Ultra has won several demonstration contracts in this area which apply technology to the soldier.

[1]

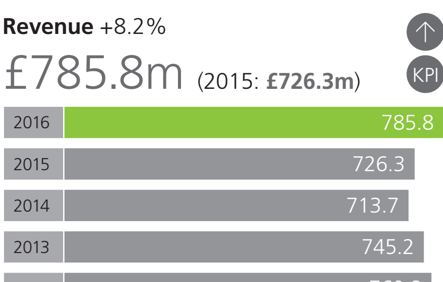
Strategy in action

Building on its expertise in land vehicle architecture systems, Ultra has developed technology to solve the problems of man-to-platform interface by providing a seamless power and data transfer. This expansion into soldier-wearable technology has positioned Ultra to participate in the UK Dismounted Soldier Awareness programme as well as the US Army's Nett Warrior system. Ultra's soldier-wearable technology is also of interest to paramilitary organisations and was successfully trialled with the Police Services of Northern Ireland in 2016.

Financial review

The Group's businesses sustained their focus on costs, delivering an underlying operating margin* of 16.7% (2015: 16.5%).

> Order intake for the year was £778.3m… the underlying increase was 10.4%.



Amitabh Sharma
Group Finance Director

Ultra's 2016 results
Order intake for the year was £778.3m, a 22% increase over the £638.1m achieved in 2015. After adjusting for foreign exchange, acquisitions and disposals, the underlying increase was 10.4%. At the end of 2016 the order book was 6.0% higher at £799.3m (2015: £753.8m). Foreign exchange contributed 7.3% to this increase whilst orders from acquisitions reduced by 1.7%. The underlying order book was unchanged. Order cover for 2017 is at its customary levels.

Revenue
Revenues of £785.8m represented an increase of 8.2%, or £59.5m, on the prior year (2015: £726.3m). Acquisitions contributed 5.8% to the increase, offset by an organic decline of 4.1% arising from delayed export opportunities, including the India torpedo defence contract, and the completion of the End Cryptographic Unit Replacement Programme (ECU RP). The weakening of Sterling during the year meant there was a positive impact of 7.5% from the translation of overseas revenues. The average US Dollar rate in 2016 was $1.35 compared to $1.53 in 2015. The disposal of the ID business in August 2016 resulted in a year on year revenue reduction of 1.0% as it was only included within the Group results for eight months.

*see footnote on page **144**

Operational excellence

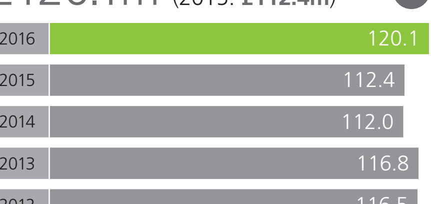
Underlying operating profit* +9.3%

£131.1m (2015: **£120.0m**)

Underlying profit before tax* +6.9%

£120.1m (2015: **£112.4m**)

KPI



Aerospace & Infrastructure revenues (see pages **30-31**) benefited from growth in licence sales of propeller electronic controllers at the Precision Control Systems business, as well as greater demand for nuclear sensor products at Nuclear Control Systems and a full year of revenues from Furnace Parts, which was acquired in 2015. These gains were offset by customer delays to a number of land vehicle programmes and the timing of the JSF programme. The civil aerospace industry is largely denominated in US Dollars, so the weakening of Sterling provided much of the growth for this Division. The order book was broadly flat compared to the end of 2015 when adjusting for acquisitions and foreign exchange.

Communications & Security's results (see pages **32-33**) included a full year of revenues from Herley and a part-year for the ID business. The Division was impacted by the timing of overseas export orders, which caused revenue declines at GigaSat and the legal intercept business. As the ECU RP programme reached completion, revenue reduced significantly as expected, although this was partially offset by the follow-on End Cryptographic Unit Contracts Logistic Support (ECU CLS) contract. TCS, our military radio and Electronic Warfare (EW) business based in Canada, grew in 2016 as a result of its activity on the Electronic Intelligence (ELINT) contract won during the year.

Encouragingly, the Division's order book increased on an underlying basis to £227.0m. This was due to a number of contract wins, notably the ECU CLS contract and the TCS ELINT contract.

The Maritime & Land Division (see pages **34-35**) achieved growth, driven by an increase in sales of US and international sonobuoys. This reflects the continued global focus on underwater warfare, particularly in the US. Increased sales of sonobuoy receivers at Flightline on the MH-60 programme and data switching products also contributed to this year's growth. This was partially offset by Astute-related programmes coming to an end at our PMES business, and a slight decline in revenues at Ocean Systems relative to a particularly strong 2015. The order book was largely flat at constant currencies.

Operating profit and margins*

Underlying operating profit* was £131.1m (2015: £120.0m), an increase of 9.3%. Acquisition growth contributed 4.4% and foreign exchange 6.2%, whilst the disposal of the ID business in August resulted in a profit reduction of 1.5% relative to a full year's contribution from that business in 2015. Organic growth was therefore positive at 0.2%. A number of factors contributed to the increased underlying operating margin* of 16.7% (2015: 16.5%), notably the continued focus by the Group's businesses on restructuring their cost bases and the strong margin performance in the Maritime & Land Division.

Aerospace & Infrastructure margins improved by 0.9%, to 15.8% from 14.9% in 2015. This was helped by the increased revenues from higher margin sales in the period and an improved operational performance at CEMS arising from the site rationalisation plan in early 2016.

In Communications & Security, the divisional margin was 15.3% compared to 16.9% in 2015. A strong performance from Herley, particularly over the last quarter, was offset by the ECU RP programme completion and the sale of the ID business.

Within Maritime & Land, margins improved to 18.3%, from 17.3% in 2015, owing to increased revenues and the production phase of a number of US sonobuoy contracts, although this was partly offset by the completion of some Astute-related programmes at PMES.

Acquisitions contributed an additional £5.3m to profit, primarily in Communications & Security, with Herley (acquired in 2015) being the largest proportion.

The integration of Herley is ahead of schedule with $2.3m of the cost synergies already realised in 2016, $1.5m ahead of the $0.8m planned for 2016 in the acquisition case.

Ultra continued its programme of investment to position for medium-to-long-term growth, with total spending in 2016 of £39.9m (2015: £215.1m), comprising £5.8m (2015: £179.1m) on acquisitions and £34.1m (2015: £36.0m) on new capabilities, the latter representing 4.3% of Group turnover in 2016. The lower spend in 2016 reflects the end of a period of investment in our aerospace segment and the timing of our investment in the underwater warfare segment. Customer-funding for new product development was £112.8m (2015: £110.6m).

The Group's **S3** programme is on track with the UK Global Business Service (GBS) centre now open. A number of the activities of the Group's UK businesses, including indirect sourcing, have started to be transferred across to GBS. The location of the second GBS centre will be in the US co-located with the Group's Flightline business in Rochester, New York. The Group's ERP strategy was determined in 2016 and Ultra companies will standardise onto four ERP systems over the next five to seven years. This will happen when they are next due to upgrade their ERP system. In respect of other workstreams, the **S3** project continues to deliver savings, with property closures, consolidations and procurement delivering £6.9m in 2016, £8m cumulatively.

*see footnote on page **144**

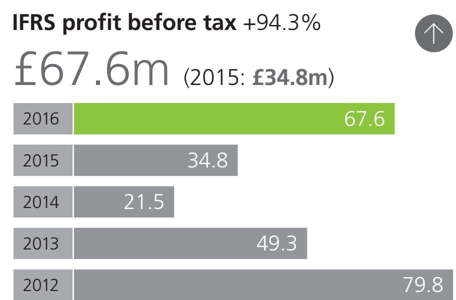
Financial review (continued)

92%

Underlying cash conversion for the year was **92**%.

IFRS profit before tax +94.3%

£67.6m (2015: **£34.8m**)



Interest and profit before tax*

Net financing charges* were £11.0m (2015: £7.6m). The increase reflects a full year of interest charges on the Herley-related debt. The interest on bank debt was covered 12 times (2015: 16 times) by underlying operating profit*.

Underlying profit before tax* was £120.1m (2015: £112.4m).

	2016 £m	2015 £m
Underlying profit before tax	**120.1**	112.4
Amortisation of intangibles arising on acquisition	**(32.7)**	(30.8)
Net interest charge on defined benefit pensions	**(3.0)**	(3.0)
Loss on fair value movements on derivatives	**(19.1)**	(4.0)
Unwinding of discount on provisions	**(0.4)**	(0.6)
Acquisition and disposal related costs and adjustments	**(2.2)**	(9.4)
Disposal loss (after intangible and goodwill eliminations)	**(4.1)**	-
Deemed disposal of Ithra	**-**	(16.5)
S3 programme	**(6.5)**	(4.9)
Pension scheme curtailment gain	**15.5**	-
Impairment charges	**-**	(8.4)
Reported profit before tax	**67.6**	34.8

IFRS profit before tax

Ultra's IFRS profit before tax almost doubled, increasing from £34.8m in 2015 to £67.6m. The Group's UK defined benefit pension scheme was closed to future accrual on 5 April 2016. This resulted in a one-off curtailment gain of £15.5m, which was recognised during the year.

The loss on the mark-to-market valuation of our forward foreign exchange contracts and interest rate swaps was £19.1m in 2016. This was primarily caused by the significant weakening of Sterling against the US Dollar and compared to a £4.0m loss in 2015.

The cost of the S3 programme totalled £6.5m (2015: £4.9m), and includes property lease write-offs and associated costs relating to facility consolidations. Other costs included are business consolidation costs, project management costs, set-up costs of the GBS centre and costs incurred on the initial phases of developing an ERP implementation plan.

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

In the prior year, the deemed disposal of Ithra resulted in a non-cash, non-underlying IFRS accounting charge of £16.5m and 2015 also included £8.4m of impairment charges arising on intangible assets, and from the sale of Ultra's minority shareholding in the Al Shaheen joint venture.

Acquisition and disposal related costs have reduced to £2.2m (2015: £9.4m). Last year included costs relating to the acquisition of Herley.

*see footnote on page **144**

Operational excellence

47.8p

Full year dividend of **47.8**p.

Tax, EPS and dividends

The Group's underlying tax rate* in the year improved to 21.1% (2015: 22.8%) owing to the full year tax benefit from the acquisition of Herley and patent box claims. Underlying earnings per share* increased as a result to 134.6p (2015: 123.9p).

A final dividend of 33.6p (2015: 32.3p) is proposed. If this is approved at the Annual General Meeting, this will give a full year dividend of 47.8p (2015: 46.1p) and will be covered 2.8 times by underlying earnings per share*.

Operating cash flow

Underlying operating cash flow* was £120.4m (2015: £81.3m) and the ratio of cash to underlying operating profit* increased significantly to 92% (2015: 68%). This represents the highest cash inflow and cash conversion percentage achieved since 2011.

The divestment of the ID business generated £22m, whilst earn-out payments relating to previous acquisitions were £5.8m. A non-underlying operating cash outflow of £8.2m, relating to a one-off calling of the performance bond associated with the Oman Airport IT contract, was incurred in 2016.

Capital expenditure, including on systems, was similar to last year, at £4.6m (2015: £4.6m).

Working capital increased by £11.1m (2015: increase £40.0m), reflecting a reduction in inventories and a decrease in creditors.

The ongoing Company-wide initiative targeting working capital led to a further reduction in inventories, which reduced by £8.3m over 2016 (2015: £6.6m). The reduction in inventories was offset by a £19.0m reduction in creditors. £9.5m of this was due to the unwind of a number of advanced payment balances, some of which related to the timing of sonar programmes.

The balance of the reduction in creditors was largely due to lower trade creditors.

The other outflow primarily represents the pension deficit reduction payments of £9.0m (2015: £8.5m) agreed with the trustees.

Non-operating cash flow

The underlying operating cash flow* of £120.4m (2015: £81.3m) funded the Group's various non-operating items and as a result net debt improved to £256.7m (2015: £295.6m). The main non-operating cash items were:

- cash tax of £9.0m (2015: £17.3m)
- a disposal inflow of £22.0m (2015: nil); this represents disposal proceeds (see below)
- an £8.2m outflow related to the calling of a performance bond associated with the Oman Airport IT contract
- a £2.0m third-party investment receipt for our Corvid business
- dividend payments of £32.6m (2015: £31.3m).

Effect of acquisitions and disposals

The disposals made in the year, ID and the legal intercept assets, resulted in cash proceeds received of £22.0m. £5.2m was spent on the final acquisition payments in respect of Herley and Forensic Technology. A further £1.7m was expended on disposal costs and various acquisition-related items.

> Underlying operating cash flow* was £120.4m. This represents the highest cash inflow and cash conversion percentage since 2011.

*see footnote on page 144

Financial review (continued)

£87.0m

The total borrowings drawn from the revolving facilities were **£87.0**m (2015: £140.2m).

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.

Banking facilities

Ultra's current banking facilities amount to £482.9m in total, together with a £15.0m overdraft. They are provided by a small club of banks, led by the Royal Bank of Scotland, and comprise three tranches, all of which are due to expire in August 2019. The first two tranches comprise £200m and £100m revolving credit facilities that can be drawn down in any major currency. The third tranche is a $225m term loan which was put in place at the time of the Herley acquisition in 2015. The covenants match the revolving credit facilities.

The Group also has loan notes in issue to Prudential Investment Management Inc. ("Pricoa"). At the 2016 year end, $70m (2015: $70m) of loan notes, which mature in 2018 and 2019, had been issued.

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

At the year end, the total borrowings drawn from the revolving facilities were £87.0m (2015: £140.2m), giving headroom of £213.0m (2015: £159.8m) in addition to the £15m overdraft, £56.9m (2015: £47.2m) of Pricoa loan notes had been issued. The Group also held £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 1.76 times (2015: 2.19 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-rates, 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, following the end of consultation and discussion with the Trustees, closed to future benefit accrual from 5 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 closure of the scheme to future accrual. The scheme was actuarially assessed using the projected unit method in 31 December 2016 when the net scheme deficit, calculated in accordance with IAS19, was £92.1m (2015: £68.1m). The present value of the liabilities rose by £74.7m to £382.4m in 2016 primarily due to the decrease in discount rate relative to December 2015, partially offset by a curtailment benefit of £15.5m arising on closure of the scheme to future accrual. The increase in the scheme liabilities was offset by a £46.7m increase in the value of the scheme assets to £271.2m.

*see footnote on page **144**

Operational excellence

100%

Foreign exchange risks: **100**% of expected exposure for 2017 is covered.

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 £9.5m payable in 2017, £10.0m 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.

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 £0.6m at the end of the year (2015: £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 £1.0m at 31 December 2016 (2015: £0.7m).

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.

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 2017, 100% of the expected exposure is covered, reducing to 79% of the exposure for 2018, increasing to 97% for 2019 and then reducing to 25% for 2020. Exposure to other currencies is hedged as it arises on specific contracts.

Amitabh Sharma
Group Finance Director

“Net debt/EBITDA has improved to 1.76 times.”

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.

+8.2%

Year	Revenue growth
2016	+8.2%
2015	+1.8%
2014	-4.2%
2013	-2.1%
2012	+4.0%

Comment
Revenues increased by 8.2% or £59.5m to £785.8m. A 5.8% increase reflecting the impact of acquisitions together with a 7.5% benefit from the positive impact on overseas revenues was partially offset by an organic decline of 4.1% and 1% for the disposal of the ID business.

Underlying profit before tax* growth

Description
Growth in Group underlying profit before tax* compared to the prior year, confirming that additional revenue is being gained without profit margins being compromised or that profits from new acquisitions are not being diluted.

+6.9%

Year	Underlying profit before tax* growth
2016	+6.9%
2015	+0.4%
2014	-4.1%
2013	+0.3%
2012	+0.1%

Comment
Underlying profit before tax* was £120.1m (2015: £112.4m). This contributed to the increased underlying operating margin* of 16.7% (2015: 16.5%).

Growth in underlying earnings per share*

Description
Annual growth in underlying earnings per share* calculated over a rolling three-year period, indicating progress towards the Board's primary objective.

+2%

Year	Growth in underlying earnings per share*
2016	+2%
2015	0%
2014	+1%
2013	+5%
2012	+9%

Comment
Underlying earnings per share* increased to 134.6p (2015: 123.9p). A final dividend of 33.6p (2015: 32.3p) is proposed. If this is approved at the Annual General Meeting, this will give a full year dividend of 47.8p (2015: 46.1p) and will be covered 2.8 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 the Oman performance bond, 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.

92%

Year	Operating cash conversion
2016	92%
2015	68%
2014	70%
2013	65%
2012	74%

Comment
Underlying operating cash flow* was £120.4m (2015: £81.3m) and the ratio of cash to underlying operating profit increased significantly to 92% (2015: 68%). This represents the highest cash inflow and cash conversion percentage achieved since 2011.

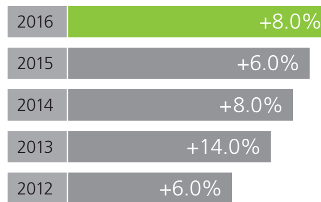
*see footnote on page **144**

Operational excellence

Total shareholder return

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

+8.0%

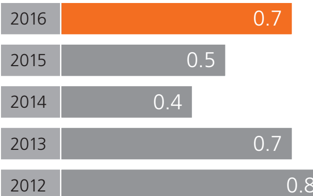


Comment
Annual total shareholder return over the 5-year period from 2012 to 2016 is 8%.

Health and safety

Description
The number of externally reportable accidents per 100 employees.

0.7



Comment
The number of externally reportable accidents increased slightly in 2016. Ultra continues its efforts to drive a health and safety aware culture.

YOURviews employee engagement survey

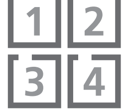
Description
Ultra's internal employee satisfaction survey, YOURviews, provides an employee engagement rating for each individual business within Ultra and is completed every one to two years. Answers to various questions are combined to give the overall employee engagement scores.

82%

Year	Score
2016	82%
2015	82%
2014	81%
2013	81%
2012	81%

Comment
The level of employee engagement has remained stable in 2016. Drawing on best practice examples, businesses develop an action plan to ensure that employee engagement continues to rise against both internal and relevant external benchmarks.

see pages **46-50** for details



Additional non-financial performance indicators
Ultra's four strategies for growth are described on pages **10** and **11** of this report. Performance indicators relating to the Group's success in these four dimensions are shown on those pages. The Group's right people are its most important asset. Performance indicators that relate to the recruitment, retention and development of Ultra's staff are included on pages **48-50** of this report.

Aerospace & Infrastructure

This Division is responsible for the following segments:

Aerospace

Infrastructure

Nuclear

Aerospace & Infrastructure revenues benefited from growth in licence sales of propeller electronic controllers at Precision Controls Systems (PCS), as well as greater demand for nuclear sensor products at Nuclear Control Systems (NCS) and a full year of revenues from Furnace Parts acquired in 2015. These gains were offset by customer delays to a number of land vehicle programmes and the timing of the JSF programme. The civil aerospace industry is largely denominated in US Dollars, so the weakening of Sterling provided much of the growth for this Division.

The Division's margins improved to 15.8% (2015: 14.9%). This was helped by the increased revenues from higher margin sales in the period and an improved operational performance at CEMS arising from site rationalisation in early 2016.

The order book was broadly flat compared to the end of 2015, when adjusting for acquisitions and foreign exchange.

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

- Entering into a partnership with Nanjing Engineering Institute of Aircraft Systems (NEIAS) to supply the Nose Wheel Steering System for the MA700. This is Ultra's first partnership with a Chinese company for the provision of aerospace systems.
- Securing orders for cockpit, lighting and HiPPAG equipment on the Typhoon aircraft amounting to £12.3m, largely due to the new export order for 28 aircraft for Kuwait.
- Continuing strategic partnership with NuScale to provide a suite of instrumentation in support of their Small Modular Reactor (SMR).

For further information on Ultra's strategies see pages **10-11**

Operational excellence

Revenue
£204.7m +6.0%

Profit*
£32.4m +12.9%

Order book
£267.8m +0.9%

Number of employees
1,205

Delivering our vision

What?
We offer superior solutions in regulated markets.

Ultra provides the innovative HiPPAG solution for the F-35 aircraft which jettisons external stores and also cools the weapon seekers. Traditionally, aircraft use either compressed gas storage bottles or pyrotechnic charges to jettison external stores. Both of these methods present problems; compressed gas bottles need to be stored, filled and replaced on the aircraft, which presents a significant logistical burden; pyrotechnics are dirty and require cleaning of the pylons after use, and the heat generated by the pyrotechnic creates a thermal signature that can be used to locate the aircraft and is a problem for the aircraft's internal weapon bay required for stealthy aircraft.

How?
We innovate to disrupt market dynamics.

Ultra's HiPPAG solution takes air from the atmosphere, compresses, cleans and dries it, and then provides it as required removing logistical and other problems. It fits in the same volume that would have been needed for a compressed gas bottle. The system is also capable of providing cryogenic cooling for weapon seekers, which is something no other system can do.

The system was developed from existing high-pressure gas products to solve problems in a way never before seen in the market. The Ultra solution is technically superior to all competitor products and has now been fitted to many aircraft types including the F-35.

Why?
We enjoy solving tough problems!

Strategy in action

PCS was awarded a $751k contract from Boeing to provide HiPPAG compressors for the New Zealand Navy's P-3 Orion aircraft. This win is the first application of a HiPPAG for the purposes of sonobuoy ejection, representing the first step in a strategy to exploit the technology to provide sonobuoy launchers for unmanned air vehicles, lightweight maritime patrol aircraft and helicopters. PCS has a longer-term strategic goal to be able to provide an integrated solution using Ultra's sonobuoy technology.

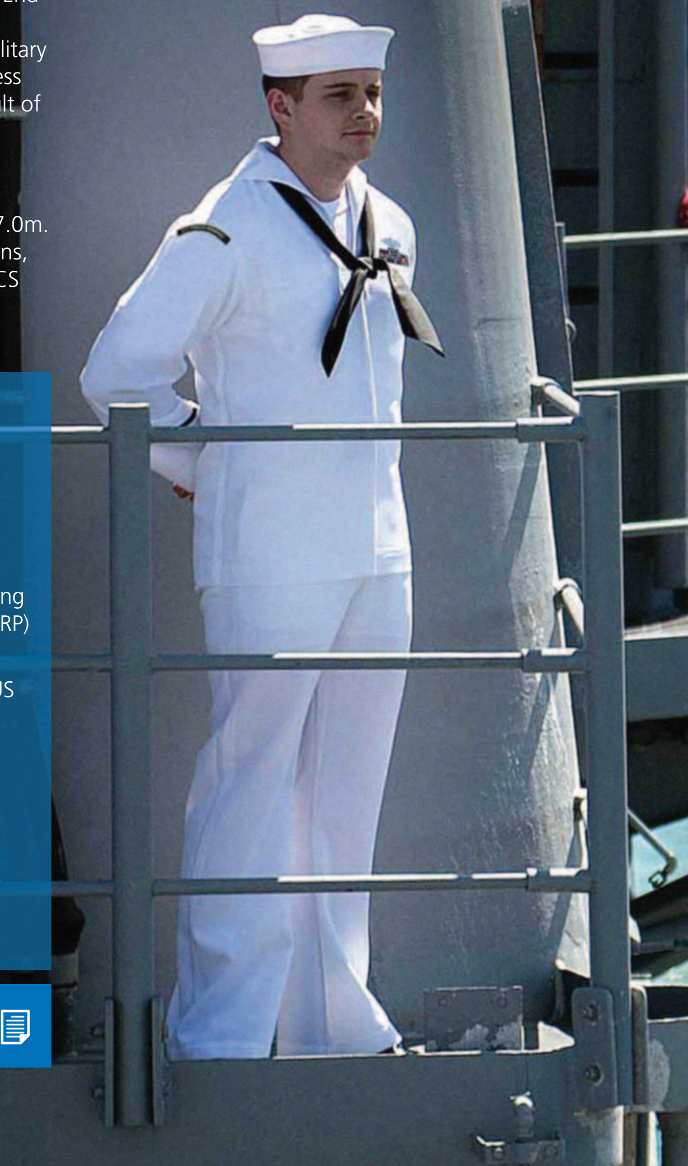
*see footnote on page 144

Communications & Security

This Division is responsible for the following segments:

Communications

C2ISR



Communications & Security's results included a full year of revenues from Herley and a part year for the ID business. The Division was impacted by timing of overseas export orders, which caused revenue declines at GigaSat and the legal intercept business. As the ECU RP programme reached completion, revenue reduced significantly as expected, although this was partially offset by the follow-on End Cryptographic Unit Contracts Logistic Support (ECU CLS) contract. TCS, our military radio and Electronic Warfare (EW) business based in Canada, grew in 2016 as a result of its activity on the Electronic Intelligence (ELINT) contract won during the year.

Encouragingly, the Division's order book increased on an underlying basis to £227.0m. This was due to a number of contract wins, notably the ECU CLS contract and the TCS ELINT contract.

The divisional margin was 15.3% compared to 16.9% in 2015. A strong performance from Herley, particularly over the last quarter, was offset by the ECU RP programme completion and the sale of the ID business.

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

- Securing a £16m programme for the continued support of our world-leading software defined crypto device (ECU RP) for the UK MoD.
- Awarded a $34.6m contract by the US DoD to continue providing critical infrastructure protection solutions.
- A substantial contract to supply Ultra Orion radios, through a strategic collaboration with a major systems integrator, for a large military communications programme in the Middle East.

For further information on Ultra's strategies see pages **10-11**

Operational excellence

Revenue
£259.0m +8.2%

Profit*
£39.7m -1.7%

Order book
£227.0m +6.2%

Number of employees
1,506

Delivering our vision

What?

We offer superior solutions in regulated markets.

Over the past four years, Ultra TCS, which has provided three generations of high-capacity radio systems for the US Army's Tactical C2 Network, has worked closely with the customer to position the ORION X-500 radio as the Line of Sight and Mesh solution for the Army's Signal Modernisation Tactical Network Transmission (TNT) Programme.

How?

We innovate to disrupt market dynamics.

ORION was specifically designed to meet the requirements of the programme and is interoperable with in-service High Capacity Line of Sight systems. It has been thoroughly tested and proven to meet programme requirements. The US trial team referred to it as "the magic radio". Following the assignment of Department of Defense nomenclature (AN/GRC-262) in December 2016, TCS was awarded its first contract for the programme and is anticipating a further award early in 2017 prior to Limited Rate and Full Rate production awards later in the year.

Why?

We enjoy delighting our customers!

Strategy in action

In May 2016, Ultra TCS was awarded a contract valued at Canadian $18.4m for a customer in a NATO country with options for after-sales support. This significant award was to provide Electronic Warfare equipment and engineering support for the delivery of UAV platforms that will be used in surveillance missions.

*see footnote on page 144

Maritime & Land

This Division is responsible for the following segments:

Underwater Warfare

Maritime

Land

The Maritime & Land Division achieved growth driven by an increase in sales of US and international sonobuoys. This reflects the continued global focus on underwater warfare, particularly in the US. Increased sales of sonobuoy receivers at Flightline on the MH-60 programme and data switching products also contributed to this year's growth. This was partially offset by Astute Class Submarine-related programmes coming to an end at our PMES business, and a slight decline in revenues at Ocean Systems relative to a particularly strong 2015. The order book was largely flat at constant currencies.

Within Maritime & Land, margins improved to 18.3% (2015: 17.3%) owing to increased revenues and the production phase of a number of US sonobuoy contracts, although this was partly offset by the completion of some Astute Class Submarine programmes at PMES.

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

- Successful delivery of the first of three Air Warfare Destroyer (AWD) integrated sonar suites (ISS) to the Royal Australian Navy.
- The provision of seamless power and data transfer technology to solve the problems of soldier-to-platform interfacing. This expansion in capability into soldier wearable technology has positioned Ultra to participate in the UK Dismounted Soldier Awareness programme as well as the US Army's Nett Warrior system.
- A strategic memorandum of agreement with Northrop Grumman (NG) Corporation to deliver new Maritime Domain Awareness (MDA) and Anti-Submarine Warfare (ASW) capabilities for NG's family of autonomous vehicles and systems.

For further information on Ultra's strategies see pages **10-11**

Ultra products are featured on a range of submarine platforms including:

Trafalgar (UK)

Astute (UK)

Vanguard (UK)

Operational excellence

Revenue
£322.1m +9.6%

Profit*
£59.0m +15.9%

Order book
£304.5m +10.8%

Number of employees
1,755

Delivering our vision

What?

We offer superior solutions in regulated markets.

To meet the anti-submarine warfare requirements for Australia's Air Warfare Destroyer programme, Ultra has conceived a novel solution that runs counter to traditional naval sonar implementations, developing the world's first truly integrated sonar solution. Whereas previous ship sonar fitments operate as discrete and independent systems, Ultra's Integrated Sonar Suite (ISS) employs a holistic, capability-led anti-submarine warfare methodology.

For the Royal Australian Navy's new Hobart Class destroyer, Ultra's ISS underwent extensive development, sub-system design proving, and dry land integration before the sonar was deemed ready for in-water testing. This process has resulted in a "best-in-class" sonar solution whose on-going sustainment will be undertaken in-country.

How?

We innovate to disrupt market dynamics.

Recognising that the primary purpose of the Royal Australian Navy's new Hobart Class destroyer is anti-aircraft warfare, Ultra has devised an innovative solution to provide the platform with an effective Anti-Submarine Warfare (ASW) system with a view to minimising any impact to the warship's primary role. Ultra's ISS is the world's first single-tow active-passive sonar that is fully integrated with the ship's hull-mounted sonar. Employing an industry first dual-frequency towed horizontal projector array in combination with a quadrature receive array. Ultra's ISS only requires one winch, instead of the two normally required for a traditional active-passive sonar system.

Use of a single-winch system significantly reduces the weight and volume dedicated to the sonar suite and enables the operator to focus acoustic energy on underwater targets of interest and rapidly pinpoint their position. This, coupled with Ultra's Ping Wizard, which utilises knowledge of the environment and reduces operator workload, has enabled the development of integrated acoustic displays in its ISS solution, reducing both operator training and ship's personnel requirements as one operator can operate both sensors from a single station.

Why?

We enjoy beating our competitors!

Virginia (US)

Strategy in action

Ultra Electronics USSI significantly broadened its acoustic hailing and indoor/outdoor mass notification customer base with the development of the HS-10 portable loudspeaker. Based on the same HyperSpike® technology employed in military and life safety applications, the HS-10 was chosen by the University of Notre Dame, Singapore Interior Police, and numerous law enforcement agencies due to its capability to broadcast intelligible voice commands at great distances with exceptional clarity. This commercial success was leveraged highly from voice of the customer design and cost targeting that was disruptive to the marketplace. USSI created a new online e-commerce system that is resulting in orders from previously unknown customers and will continue to introduce new products to the market utilising this 21st-century business model.

*see footnote on page **144**

Analysing and managing uncertainty

The analysis and management of risk is a fundamental aspect of Ultra's operating, financial and governance activities. Analysing the risks the Group faces, understanding the effectiveness of its responding control environment and early consideration of emerging risks will help Ultra deliver on its commitments, improve long-term performance and enhance its reputation in its markets.

Profitable growth cannot be achieved without some degree of considered risk. Our objective to outperform the market in terms of the annual increase in shareholder value is reflected in our appetite for risk. We have a low risk appetite in situations where our culture, reputation or financial standing may be adversely affected; however, we do consider taking higher risks where the opportunity is seen to outweigh the risks, provided appropriate levels of mitigating controls are put in place.

Risk management and internal control

The Board has overall responsibility for establishing, monitoring and maintaining an effective system of risk management. The responsibility for risk oversight is principally delegated to the Audit Committee and a continuous review and challenge of risks is provided by the Executive Team.

The approach to risk management across the Group has continued to develop and "Risk Champions" are now an integral part of each Division's identification, assessment and management of risk. The work of the Risk Champions is supported by the following enhancements which have been implemented during the reporting period covered by this Report:

- An internal Group Risk Manager was appointed to provide continuous development and co-ordination of the risk management framework and to consolidate, challenge and report on all risk management information
- "Deep dive" reviews were performed in respect to contract win/delivery and the Company's acquisition process in order to support the management of the "growth" principal risk (see case study outlining the actions resulting from the contract win/delivery "deep dive" and case study on the integration of the Herley acquisition on page **37**)
- The Risk Appetite metrics were reviewed
- An assessment of the Group's aggregate risks was undertaken by the Board.

The evolution of our risk management maturity will continue in 2017 with particular focus on:

- The embedding of the Risk Management Framework at business level to ensure consistency in the reporting and escalation of risk awareness across the Group and further embed a risk management culture
- The implementation of a risk management software tool to capture all risk registers and to provide live updates and better management information for the "risk leads"
- The performance of a "deep dive" into the "delivering change" principal risk.

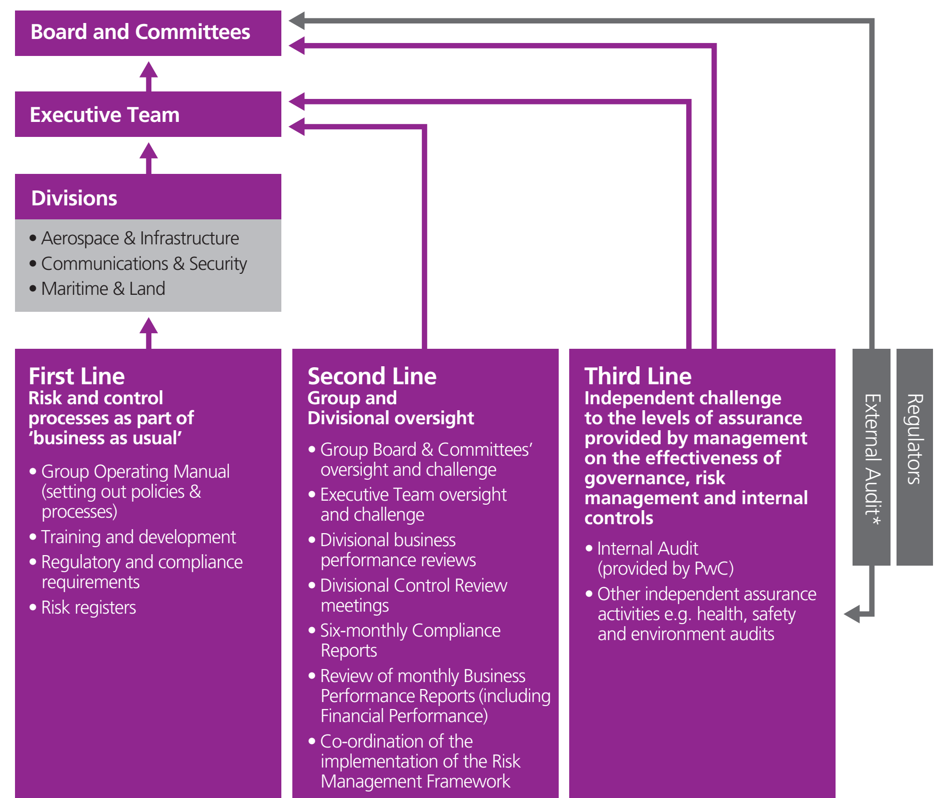
Risk management

The Risk Management Framework governs the approach we take while the **LEAP** culture and behaviours inherent within Ultra (see page **47**) ensure risk consideration is embedded into the way we operate.

The Risk Management Framework facilitates the following objectives:

- Identification, measurement, control and reporting of risk that can undermine the business model, future performance, solvency or liquidity of the Group
- Better allocation of resources for the management of principal and emerging risks
- Assurance from management that all risks are owned by a "risk lead" being an individual best positioned to control and mitigate the risks
- Driving business improvements and provision of enhanced intelligence for key decision-making
- Support and developed of our reputation as a well-governed and trusted organisation.

The risk management process



*provided by Deloitte

2016 Principal risks and uncertainties

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" ensuring 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 risks emerge and are identified. Risk leads are identified for all risks and they have the responsibility for monitoring 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, biannual, quarterly and monthly reporting to the Board, Audit Committee, Executive Team and Divisional/individual business management teams. A risk management software tool which is being introduced will facilitate this process.

The principal risks and uncertainties which could have a material impact on the Group's performance have not changed significantly from those set out in the Group's 2015 Annual Report and Accounts. However, following a review by the Board during 2016, the number of principal risks has been reduced and some risks have been reclassified to improve scrutiny, management and reporting. Each principal risk continues to have an Executive Team risk owner allocated to them who is responsible for risk mitigation, management and reporting.

During the last year the Board considered the impact on the Group of the EU referendum and considered that the decision for the UK to exit the EU does not pose a significant risk for Ultra.

Case study

"Deep dive"

The "deep dive" risk review focused on the challenges and areas of concern associated with the conversion of pipeline opportunities into contract wins and the delivery of contracted customer commitments (on budget, on time and to the agreed quality and specification).

The current risk exposure was identified, mitigation measures were assessed, lessons learnt were documented and actions to enhance the existing controls were allocated. The risk appetite statements and supporting metrics were also reviewed and updated. A key action resulting from the review was to update the Group's bid management and contract management policies to ensure, amongst other things, that the risk appetite gate reviews for all major bids and contracts are aligned with the approved bid terms.

Other key controls introduced in the new policies include:

- An improved bid approval process
- The use of risk registers at a project level aligned with the Group methodology
- The reporting of significant project risks by the businesses to their Division on a monthly basis
- Ensuring only individuals with the appropriate competences are engaged to undertake the contract and project management roles.

Case study

Herley acquisition

In August 2015 Ultra completed its largest ever acquisition when the Electronic Products Division of Kratos Defense & Security Solutions was purchased for $258m (now Ultra Electronics Herley). This acquisition provided Ultra with an established major presence in the Electronic Warfare market. However, it brought about other challenges which, had they not been managed effectively, could have had a material impact on the Group's performance. This case study outlines the steps taken by Ultra to mitigate the Herley integration risk.

INTEGRATION
Following a series of welcome presentations by the Chief Executive to all Herley employees the Divisional MD relocated to Herley's Woburn facility to manage the integration activities. A baseline integration plan was formed, responsibilities were assigned and fortnightly progress meetings were scheduled to ensure key objectives were met.

Within six months of the acquisition a YOURviews survey was conducted to measure employee engagement. Key metrics showed that 86% of all Herley employees thought the transition to Ultra was handled well and 90% enjoyed working at Herley.

TRAINING
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. The senior management team also attended Ultra's Maximising Leadership Impact (MLI) course.

24 employees were selected from across the sites to attend two separate "Making a Difference" (MAD) workshops. The themes for the workshops included operational efficiency, YOURviews action plans and creating a "One Herley" culture.

COLLABORATIVE WORKING
A cross-site Operations Council was established to exploit the gross margin efficiency savings assumed in the business case.

Within 12 months of the acquisition Herley was fully engaged in the **S3** programme including:

- involvement in meetings around the consolidation of all US purchasing, and
- evaluating options to maximise the sale value of unused land in Lancaster.

BOARD FOCUS AND CONTROL
During 2016, the Board received quarterly reports on the Ultra Electronics Herley integration plan to ensure the integration risk was being managed effectively and appropriate controls had been established.

Principal risks

The Group's reclassified principal risks are set out opposite, along with the principal risks reported in 2015 which they have replaced, and on the following pages, together 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.

2016 Principal Risks	2015 Principal Risks	
Risk 1. **Growth***	Strategy and market environment Contract win/delivery Innovation and development Acquisitions	Decreased risk
Risk 2. **Delivering change**	No change	Increased risk
Risk 3. **People and culture***	People Culture	No significant change
Risk 4. **Information management and security***	Cyber Intellectual property/information security	No significant change
Risk 5. **Supply chain**	No change	No significant change
Risk 6. **Governance and internal controls**	No change	No significant change
Risk 7. **Pensions**	No change	Decreased risk
Risk 8. **Legislation/regulation**	No change	No significant change
Risk 9. **Health, safety and environment**	No change	No significant change

***newly reclassified risk**.
Note: the "Treasury and Tax" risk reported in 2015 is no longer considered a principal risk.

Risk 1. **Growth**

Trend: Decreased risk

Changes during 2016

Whilst the defence market has been challenging in recent years there are now strong indications of a return to growth, particularly in the USA. Export markets remain problematic but these constitute only about 15% of revenue. The Company's focus in the year on its market-facing segment strategies, successfully integrating Ultra Electronics Herley and improving its bid and contract management policies, leaves us well placed to exploit this upturn. The overall level of risk has reduced from the prior year.

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.

See our market section on page **2**

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):

- Challenges in the UK defence market offset by expansion into targeted overseas regions exhibiting long-term growth characteristics
- The market-facing segment strategies enable Ultra to utilise the capabilities of its businesses more effectively to deliver enhanced solutions to its customers
- The **LAUNCH** approach to customer engagement ensures Ultra understands the real needs of its customers
- Following an audit conducted by PwC on Ultra's bid process and long-term project management, the Group has revised its internal bid and contract management policies to ensure that bids are submitted and won at acceptable margin levels and risk tolerances and contracts are effectively executed
- 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. In 2016, the Board received quarterly reports on the Ultra Electronics Herley integration plan.

2016 Principal risks and uncertainties

Risk 2. **Delivering change**

Trend: Increased risk

Changes during 2016

The scale and complexity of change has increased as **S3** initiatives and business consolidations take effect.

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.

See pages **12-13** for information on **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 to business performance.

Mitigations (examples):

- A "deep dive" review of this principal risk in 2017
- An Executive Team sponsor is allocated to all major change programmes, which are also monitored on a monthly basis by the Board
- In 2016, PwC undertook a risk review of **S3**. The recommendations from this review are being considered for implementation
- An **S3** steering committee, chaired by the Chief Executive, meets monthly to track progress against the plan
- An **S3** communications manager is being 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 2016

Talent and succession planning has been a focus for the Board and Executive Team in 2016. The Board considers there is more work to do in this area and it remains a focus in 2017.

Description

Preserving Ultra's culture (innovation, agility and accountability) 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 objective.

See developing Ultra's people on pages **46-50**

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 lead to operational inefficiencies and loss of productivity
- Staff morale could be impaired resulting in a rise of employee related issues (e.g. grievances and sickness)
- Not maintaining a strong ethical culture would increase the Group's exposure to legal and regulatory breaches.

Mitigations (examples):

- Ultra is engaged in a number of initiatives with local schools, colleges and universities which provide access to the best people for its apprenticeship and graduate recruitment programmes. Employee development needs are identified during the performance and development reviews and future development is aligned with these specific needs
- The annual Organisation, Succession & Development Plan (OSDP) results in high-potential employees being identified and their development monitored. The establishment of the "Chief Executive's Mentoring Club" has enhanced this process.
- Employee engagement and morale is measured through YOURviews surveys. The survey identifies any areas of concern which are then addressed by the businesses' leadership teams
- Talent and succession planning has been, and will continue to be, a focus for the Board (see page **50**).

Principal risks (continued)

Risk 4. **Information management and security**

Trend: No significant change

Changes during 2016

CORVID Protect and Ultra's approach to security provide a high level of assurance. However, the global increase in the frequency and sophistication of cyber security crime means this risk continues to be a priority for the Company.

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 loss of data/data integrity and disruption to operations.

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 to business activity as systems are cleansed and restored.

Mitigations (examples):

- Continued investment in Ultra's Cyber Protection Group (CPG) (now part of CORVID Protect), which provides Group-wide monitoring, incident response and continued enhancement of Ultra's IT systems and processes
- Board is kept updated on CPG's developments on protecting Ultra's network, including protecting Ultra from phishing attacks
- The Group's Information Security Policy has been updated
- Protection of intellectual property was addressed in the bid and contract management review (see page **38**)
- Security clearance processes in place for all employees
- Established physical security processes implemented at all sites.

Risk 5. **Supply chain**

Trend: No significant change

Changes during 2016

We do not consider that the level of risk has changed 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 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.

See **S3** work on improving the supply chain on pages **12** and **13**

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):

- The Bid Management Policy has been updated to ensure any major supplier issues and risks (including single-source arrangements) are highlighted and mitigated against, prior to customer contracts being accepted
- The Board has adopted an Anti-Slavery and Human Trafficking Statement in compliance with the Modern Slavery Act 2015 (**www.ultra-electronics.com/investors/anti-slavery-and-human-trafficking-policy.aspx**)
- Pre-contract audits of key suppliers and sub-contractors and continuing review of their performance
- Business continuity and IT disaster recovery plans are in place
- **S3** improvements to the supply chain process
- Business interruption, property damage, professional indemnity and product liability insurance.

2016 Principal risks and uncertainties

Risk 6. Governance and internal controls

Trend: No significant change

Changes during 2016

We do not consider that the level of risk has changed in the year.

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.

Read more about accountability on page **64**

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 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 2016

We consider this risk to have reduced due to the closure of the UK pension scheme to future accrual, the completion of the 2016 triennial valuation and the increase in hedging of the pension scheme liabilities.

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.

Read more about the Group's UK defined benefit pension scheme on pages **26-27**

Potential impact of failure:

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

Mitigations (examples):

- Group's UK defined benefit pension scheme was closed to future accrual with effect from 5 April 2016
- The Company agreed the pension triennial valuation in 2016
- The Pension Trustees and 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 Company agreed to increased hedging of the scheme's liabilities in 2016
- The Board undertakes regular Pension Strategy Reviews.

Principal risks (continued)

Risk 8. **Legislation/regulation**

Trend: No significant change

Changes during 2016

We do not consider that the level of risk has changed in the year. The Company continues to take compliance very seriously and the Board and Executive Team strive to reinforce an ethical culture.

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.

Read more about Ultra's approach to ethics on page **51**

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 has well-established and regularly updated policies and procedures covering legislative and regulatory requirements and compliance training. Individual businesses are required to provide compliance statements as part of their monthly business performance reports
- The Ethics Overview Committee provides independent advice and scrutiny of Ultra's business activity and provides assurance that the Group's current and planned undertakings are transparent and conducted in a manner consistent with 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 Company has taken steps to ensure it is compliant with the Modern Slavery Act 2015
- The Board receives regular updates and presentations on the Company's legal and regulatory requirements
- A working group has been established to evaluate the impact of the General Data Protection Regulation and to ensure Ultra is compliant with its obligations.

Risk 9. **Health, safety and environment**

Trend: No significant change

Changes during 2016

Ultra has strong health, safety and environment (HS&E) processes and procedures. The Board has a zero appetite for HS&E reportable incidents and has elected to report health and safety as one of its KPIs (see page **29**). The externally reportable accident rate per 100 employees and the number of lost time accidents per 1000 employees increased slightly in 2016. Investigations of these accidents were undertaken and appropriate risk mitigations were implemented. The Company does not consider the HS&E risk profile of the Group to have changed from last year.

Description

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

Read more about Ultra's approach to HS&E on page **52**

Potential impact of failure:

- Incidents may occur which could result in harm to employees and/or 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 a low appetite for HS&E risk and is committed to ensuring that the Group's leadership see this as a top priority. Any material incidents are reported to the Board along with a correction/mitigation plan
- 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.

2016 Principal risks and uncertainties

Statement of going concern

Ultra's committed banking facilities amount to £482.9m in total, together with a £15.0m overdraft. They were established in three tranches.

The first tranche comprises £100m of revolving credit, denominated in Sterling, US Dollars, Canadian Dollars, Australian Dollars or Euros. This facility was signed in December 2012, amended and extended in July 2015 and expires in August 2019. The facility is provided by a group of five banks.

The second tranche provides a further £200m of revolving credit in the same currencies. This was signed in August 2014 with seven banks and expires in August 2019. Both facilities have the same covenants.

The third tranche, agreed in May 2015, is a $225m term loan with a group of banks from our lending group. This loan, denominated in US Dollars, was drawn in full in August 2015 to complete the Herley acquisition, and expires in August 2019. The covenants match the revolving credit facilities.

The Group also has loan notes in issue to Pricoa; at the year end, $70m (2015: $70m) of loan notes, which mature in 2018 and 2019, had been issued.

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 23 – Financial Instruments and Financial Risk Management.

Although global macroeconomic conditions remain uncertain, the long-term nature of Ultra's business and its positioning in attractive sectors of its markets, 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 2019, to coincide with its review of the Group's financial budgets and medium-term forecasts from its Strategic Plan. The 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 2019. 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 over the period. The Directors have determined that the three-year period to December 2019 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 account of the Group's financial projections together with available cash and committed borrowings, financial covenants and any 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

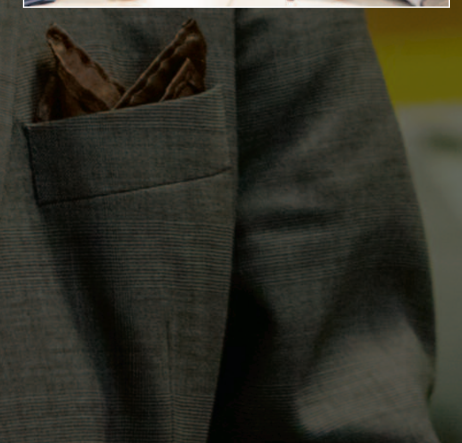
Ultra recognises that the success and sustainability of the business is enhanced by positive relationships with stakeholders and continues to focus on value creation for all: shareholders, customers, employees, the environment, local communities and suppliers.

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 special relationships with educational establishments in the surrounding communities offering work placements and visits to businesses as part of AS level courses, as well as providing interview practice sessions, supporting lessons, careers events and school science fairs. Ultra is involved in the nationwide initiatives on STEM* education and also offers Arkwright scholarships: a scholarship that sponsors A-level students looking to pursue a career in engineering through their education. Ensuring a long-term supply of talent to the business is essential and Ultra commits itself to developing the talent pipeline in schools and higher education institutions. This was exemplified at the Dorset Business Awards where NCS was a finalist in the Best Engagement with Education award. Each business manages its own charitable budget, which it uses to maintain and grow connections with local communities.

*STEM: Science, Technology, Engineering and Mathematics

Fundraising and voluntary work in the local community or at a national level is something the Group is keen to encourage. It actively supports employees who undertake voluntary activities. Some noteworthy examples in 2016 include:

- Ultra has created "Charity Champions" within each Ultra UK business to promote the Group's partnership with Macmillan Cancer Support to raise enough money to fund a Macmillan nurse for a whole year. The initiative began with the World's Biggest Coffee Morning on 30 September and continues until April 2018.
- ATS has received the Distinguished Partnership Award from the Del Valle independent school district in Texas for a third year in a row for outstanding contributions throughout the year to Smith Elementary School. This is a neighbouring elementary school which ATS has "adopted".
- CIS worked in collaboration with SPEAR Group, an organisation dedicated to helping young people who find it difficult to gain employment to become more employable. Together they have run CV workshops and introduced participants to various professionals, sharing career knowledge and success stories.



For more about securing the talent pipeline, see page **48**

Sustainability, people and culture

Shareholders:
The Group's primary objective is to outperform the market by delivering above-average increases in total shareholder return, which it has a long track record of doing, and by communicating effectively with shareholders and the financial community.

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 its commitments. Ultra's businesses aim to build long-term, mutually beneficial relationships with their customers and become part of the customers' extended enterprise.

Examples from 2016 that highlight Ultra's commitment to its broad customer base are:

- NCS was named EDF's "Supplier of the Year" at the EDF Energy Generation's 5th Annual Performance and Innovation Awards ceremony. This is in recognition of the Neutron Flux Detector programme.
- Herley, which was acquired by the Group in 2015, received Raytheon's Operational Excellence Award. In addition to this, Lockheed Martin and the US Navy presented Certificates of Recognition to employees who went above and beyond in service on the Trident Fleet Ballistic Missile programme.
- EMS received special recognition as a critical supplier of the hand controllers used in the Boeing Commercial Crew Transportation System (CCTS) for NASA.

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 strong 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 essential. 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:

- In 2016 a "Chief Executive's Mentoring Club" was established across the Group. This aims to help high-potential people develop their careers and realise their full potential by being mentored by the Chief Executive.
- Airport Systems was a finalist in the national award for the best employee engagement initiative by the professional HR body CIPD, following the turnaround of business morale, engagement levels and YOURviews feedback over the past three years.
- For the second year in a row Ultra Electronics US was presented with the Gold Wellness Award by the Business Council of Fairfield County, Connecticut. This recognises the UltraFit programme and Ultra as a leading company in promoting a healthy workplace for its employees.

The environment:
Ultra is committed to implementing and enforcing 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 for its suppliers to reduce their environmental impact.

Initiatives that have taken place within the Group include:

- 3eTI continued to promote its "Go Green Campaign" with the addition of the "Paper Reduction Campaign" which supplements the on-going paper recycling initiative.
- CIS held a waste and recycling awareness day to improve the awareness and visibility of waste management for all employees.
- Flightline hosted the New York State Department for a voluntary audit of the facility. This is a proactive effort to keep employees safe and ensure compliance.
- A two-day external Achilles Audit at NCS resulted in the Environmental Management system gaining a 100% score.

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.

To read more about Ultra's customers, see page **2**

To read more about Ultra's people, see pages **46-50**

To read more about the environment, see pages **52-53**

Developing Ultra's people

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

The right people

Most companies state that their people are the company's most important asset. Ultra varies this slightly: the right people are the Group's most important asset. It is generally recognised that Ultra is successful in innovating to meet customers' needs due to the broad range of skills and capabilities of the Group's employees. Therefore, people and their development are key initiatives for the Group as it strives to achieve an efficient organisation with engaged and committed people.

Domain expertise

Ultra maintains its domain expertise by ensuring that employees maintain 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. Ultra maintains its domain expertise by ensuring that employees maintain continuing professional development and close links with customers and end-users of Ultra's products. The Group ensures it has the right people to work with customers to support their needs by understanding their problems and creating winning solutions.

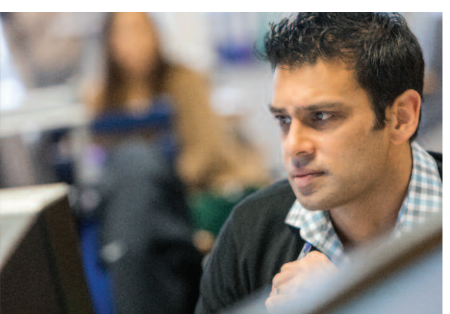
> "I have enjoyed working at Ultra immensely! The highly varied work that Ultra gives me has provided me with a challenging, but highly enjoyable, working environment."

Nicholas Roberts Graduate Engineer, Precision Control Systems

How Ultra manages its people

Ultra values 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.



People in action

Nicholas Roberts (above left) is a Graduate Engineer at Precision Control Systems, having joined Ultra through an Arkwright Scholarship.

Why did you choose Ultra?

I chose to go with Ultra as my full time employer as, over the years, I had gained fantastic working relationships with many of my co-workers. During my many work experience placements, I had seen the progression of several projects and was excited to be involved in them and everything Ultra does.

What is your role at Ultra?

I currently work within the Systems department. My role includes creating, maintaining and supporting the use of an increasing number of business tools throughout Ultra's different departments, while gaining valuable experience of how the business functions.

How long have you been here?

Overall I've worked with Ultra for just over seven years. I started as an A-level student (through an Arkwright Scholarship at the end of my GCSEs), coming to Ultra for work experience and help with school projects. I then continued my work experience with Ultra every holiday throughout my university course, where my group and individual dissertation projects were supplied by Ultra. Once I graduated from university, I joined Ultra full time as a graduate engineer and have currently completed over half of the two-year course.

What have you enjoyed most about this role?

I have enjoyed working at Ultra immensely! The highly varied work that Ultra gives me has provided me with a challenging, but highly enjoyable, working environment. Ultra has given me the opportunity to improve, expand and utilise my skill set. I have been able to follow along my own career path knowing that the direction I am taking has all been of my own decision.

Sustainability, people and culture

Ultra is committed to securing the talent pipeline and developing people to ensure the continued growth and success of the Group. Focus is placed on ensuring that the right people are in the right roles. Furthermore businesses are responsible for and encouraged to develop their teams and individuals continuously, which will enable people to grow with the business and not become a constraint on the development of the Group.

Culture
The Group believes 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. As the Group expands through organic growth, natural staff turnover and acquisitions, Ultra is committed to keeping its culture strong. 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**.

What people mean to Ultra
Ultra's aim of delivering an efficient organisation, with engaged and committed people to meet the Group's business commitments, is a goal 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.

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.

- **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?

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.

Developing Ultra's people (continued)

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. Relationships with schools and colleges take a variety of forms, including work experience, longer work placements, visits as part of AS-level courses interview practice sessions, careers events, and Ultra employees supporting both lessons and after school clubs. Examples include:

- CIS has a STEM* ambassador supporting local schools and a senior manager serves as a Local Area Board Member for the "Career Ready" initiative at another local school.
- The EDT Engineering Education Scheme for Sixth Form students, which runs for nine months of the year, has been adopted by Precision Controls Systems (PCS). This year the students worked with employees to research and build a prototype model for recovering electrical energy on military vehicles.
- NCS undertakes many activities with local schools, including hosting pupils for site visits, attending "next steps" careers evenings and careers fairs, and presenting the Post 16 conference, which is attended by Heads of Sixth Form, careers advisors and local authority.

Ultra's focus is mainly engineering but extends to include other STEM* subjects, as well as finance and commercial disciplines. The Group also sponsors students through their last years at school 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, many of whom were recognised at this year's awards ceremonies.

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 42 apprentices in training in the UK.

There have been a number of notable successes:

- NCS has celebrated the graduation of its first group of apprentices after four years of hard work. The four apprentices completed their Advanced Apprenticeship in Engineering Manufacturing and will now successfully continue on to the next stage of their Ultra career. The success of the 2012 intake has demonstrated the value of apprenticeships to both learners and the business.
- Three Advanced Apprentices at PCS are continuing their academic qualifications and enrolled in degree courses at the University of West England; their Advanced Apprenticeships mean they are able to start at the 2.2 level rather than entry level.
- At the Engineering Trust awards, three apprentices were recognised for first-year achievements and endeavour, two for third-year achievements and endeavour and one was Electrical Student of the Year. In addition to this, two apprentices have been shortlisted for the prestigious National Skills Academy for Nuclear Apprentice of the Year Awards.

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 allows Ultra 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 17 university students and also provides a number of work placements as part of degree courses (23 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.

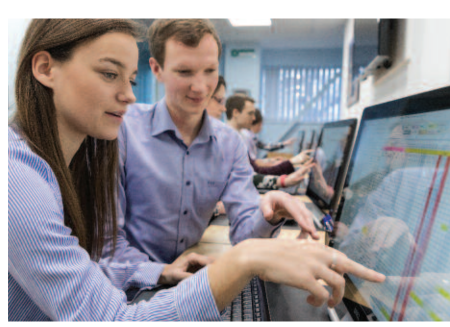
SUCCESS STORIES

- Ultra PCS has formed relationships with several universities resulting in seven offers of employment to undergraduates this year alone.
- Maritime Systems has received an award for the "Best Co-op Student Employer" in Nova Scotia.
- 3 Phoenix is currently working with ten interns from their partner Universities and Colleges.
- Command & Sonar Systems received a certificate in recognition of working in partnership with Birmingham City University as well as being an Uxbridge College Employer Champion.

INSTITUTIONS
Ultra's UK businesses are members of Engineering UK, Cyber Challenge 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



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

UK data

Employees	2,204
Apprentices	42
University placement students	7
Sponsored university students	3
Arkwright scholars	11

US data

Employees	1,700
Undergraduate interns	16
New graduates	5
Employees working on graduate-level degrees	14

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, and 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 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.

Training and development in action

As a part of its commitment to supporting employees, 2016 saw the completion of Ultra's new Training and Development Suite based in Cheltenham, UK. The centre allows up to 21 people, at all levels of the business, to increase their knowledge and take part in a variety of inclusive, practical workshops. Ultra sees this as a ground-breaking opportunity to encourage its people to grow and develop a variety of skills including International Traffic in Arms Regulation (ITAR) Awareness, Human Factors in the Work Place, Foreign Object Damage (FOD) and external Northern Advisory Council for Further Education (NCFE) Level 2 training. As well as these professional skills the training centre also encourages people to drop in and learn more practical skills such as using computers and tablets, and sending emails. The success of the centre and the enthusiastic response from employees demonstrates Ultra's commitment to helping its people develop, and the fostering of an environment in which employees are keen to progress.

*STEM: Science, Technology, Engineering and Mathematics

Developing Ultra's people (continued)

Succession planning and retention

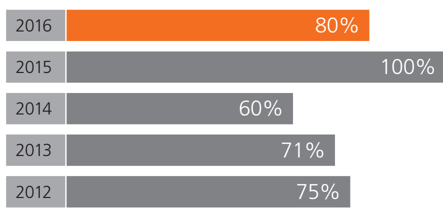
Each of Ultra's businesses prepares an annual "Organisation, Succession & Development Plan" to ensure that Ultra has the right people in the right place in the organisation. The plan assesses individuals' performance in their current role and their potential to perform a larger role in the short or longer 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 of 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 the 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. Ultra continuously recruits new employees and acquisitions in order to bring additional new people into the Ultra family.

Retention of "high-performers"

Year	%
2016	98%
2015	100%
2014	98%
2013	97%
2012	97%

"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."

Sustainability, people and culture

Corporate and social responsibility

Ultra believes that a successful and sustainable business is built on more than just financial results. Ultra has built a reputation for meeting its commitments.

Ultra believes that a successful and sustainable business is built on more than just financial results. Ultra has built a reputation for meeting its commitments to all its stakeholders.

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 in 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. In 2016, the Company reviewed its supply chain management processes in light of the Modern Slavery Act 2015 and has published a statement on Slavery and Human Trafficking which can be found on the Group's 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, competition and anti-trust 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:
http://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 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

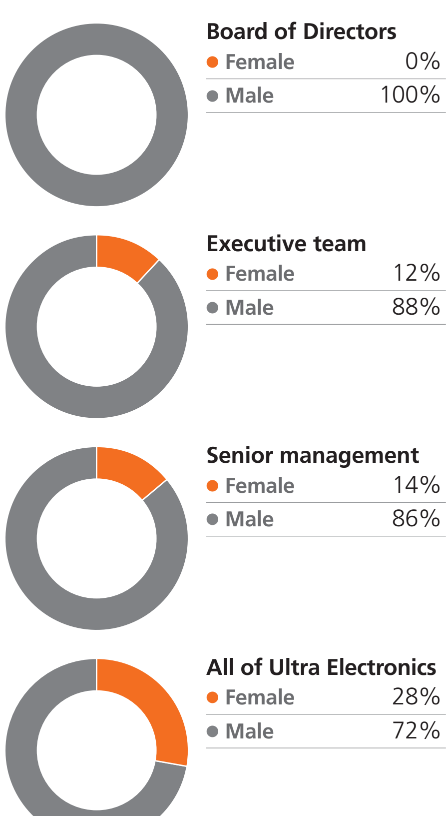
The Ethics Overview Committee was formed to provide independent advice and scrutiny of Ultra's business activity, giving assurance that the Group's current and planned undertakings are conducted in a manner consistent with the legislative environment and are transparent. The Committee comprises six permanent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

Corporate and social responsibility (continued)

Diversity and inclusion

These values are embedded into the organisation to ensure 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.



% of gender diversity

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

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 and 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 Chief Executive.

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.

Historically, Ultra has reported lost time accident data per 200,000 hours and reportable/recordable accident rate per employee. To bring Ultra's reporting into line with its peers and to reflect a new, non-financial KPI (see page **29**), Ultra has elected to report lost time accident rate (being an accident resulting in half a day or more off work) per 1000 employees, see **Figure 1** and externally reportable accidents per 100 employees, see **Figure 2**.

Figure 1
Lost time accidents per 1000 employees

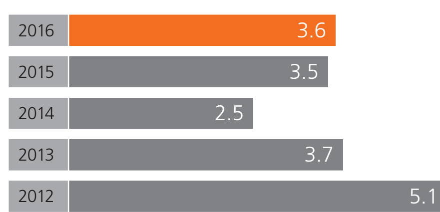
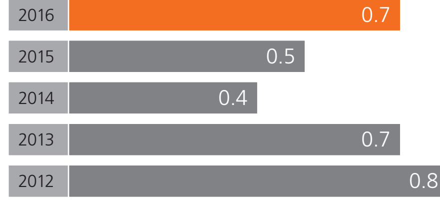


Figure 2
Externally reportable accidents per 100 employees



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.

Sustainability, people and culture

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

IMPLEMENTATION

The Chief Executive 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.

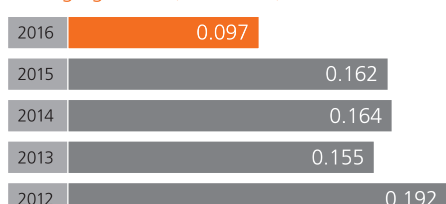
Ultra's formal environmental policy addresses compliance with environmental legislation, conformity with standards for air, waste disposal and noise, the economical use of materials and the establishment of appropriate environmental performance standards. Progress is monitored through annual reporting and a biennial external audit process, the last of which took place in 2015. 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 2016, continuing the excellent track record of the previous five years.

There was one environmental incident reported in the year, which has been resolved.

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.

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

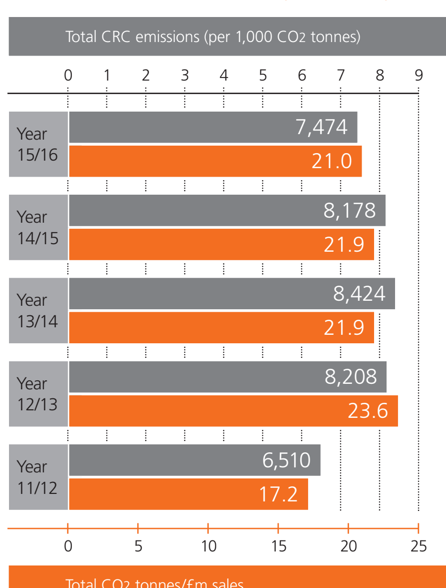


Note: 2016 figures show reduction due to in-year disposal of ID Systems

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 2015/16 were 7,474t CO_2. Historical performance data is shown in **Figure 4**.

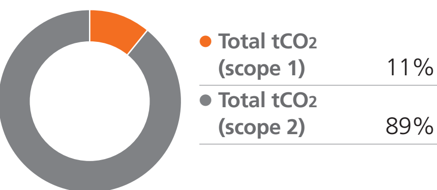
Figure 4
Total tonnes of CO_2 emitted (t/£m sales)



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 19 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



Ultra's Greenhouse gas emissions – tonnes of CO2 (tCO_2)

Total tCO_2 emitted by all Ultra businesses	**20,895**
Total tCO_2 from Ultra's business activities (scope 1)	**2,201**
Total tCO_2 purchased by Ultra (scope 2)	**18,694**
Ultra's annual emissions in relation to Ultra's business activities shown as tCO_2 per £m of revenue	**26.59**

Methodology

In 2016, 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 our 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 2015, ProLogic, 3 Phoenix, 3eTI, ATS, Flightline and NSPI all achieved 100% in the audit. Additionally in the UK, CIS, ID, Sonar Systems, PMES, PALS and Controls all maintained the ISO14001 environmental standard.

Sharon Harris
Company Secretary & General Counsel

To read more about Ultra and the environment, see page **45**

Board of Directors

Douglas Caster 1
Chairman

Time with Ultra: **28 years 2 months** | Time in position: **5 years 8 months**

Rakesh Sharma 2
Chief Executive

Time with Ultra: **27 years 2 months** | Time in position: **5 years 8 months**

Amitabh Sharma 3
Group Finance Director

Time with Ultra: **12 months** | Time in position: **8 months**

Mark Anderson 4
Group Marketing Director

Time with Ultra: **5 years 7 months** | Time in position: **4 years 8 months**

Sir Robert Walmsley 5
Non-Executive Director

Time in position: **7 years 11 months**

Martin Broadhurst 6
Non-Executive Director

Time in position: **4 years 5 months**

John Hirst 7
Non-Executive Director

Time in position: **2 years**

Sharon Harris 8
Company Secretary & General Counsel

Time with Ultra: **5 years 1 month** | Time in position: **4 years 8 months**

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

NOTE: All details correct as at 31 December 2016

1. Douglas Caster
CBE BSc FIET

Douglas is a highly experienced engineer and manager of electronics businesses. He has a long track record of delivering growth through effective acquisitions and 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 and became Chairman of Ultra in April 2011.

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

2. Rakesh Sharma
BSc EMBA MInstP FRAeS FREng CPhys

Rakesh has managed businesses and divisions across the full range of Ultra's wide portfolio, with consistent success in driving growth in the Group. Combining business and technical insight, he ensures Ultra businesses maintain a competitive advantage in the Group's specialist market sectors.

Rakesh started his career as an electronic design engineer at Marconi in 1983, before moving to Dowty as Chief Engineer of Sonar & Communication Systems in 1989. He was appointed Marketing Director of that business in 1993, when Ultra Electronics was formed. From 1997 to 1999, he worked in the US as Ultra's Operations Director, North America. After returning to the UK, he was Managing Director of PMES and then of Sonar & Communication Systems, before taking his first divisional role in 2005 as Managing Director, Tactical & Sonar Systems. In 2008, he moved to run the Group's Information & Power Systems division, before being appointed Chief Operating Officer in January 2010. He was appointed to the Board in April 2010 and became Chief Executive in April 2011.

3. Amitabh Sharma
BSc FCA

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.

4. Mark Anderson
CB BSc

Ultra's strategic process benefits from Mark's broad customer perspective and operational experience.

Mark joined the Royal Navy in 1974 as a weapon system engineer, before switching career path to achieve both nuclear submarine and ship command. His MoD staff appointments include policy roles in two Strategic Defence Reviews and equipment customer responsibility for all underwater programmes. He has worked closely with the United States throughout his career, including sensitive roles within the US Joint Staff. Promoted to Rear Admiral, he commanded all Fleet Operations and headed the UK submarine service up to the end of his 36 years' service in June 2011. He then joined Ultra in a divisional strategy role, before being selected to join the Board in April 2012.

5. Sir Robert Walmsley
KCB, FREng

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.

6. Martin Broadhurst
OBE MA C.Dir FIoD FRAeS

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 Beagle Technology Group and Centre for Engineering Excellence; and a trustee of the Royal Aeronautical Society. He was appointed to the Board in July 2012.

7. John Hirst
CBE BA DSc FCA MCT CCMI

John is a highly experienced leader of large global organisations, in both the private and public sector. 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. Before this, 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.

8. Sharon Harris
LLB

Sharon is the Group's Company Secretary and General Counsel. She brings corporate legal expertise to the Board role, together with plc experience in corporate governance.

Sharon graduated from Kings College, London with a law degree. She started her career at Norton Rose as a trainee solicitor and has international plc experience gained in the FMCG, pharmaceutical, media and electronics sectors. She joined Ultra in November 2011 and was appointed Company Secretary in April 2012.

Chairman's governance statement

Dear Shareholder,

On behalf of the Board, I am pleased to present Ultra's Corporate Governance Report, which provides an insight into how the Board spent its time during 2016. In the pages that follow, we have set out how we discharged our governance duties and applied the principles of the UK Corporate Governance Code.

Douglas Caster
Chairman

Culture

One of the key roles of the Board is to establish the culture, values and ethics of the Company. Ultra's Board recognises that strong corporate governance, underpinned by a sound, ethical culture, is fundamental to Ultra's success. It ensures we deliver on our promises and continue to be a resilient and sustainable business.

The Board's programme of Non-Executive Director site visits continued in 2016. This provides an opportunity for the Directors to satisfy themselves that the culture, values and ethics, which are set from the top, are reflected in the businesses.

The Board continuously considers the impact of activities on Ultra's culture. In evaluating an acquisition case, the Board considers the cultural fit. The Board is conscious of the need to ensure Ultra's culture of accountability and responsibility is maintained throughout the implementation of the **S3** workstreams (details of which are on pages **12-13**); and consolidation of the businesses as described in the Chief Executive's report (see page **6**). "People and culture" is one of the Group's principal risks (as further described on page **39**) and a Board strategy session was dedicated to considering this topic.

Growth

Revenue growth is one of Ultra's KPIs. In the year, the Board considered the impact of the UK defence budget on Ultra's UK defence strategy and the actions the Company should take to secure a larger share of the UK defence budget and positions on major programmes. The Board also considered the Company's expansion into overseas markets and the Company's engagement with The Defence Growth Partnership in support of this.

Investor engagement

In the year, we continued our active engagement with the investor community (see page **64**). Ultra's main institutional shareholders were consulted on the appointment of Amitabh Sharma as the Group Finance Director and the new Remuneration Policy. The Remuneration Policy is set out on pages **74-88**.

Director appointment and succession planning

On his appointment as Group Finance Director, Amitabh underwent a rigorous induction programme (see pages **62-63**).

Succession planning for the Board and senior management continued to be a focus of the Board in 2016. Succession and talent management were discussed at a half-day Board strategy session (see page **59**) and Board dinners were held which were attended by potential successors. These occasions provided a relaxed forum to meet high-potential employees.

Ultra's strategy, reinforced by its culture of accountability and responsibility and a robust governance framework, ensures Ultra remains a resilient and sustainable business.

Douglas Caster CBE
Chairman
3 March 2017

Corporate Governance Report

Compliance statement

Throughout the financial year ended 31 December 2016, the Board considers that it, and the Company, has complied with the provisions set out in the September 2014 edition of the UK Corporate Governance Code (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 the right decisions are made in the right way.

Read more about the Board's leadership on pages **58-61**.

Effectiveness

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 **62-63**.

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 **64**.

Relations with shareholders

We maintain strong relations with our shareholders through events and consultations.

Read more about shareholder relations on pages **64-65**.

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 **74-88**.

Role of the Board

The role of the Board is to provide effective leadership and direction in delivering the key corporate objective to outperform the market in terms of annual increases in Shareholder return. 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 Chief Executive and his Executive Team, to run the operations of the Group.

In addition to the ten scheduled Board meetings, the Board held a number of unscheduled Board meetings in the year to, amongst other things, evaluate potential acquisitions. Following such reviews, the Board decided not to pursue any acquisitions in 2016.

A summary of how the Board spent its time in 2016 is set out on pages **58-59**. 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**).

> 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.

Corporate Governance Report (continued)

Leadership

How the Board spent its time in 2016

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 meeting devoted wholly to the review of the five-year strategic plan and principal risks was held. This meeting ensures the Company has a well-articulated strategy for growth. The focus was on the Divisional and market segment strategies (see pages **14-21**). Presentations were given by the Executive Team and discussions were held on significant matters identified in the proposed plans.
	Two half-day strategy sessions were held in the year at which the following were considered:
	• Ultra's UK defence strategy
	• Expansion into overseas markets
	• Talent management
	• Risk management, including a "deep dive" into contract win and delivery and the Group's acquisition processes
	• Internal and external teaming
	• Business structural changes.

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'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 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.
	• The Board approved the closure of the Ultra Electronics Pension Scheme to future benefit accrual with effect from 5 April 2016 and the pension triennial valuation (read more on this on page **41**).

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's Report providing a brief on market developments, order intake and bids. Improvements were made to this report in the year to improve order pipeline visibility.

Group risk framework and management	
Set the Group's risk appetite and monitor the Group's significant risks.	• The Board conducted an annual refresh of the Group risk register (including risk appetite); undertook an assessment of the total risk basket to which the Company was exposed and the consequences of a number of high-impact risks occurring simultaneously; approved the risk section of the Strategic Report; and undertook a mid-year review of the Group risk register. • The Board considered the risk profile of major projects and the impact of the EU referendum result 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. • A review was undertaken of Ultra's Cyber Protection Group's role in mitigating the Group's cyber security risk, including the increase in phishing attacks. • An updated crisis and incident management plan was approved. • The Board approved the Group's insurance programme.

People, Board effectiveness and succession planning	
Receive reports on changes in senior management. Review succession planning and undertake an annual Board evaluation.	• At each scheduled Board meeting, the Board received an update on changes in senior management. At a half-day Board strategy session, the Board considered the Company's approach to talent management in depth. • The Board partook in an annual Board evaluation (see page **63** 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 and evaluated acquisition opportunities. • The Board considered and approved the divestment of the ID business. • The Board considered and approved the consolidation of the Group's businesses and the establishment of CORVID Protect and CORVID Paygate. • Quarterly reports on the Ultra Electronics Herley integration plan were considered. • The Board received briefings on the legal proceedings 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.

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 **57**). • The Board considered and approved Group policies, including Ultra's anti-slavery and human trafficking policy and bid and contract management policies. • The Board undertook corporate governance compliance training. The topics included Directors' duties, significant transactions, compliance with the Market Abuse Regulations and related party transactions. • The Board considered Ultra's compliance with the Energy Savings Opportunity Scheme. • The Board received reports on the Company's processes for compliance with the Insurance Act 2015 and the Group's offset policy.

Corporate Governance Report (continued)

Leadership

Board priorities for 2017

- Monitor the implementation of the Group's strategies for growth.
- Support the further development of talent and succession planning across the Group with particular focus on the 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 EU General Data Protection Regulation and the April 2016 version of the Code.

How Ultra's governance supports the delivery of its strategy

Good governance is crucial to ensuring we are well managed and can deliver our strategy.

The Board

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

Members of the Board and their biographies are shown on pages **54** and **55**.

The Board has delegated certain key responsibilities to the **Nomination Committee** (see page **67**), the **Audit Committee** (see pages **69**), the **Remuneration Committee** (see pages **74**) and the **Chief Executive** (see page **60**). The Committees make recommendations to the Board for approval. However, ultimate responsibility is 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**).

Chief Executive: Rakesh Sharma

The Executive Team comprises:
Chief Executive; Group Finance Director; Group Marketing Director; Chief Operating Officer; Group Human Resources Director; Company Secretary & General Counsel; and the Divisional Managing Directors/Presidents of the three Divisions.

The Executive Team is the body through which the Chief Executive exercises the authority delegated to him by the Board. It considers major business issues, makes recommendations to the Chief Executive and typically reviews those matters which are to be submitted to the Board for its consideration. The Chief Executive is responsible for establishing the Executive Team and chairing the Executive Team meetings. In 2016, to support the Company's compliance with the Market Abuse Regulations, the Company established a Disclosure Committee. The Disclosure Committee is made up of the Chief Executive, the Group Finance Director, the Group Marketing Director and the Company Secretary & General Counsel. Its role is to determine on a timely basis the disclosure treatment of material information.

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**). In 2016, the Board considered and approved an anti-slavery and human trafficking policy which was added to the Policy Statement.

Ethics Overview Committee

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

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

Further details about the Ethics Overview Committee are given on page **51**.

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 Merge Director. This enables a full discussion of the merits and risks of any acquisition proposal to take place at an early stage. The Chief Executive and Group Finance Director explain the significance of any major impacts on the financial performance and draw the Board's attention to any significant trends or deviations from budget revealed by monthly forecasts of future performance.

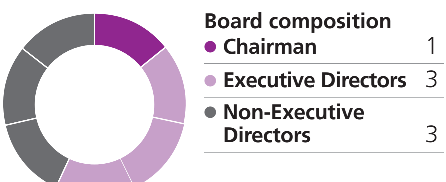
Other significant matters that require formal Board approval, which are routinely presented by the appropriate business, include major bids, updates on key strategic initiatives and major capital and private venture development expenditure proposals.

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 2016, the Board visited three operating businesses in the UK. Non-Executive Directors individually undertook site visits of some of Ultra's North American Businesses and provided a report of their 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 business units detailing recent performance, key opportunities 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.



Board composition

Chairman	1
Executive Directors	3
Non-Executive Directors	3

Throughout 2016, the Board structure was in line with the Code.

Meeting attendance 2016

The table below shows attendance by Directors at the 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
Chairman								
Douglas Caster	18	18	-	-	-	-	3	3
Chief Executive								
Rakesh Sharma	18	18	-	-	-	-	-	-
Executive Directors								
Mark Anderson[1]	17	18	-	-	-	-	-	-
Amitabh Sharma[2]	13	13	-	-	-	-	-	-
Mary Waldner[2]	2	2	-	-	-	-	-	-
Non-Executive Directors								
Martin Broadhurst[1]	17	18	4	4	7	7	3	3
John Hirst	18	18	4	4	7	7	3	3
Sir Robert Walmsley[1]	17	18	4	4	7	7	3	3

[1] Mark Anderson was unable to attend one Board meeting and Martin Broadhurst and Sir Robert Walmsley were each unable to attend one unscheduled Board meeting.

[2] Amitabh Sharma attended all Board meetings after his appointment and Mary Waldner ceased to attend Board meetings following her departure.

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 a deep 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 and growing international businesses. This range of skills and experience inform 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 page **55**.

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 from such external appointments.

Board tenure and independence

	Tenure years	Independence	Experience on other plc boards
Chairman			
Douglas Caster	6	No	Yes*
Non-Executive Directors			
Martin Broadhurst	4	Yes	No
John Hirst	2	Yes	Yes
Sir Robert Walmsley	8	Yes	Yes
Executive Directors			
Rakesh Sharma	6	No	No
Amitabh Sharma	less than 1	No	No
Mark Anderson	5	No	No

*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).

Board roles
There is a clear division of responsibilities between the Chairman, the Chief Executive and the Senior Independent Director. This formal division of responsibilities has been agreed by the Board and is summarised in a table which is available from the Investors' section of the Group's website (**www.ultra-electronics.com**).

NON-EXECUTIVE DIRECTORS
Martin Broadhurst, John Hirst and Sir Robert Walmsley are the Group's independent Non-Executive Directors. The Board considers all Non-Executive Directors 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 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 Chairman and Non-Executive Directors serve to align their interests with those of its shareholders.

The key role of the Non-Executive Directors, along with the Chairman, 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 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 recruitment process for the appointment of Amitabh Sharma as Group Finance Director was set out in the 2015 Annual Report and Accounts.

Ultra's succession planning process is described on page **67**.

Directors' induction and training
All new appointments to the Board receive a comprehensive 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. It is important for these to encompass as many businesses as possible, since Ultra's businesses cover a broad range of capabilities. New Directors are encouraged to meet business and Divisional management teams to gain a feel for the Group's style and culture.

As reported in the 2015 Annual Report & Accounts, the Company Secretary & General Counsel reviewed and updated the Directors' induction programme. Opposite is a summary of what Amitabh Sharma's induction programme involved.

The Company Secretary & General Counsel annually presents to the Board 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. 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.

Induction for Amitabh Sharma
Following our announcement in May of Amitabh Sharma's appointment to the Board, Amitabh has undergone a comprehensive induction programme. This included:

- Meeting with the Audit Committee Chairman, Deloitte audit partner, PwC internal audit lead Director and other professional advisors
- Meeting each Divisional Managing Director and Finance Director to gain a good understanding of their Divisions
- Speaking to other senior executives across a range of functions, such as investor relations, tax, pensions, marketing, human resources and legal
- Visits to some of Ultra's businesses
- Reviewing Ultra's Group Operating Manual
- Attending a CFO training course and receiving internal leadership coaching.

"Ultra's induction programme was comprehensive and gave me open access to key stakeholders across the organisation and externally. The training was wide-ranging and thorough and enabled me to get to grips with the external and internal environment rapidly."

Board evaluation
The 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.

In 2016, Mr Telfer of Auxesis Consulting Ltd undertook an evaluation of the effectiveness of the Board and its Committees. The actions from this evaluation are set out in the table opposite.

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 for Board and Committee meetings and other duties is also considered sufficient for the effective discharge of their responsibilities.

Early in the year, Mr Telfer facilitated a Board discussion on the assessment of individual Directors' performance that was conducted in 2015 and reported upon in the 2015 Annual Report and Accounts.

Mr Telfer has considerable experience working at board level. He was the 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 Group and its 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.

2016 Board evaluation action points

Focus	Actions
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.
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.
Ensure correct balance at Board meetings between operation 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.

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 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.

Further details on the process for financial controls can be found in the Audit Committee Report.

Read about our risk assessment processes, risk appetite statement, principal risks and viability statement on pages **36** to **43**. Read more in our Audit Committee Report on page **69**.

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 Chairman, 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 Farnborough Airshow in September 2016, 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 stockbroker 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 28 April 2017 where they 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 communication if they wish.

In 2016:

- Main institutional shareholders (those with a 3% shareholding or more) were consulted about the appointment of Mr Amitabh Sharma as Group Finance Director
- The Chairman met with a shareholder to discuss their abstaining from voting on the 2015 Remuneration Report
- Main institutional shareholders were consulted about the new Remuneration Policy and Mr Broadhurst met with shareholders, at their request, to discuss the policy.

A full programme of engagement with shareholders, potential investors and analysts is undertaken each year by the Executive Directors.

Shareholder analysis

The majority of Ultra's shares are held by institutional shareholders. The Chairman, Chief Executive 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 2016

Category	Holding	%
Unit trusts	35,125,147	49.85
Pension funds	10,631,140	15.09
Other managed funds	5,413,730	7.68
Mutual fund	5,025,552	7.13
Custodians	2,279,103	3.23
Trading position	1,798,672	2.55
Insurance companies	1,765,263	2.51
Private investor	1,549,694	2.20
Sovereign wealth	1,487,287	2.11
Investment trust	1,286,737	1.83
Exchange-traded fund	867,860	1.23
Local authority	362,738	0.51
Charity	21,583	0.03
Other	2,848,586	4.05
Total issued share capital	**70,463,092**	**100.00**

Shareholder analysis by size of shareholding as at 31 December 2016

Size of shareholding	Total number of holdings	% of holders	Total number of shares	% issued capital
1-50	137	8.26	2,966	0.00
51-100	103	6.21	8,433	0.01
101-250	367	22.12	66,817	0.09
251-500	229	13.80	84,166	0.12
501-1,000	229	13.80	162,776	0.23
1,001-5,000	281	16.94	596,031	0.85
5,001-10,000	48	2.89	332,346	0.47
10,001-25,000	69	4.16	1,151,294	1.63
25,001-50,000	44	2.65	1,532,735	2.18
over 50,000	152	9.17	66,525,528	94.42
Total	**1,659**	**100.00**	**70,463,092**	**100.00**

Financial calendar

22 March 2017	Annual Report & Accounts published
6 April 2017	Ex-dividend date
7 April 2017	Record date
28 April 2017	Annual General Meeting
4 May 2017	Final dividend payment date
7 August 2017	Interim results announced
21 September 2017	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 **4** to **91** was approved by the Board on 3 March 2017 and signed on its behalf by:

Rakesh Sharma, Chief Executive
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 during the year.”

Douglas Caster, Chairman of the Nomination Committee

Dear Shareholder

Talented people are critical to the delivery of the Group's strategy. The Nomination Committee met three times in 2016. Its focus was on ensuring a robust selection and recruitment process for the Group Finance Director; reviewing the succession planning and career progression of senior employees; and reviewing the recruitment and development of talent across the Group.

The Committee considers that the Board continues to have the appropriate mix of skills and experience to operate effectively. 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 **62**.

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 2016

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 exceeds six years. 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.
Succession planning **Consider succession planning for Directors and senior executives below Board level.**	• Succession planning was a particular area of focus for the Committee during 2016. 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 MD/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: – The establishment of a "Chief Executive's Mentoring Club" – Addressing the demographic imbalances that exist in some businesses – Taking advantage of the larger pool of talent below MD/President level as a result of business consolidations and providing employees with increased scope to broaden their experience within the business.
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 appointment of Amitabh Sharma was agreed with effect from 4 May 2016.
Board evaluation **Consider the results of the annual Board evaluation.**	• The results of the Board performance evaluation process were considered.

Nomination Committee Report (continued)

The Committee's focus for 2017
In 2017, the focus of the Nomination Committee will be to:

- review the developments made by the Company in talent management
- consider the Board's diversity policy in light of changes to the Transparency Rules
- review succession planning for Non-Executive Directors.

Diversity
Ultra continues to follow its overriding policy of appointing the best person for a particular role, regardless of age, disability, gender re-assignment, marriage or civil partnership, pregnancy or maternity, race, religion or belief, sex or sexual orientation. The Board contends that a board composed of the right balance of skills, experience and diversity of views is best placed to support a company in its strategic objective. The Board has considered in detail the requirements of the Code regarding gender diversity. In selecting the best person for a role, the Board gives active consideration to the benefits of diversity, including gender diversity. However, setting diversity target aspirations, especially by specific dates, can distort the selection process and conflict with its preferred, diversity-aware "best person for the role" approach. 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 **52**.

With the departure of Mary Waldner in March 2016, the Board does not currently have a female Director. With the appointment of Amitabh Sharma, two of the Directors on the Board are from an ethnic minority background. In line with our diversity policy, the paramount consideration is to maintain the right mix of skills, knowledge, independence and experience on the Board. For that reason, appointments are always based on merit.

"Ultra continues to follow its overriding policy of appointing the best person for a particular role, regardless of age, disability, gender re-assignment, marriage or civil partnership, pregnancy or maternity, race, religion or belief, sex or sexual orientation."

Audit Committee Report

> As Chairman of the Audit Committee, I am pleased to present our Audit Committee Report for the year ended December 2016.

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 pages **64**. An assessment of the Group's principal risks and uncertainties can be found on pages **36-43** and the going concern and long-term viability statements can be found on page **43**.

As we indicated in the 2015 Report, in 2016, the Committee reviewed the Company's bid process, project management of long-term contracts and business continuity and IT disaster recovery practices. In addition, the Committee oversaw the embedding of the Company's Risk Management Framework. You can read more about the Committee's work in these areas on page **36-43**. The Committee's areas of focus for 2017 are set out on page **71**.

In 2016, the Committee ensured a smooth handover to Alex Butterworth as lead partner of our External Auditor Deloitte LLP (Deloitte). The Committee undertook a review of the External Auditor's independence and effectiveness (as described on page **72**), following which the Committee has made a recommendation to the Board that the External Auditor be reappointed for the year ending 31 December 2017. In addition, the Company appointed an internal Group risk manager to support the monitoring and effectiveness review of the Group's risk management systems.

John Hirst, Chairman of the Audit Committee

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

COMPOSITION
The composition of the Committee is set out on page **54**. 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 page **55**.

MEETINGS AND ATTENDANCE
The Committee met four times during the year under review. In addition to the members of the Committee, regular attendees were: the Chairman of the Board, the Chief Executive, the Group Finance Director and the Group Marketing Director. The Company Secretary & General Counsel 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 2016, 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.

Audit Committee Report (continued)

How the Audit Committee spent its time in 2016

Area	Activities
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 business units with the Group's Business Continuity and IT Disaster Recovery Policies. • The Committee discussed the Internal Controls Improvement Status Report which summarised the results from the six-monthly Divisional 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. • A risk "deep dive" was conducted into acquisitions (see page **37**) and improvements in the process were actioned by the Company. • The Committee reviewed Internal Audit reports on the process for evaluating and managing bids and long-term contracts. • The Committee considered reports on known or suspected fraud. • The Committee approved an updated Information Security Policy. Further details of the approach to risk management can be found on pages **36-43**.
Internal audit **Review the effectiveness of the Internal Audit function and discuss control issues identified by Internal Audit.**	• 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.
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 2015 Annual Report & Accounts

Areas of focus	Actions taken
Bid process	Internal Audit undertook a bid process review and its recommendations were implemented.
Project management of long-term contracts	Internal Audit undertook a long-term project management review and its recommendations were implemented.
Business continuity planning and IT disaster recovery	The Internal Audit plan includes a review of whether business continuity and IT disaster recovery testing has been conducted by businesses within the Group.
The embedding of the Risk Management Framework	Good progress has been made in embedding the Risk Management Framework (see page **36**).

The Committee's focus for 2017

In addition to the annual routine matters for consideration, the main areas of focus for the Committee for 2017 will be:

- Considering the impact of the April 2016 version of the Code on the Committee's work.
- Conducting a "deep dive" into the "delivering change" principal risk.
- Reviewing Ultra's tax strategy statement in line with the Finance Act 2016.

Significant financial judgements and financial reporting for 2016	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.
Defined benefit pension scheme valuation	The Committee reviewed the main assumptions used in determining the defined benefit post-retirement obligations.
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 Control Review (DCR) meetings are attended by the Group Finance Director, the Divisional Finance Director and by Internal Audit.

At the DCR 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.

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 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)

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 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. In 2016, an advisory review on information security across the Group was undertaken by PwC.

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, are 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. The FRC's Audit Quality Review team selected to review the audit of Ultra's 2015 Annual Report as part of their 2016 annual inspection of audit firms. The focus of the review and their reporting is on identifying areas where improvements are required rather than highlighting areas performing to or above the expected level. The Chairman of the Audit Committee received a full copy of the findings of the Audit Quality Review team and discussed these with Deloitte. The Audit Committee confirms that there were no significant areas for improvement identified within the report, or any material issues in relation to the financial statements. The Audit Committee is also satisfied that there is nothing within the report that might have a bearing on the audit appointment.

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.

This general approach is supported by a formal feedback process whereby each of the businesses in the Group are requested to feedback comments on the audit process, the performance of the auditor and any recommendations for the audit process going forward.

The Committee believes that sufficient and appropriate information is obtained from the feedback 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 the audits had been effective. In addition, the Committee concluded that Deloitte was both independent and objective and that the re-appointment of Deloitte as external auditor should be recommended to the shareholders. Accordingly, a resolution to reappoint Deloitte will be put to shareholders at the 2017 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 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 other potential providers are adequately considered. 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 must certify to the Company that they are acting independently. 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.

For the year commencing 1 January 2017 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 fees paid to Deloitte in respect of audit and non-audit services are shown on page **106** 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 **72**, 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 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 Chief Executive and Group Marketing Director also attend such Divisional/business reviews as the case requires. 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 2016, no reports were submitted (13 in 2015). In 2015, activities were undertaken to republicise EthicsPoint, in order to increase awareness. The intention is to undertake a similar activity in 2017.

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 from the Chief Executive regarding compliance with Ultra's anti-bribery policies.

The Audit Committee Report was approved by the Board on 3 March 2017 and signed on its behalf by:

John Hirst, Chairman of the Audit Committee

“An independently hosted Employee Hotline (EthicsPoint) is used to provide a process for reporting ethical concerns. Such concerns can be filed anonymously.”

Remuneration Report

> As the Chairman of the Remuneration Committee, I am pleased to present the Remuneration Report for the financial year ended 31 December 2016.

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 2016. 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 proposed **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 existing Remuneration Policy was implemented in the financial year ended 31 December 2016 and how the new Remuneration Policy will be implemented in the financial year ending 31 December 2017.

As Ultra's Remuneration Policy was last put to a shareholder vote in 2014, shareholders are being asked to support Ultra's policy at the 2017 AGM where a binding Policy vote will be tabled. In preparation for this vote, the Committee has undertaken a thorough review of the remuneration structures in place for the Executive Directors. The Committee remains committed to ensuring that the Policy is aligned with the strategic aims of the Group in adding to shareholder value and supporting the long-term success of the Company, and has undertaken an extensive consultation with major shareholders on the proposed changes.

Amendments to the Remuneration Policy

The maximum annual bonus opportunity has remained unchanged for the last eight years and is relatively low for a company of Ultra's size and complexity. The Committee proposes to increase the maximum annual bonus level in the Policy from 100% to 125% of base salary. Bonus deferral will be introduced for all Executive Directors with 20% of the total bonus awarded being deferred into Ultra shares for three years. The deferred amount will be subject to malus and clawback. Furthermore, Executive Directors will be required to retain at least 50% of post-tax shares received under the annual bonus deferral, in addition to the existing requirement to retain at least 50% of vested Long-Term Incentive Plan ("LTIP") awards, until such time as the Directors' shareholding guidelines have been met.

The maximum annual award under the LTIP has also remained unchanged for the last 17 years, other than for the Chief Executive which has remained unchanged for the last four years and is also relatively low for a company of Ultra's size and complexity. The Committee proposes to increase the LTIP maximum opportunity from 150% to 175% of base salary. However, the Committee will use the LTIP capacity prudently; for 2017, the maximum LTIP grant levels would be set below the proposed new maximum (Chief Executive LTIP award of 150% and other Executive Directors LTIP award of 125% of base salary, an increase from the existing normal limits of 125% and 100% of base salary respectively) and it is intended for the maximum to be used only in exceptional circumstances. The Committee would consult with shareholders before further increasing the normal level of LTIP award. Last year, the existing shareholder-approved Remuneration Policy was enhanced by the introduction of a two-year post-vesting holding period which was applied to LTIP awards granted to Executive Directors from 2016 onwards, taking the combined performance and holding period to five years. The Remuneration Policy is updated to include this change. In recognition of the proposed increases in variable pay quantum, the Executive Director shareholding requirement will increase to 200% of base salary, from the current level of 125% (Chief Executive) and 100% (other Executive Directors) of base salary.

As highlighted in last year's report, the Committee determined that the salary review date should be deferred from 1 January to 1 April to better align with the Group's financial results. The Remuneration Policy has been updated to reflect this change.

As was also highlighted in last year's report, the Committee has revised the Remuneration Policy in respect of the Chief Executive not being permitted to accept an outside appointment as a non-executive director. Consequently, Rakesh Sharma will be given permission to seek one external non-executive director (non-chairman) role.

ANNUAL BONUS PERFORMANCE METRICS

Whilst the Policy remains unchanged and there is no intention to change the existing measures, currently, in order for a bonus to be payable, both the profit and cash bonus criteria are required to be met. The Committee has reviewed this approach and has concluded that this additional hurdle was unduly onerous and the pay-out of the profit measure should not be dependent upon the outcome of the operating cash flow. Therefore, the Committee has decided to remove this underpin for future awards. The portion subject to operating cash flow will continue to be paid only if the profit element is payable (which is calculated after taking bonus payments into account).

LTIP PERFORMANCE METRICS

For a number of years the vesting of the LTIP has been subject to relative Total Shareholder Return (TSR) performance with a "hard" Earnings Per Share (EPS) underpin. As part of the review, the Committee considered the extent to which this approach adequately ensured that the LTIP vesting aligned with the Company's overall business strategy and, in particular, with the Company's key performance indicators. The Committee decided that the underpin should be removed. Taking into account the above, market practice across the sector and the wider market, the Committee considered a wide range of metrics and has determined that awards in the future may be subject to up to four different performance metrics. It is intended that relative TSR will be retained as one of these measures. However, the Committee will retain discretion to reduce the portion of the awards that vest that relate to TSR and revenue targets as appropriate in the event of poor EPS performance.

For 2017 awards, 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%**

Each of these measures are considered to provide the best overall indication of the Group's long-term success in improving its FTSE ranking by outperforming the market.

PENSION PROVISION

Finally, as we committed to in last year's Directors' Remuneration Report, a review of the pension provision has been carried out following the closure of the defined benefit scheme in April 2016. Rakesh Sharma ceased accruing a direct benefit from the defined benefit scheme on 6 April 2014 and his pension provision has been determined on an annual basis by the scheme actuary such that it is equivalent in value to the value of defined benefits formerly accrued. The Committee has decided to fix Rakesh Sharma's pension provision at the existing rate rather than continuing with an annual calculation by the scheme actuary, which the Committee would expect to increase over the medium to long term. This will prevent any further increases to Rakesh Sharma's pension contribution and is consistent with the closure of the scheme to future accrual for the wider workforce. The Committee did consider reducing the provision but believes the proposed approach is consistent with that taken for other senior managers who were in the defined benefit scheme and is therefore appropriate.

Long-Term Incentive Plan 2007

The rules of the Long-Term Incentive Plan 2007 expire in April 2017 after ten years in operation and shareholders will be asked to approve a new set of rules at the AGM.

Performance and reward during 2016

The continuing uncertainty in the core defence market led Ultra to adopt a prudent view of annual performance against which it has delivered. In 2016, revenue and underlying operating profit* were £785.8m (2015: £726.3m) and £131.1m (2015: £120.0m) respectively; underlying earnings per share* were 134.6p (2015: 123.9p); operating cash flow was £120.4m (2015: £81.3m); and total shareholder return was 8% (2015: 6%). Reflecting this, the Executive Directors earned an annual bonus for 2016 (see page **82**). The 2014 LTIP awards, which had been due to crystallise in 2017 based on three-year TSR and EPS performance to 31 December 2016, will not vest as a result of performance targets not being met.

Board change

As highlighted in last year's report, Mary Waldner tendered her resignation from the Group in November 2015 and left on 16 March 2016. Amitabh Sharma was appointed Group Finance Director with effect from 4 May 2016. During the year the Committee considered his remuneration arrangements which are in line with the Remuneration Policy in place at the time.

Shareholder engagement

I am pleased to say that our voting result at the 2016 AGM was 99.60% in favour of the Annual Report on Remuneration.

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

£785.8m +8.2%

2015: £726.3m

Underlying operating profit*

£131.1m +9.3%

2015: £120.0m

Underlying earnings per share*

134.6p +8.6%

2015: 123.9p

Operating cash flow

£120.4m +48.1%

2015: £81.3m

Total shareholder return

+8%

2015: 6%

*see footnote on page **144**

Remuneration Report (continued)

2. DIRECTORS' REMUNERATION POLICY

The Policy described in this section, which will be put to a binding vote at the 2017 AGM, includes the amendments described in the Chairman's letter. If approved, this Policy will take effect immediately following the AGM.

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.

Future policy
The following information summarises the Directors' Remuneration Policy:

How the element supports our strategy	Operation of the 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

How the element supports our strategy	Operation of the 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	Share plan to be approved by shareholders at the 2017 AGM 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	Defined contribution/salary supplement rates of 36.4% of base salary for the current Chief Executive, and up to a maximum of 20% of base salary for all other 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

Remuneration Report (continued)

2. DIRECTORS' REMUNERATION POLICY (CONTINUED)

How the element supports our strategy	Operation of the 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 the Company attracts Non-Executive Directors of the right calibre and background to support our strategy The 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 2017 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 2017 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 in place as at 31 December 2016 are set out on page **86**.

(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.

(7) Key changes to the policy:
The Committee proposes to:

a. Increase the bonus level in the Policy from 100% to 125% of base salary.

b. Increase the LTIP maximum opportunity from 150% to 175% of base salary. However, the Committee will use the LTIP capacity prudently; for 2017, the maximum LTIP grant levels would be set below the proposed new maximum (Chief Executive LTIP award of 150% and other Executive Directors LTIP award of 125%, an increase from the existing normal limits of 125% and 100% of base salary respectively) and it is intended for the maximum to be used only in exceptional circumstances.

c. Introduce bonus deferral for all Executive Directors with 20% of the total bonus awarded being deferred into Ultra shares for three years. The deferred amount will be subject to malus and clawback. In addition, Executive Directors will be required to retain at least 50% of post-tax shares received under the annual bonus deferral, in addition to the existing requirement to retain at least 50% of vested LTIP awards until such time as the shareholding guidelines have been met.

d. Formally include in the Policy the introduction of a two-year post-vesting holding period which was applied to LTIP awards granted to Executive Directors from 2016 onwards, taking the combined performance and holding period to five years.

e. Executive Director shareholding requirement increased to 200% of base salary.

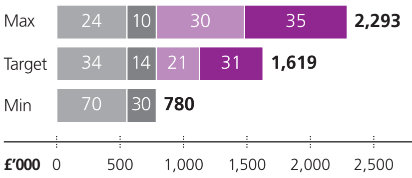
f. Defer salary review date from 1 January to 1 April to better align with the Group's financial results.

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.

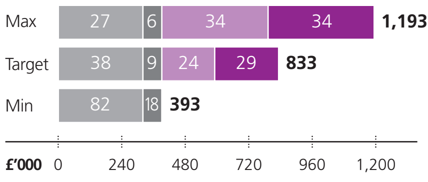
Chief Executive

Remuneration composition levels (%)



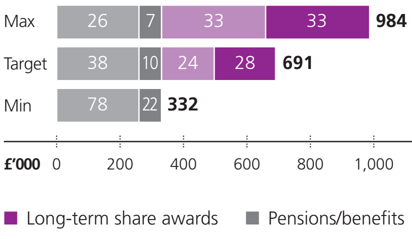
Group Finance Director

Remuneration composition levels (%)



Group Marketing Director

Remuneration composition levels (%)



■ Long-term share awards ■ Pensions/benefits
■ Annual bonus ■ Salary

Notes to remuneration scenarios:

(1) Base salary levels are based on those applying from 1 April 2017.

(2) Benefit values for 2017 have been based on 2016 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 150% of salary for the Chief Executive and 125% of salary for the other Executive Directors 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 person. 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 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 these 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 commitment. 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	Original date of contract	Notice period
R. Sharma	21 Apr 2011	12 months
A. Sharma*	4 May 2016	12 months
M. Anderson	11 Apr 2012	12 months

* Amitabh Sharma joined Ultra in January 2016 and became Group Finance Director with effect from 4 May 2016.

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, including the Chief Executive, 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.

Remuneration Report (continued)

2. DIRECTORS' REMUNERATION POLICY (CONTINUED)

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 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 proposed 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	22 Apr 2016	Nil
M. Broadhurst	3 Jul 2016	Nil
J. Hirst	1 Jan 2017	Nil
Sir Robert Walmsley	31 Jan 2017	Nil

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 2016 Annual General Meeting, 99.60% of our shareholders voted in favour of the Annual Report on Remuneration.

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.

99.60%

Our voting result at the 2016 Annual General Meeting was 99.60% in favour of the Annual Report on Remuneration.

3. ANNUAL REPORT ON REMUNERATION

Implementation of the Directors' Remuneration Policy in 2017

A summary of how the Directors' Remuneration Policy will be applied for the year ending 31 December 2017 is set out below.

Salaries

Current Executive Director salary levels, and increases effective in April 2017, are as follows:

	2017 Salary £'000	2016 Salary £'000	Increase awarded from 1 April 2017 %
R. Sharma	550	535	2.8
A. Sharma[1]	320	290	10.3
M. Anderson	261	254	2.5

[1] Amitabh Sharma was appointed Group Finance Director with effect from 4 May 2016.

Rakesh Sharma and Mark Anderson will receive an inflationary base salary increase of 2.8% and 2.5% respectively from 1 April 2017, in line with the average increase awarded to the workforce as a whole. In line with the Remuneration Policy, Amitabh Sharma was appointed with a salary below competitive levels and his salary will be increased to an industry competitive level as he gains experience in the role. From 1 April 2017, Amitabh Sharma's salary will increase by 10.3%.

Directors' pension entitlements

As we committed to in last year's Directors' Remuneration Report, a review of the pension provision has been carried out. The Committee proposes to fix Rakesh Sharma's pension provision at the existing rate of 36.4% (down from 37.3% last year), rather than continuing with an annual calculation by the scheme actuary, which the Committee would expect to increase over the medium to long term. This will prevent any further increases to Rakesh Sharma's pension contribution and is consistent with the ending of the scheme for the wider workforce.

Amitabh Sharma and Mark Anderson are eligible to participate in the defined contribution scheme, receiving annual company contributions of 18% of salary. They can elect to receive cash supplements in lieu of pension contributions on a cash-neutral basis where they have exceeded the annual allowance or the lifetime allowance.

Non-Executive Directors' fees

The Chairman's fee will increase by 2.5% and other Non-Executive Directors' fees will increase by 2.7% from 1 April 2017 in line with the Remuneration Policy.

Annual bonus for 2017

Subject to the approval of the Remuneration Policy by shareholders, the maximum bonus for Executive Directors in 2017 will be 125% of base salary; 20% of the bonus paid will be deferred into Ultra shares for three years.

Up to 22.5% of maximum will be payable for the achievement of an agreed profit target, up to 67.5% payable for achievement of an agreed operating cash flow target, and up to 10% of maximum will be payable for the achievement of strategic personal measures. 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 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. 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 2017

Consistent with the amended Directors' Remuneration Policy, the Committee intends to grant annual LTIP awards to Executive Directors in the form of shares worth 150% of salary for the Chief Executive and 125% of salary for other Executive Directors during 2017.

For 2017, 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%**

Remuneration Report (continued)

3. ANNUAL REPORT ON REMUNERATION (CONTINUED)

Long-term awards to be granted in 2017 (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[3]	Pension[4]	Subtotal	Annual performance bonus	LTIP[5]	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[1]	192	10	35	237	156	-	156	393
M. Anderson	253	25	45	323	196	-	196	519
M. Waldner[2]	65	3	12	80	-	-	-	80
Non-Executive Directors								
D. Caster	196	-	-	196	-	-	-	196
M. Broadhurst	56	-	-	56	-	-	-	56
J. Hirst	56	-	-	56	-	-	-	56
Sir Robert Walmsley	56	-	-	56	-	-	-	56
Total	1,406	68	287	1,761	789	-	789	2,550

[1] Amitabh Sharma was appointed Group Finance Director with effect from 4 May 2016 on an annual salary of £290,000 and is eligible to receive benefits and pension and participate in the incentive plans in line with the prevailing policy.
[2] Mary Waldner left the group on 16 March 2016, and therefore was not eligible for a bonus in respect of 2016 performance.
[3] Benefits comprise: taxable car benefit (in respect of Rakesh Sharma, Amitabh Sharma and Mark Anderson), car allowance (in respect of Mary Waldner), taxable fuel benefit/fuel allowance (excluding Mary Waldner and Amitabh Sharma), life assurance and private medical insurance.
[4] Pensions: Rakesh Sharma's pension is calculated in accordance with the rules of the defined benefit scheme. Amitabh Sharma and Mark Anderson, who are eligible members (and Mary Waldner, who was an eligible member) of the defined contribution scheme, received pension contributions of 18% of basic salary. They can also elect to receive cash supplements given in lieu of pension contributions on a cash-neutral basis where they have exceeded the annual allowance or the lifetime allowance.
[5] The 2014 LTIP awards which were due to crystallise in 2017 will not vest, in accordance with performance relative to the performance conditions as described on page **84**, and the aggregate gain made by the Directors under the LTIP during the year was £nil.

*see footnote on page **144**

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
2015								
Executive Directors								
R. Sharma	522	26	189	737	460	-	460	1,197
M. Waldner	317	15	57	389	279	-	279	668
M. Anderson	248	19	45	312	201	-	201	513
Non-Executive Directors								
D. Caster	192	-	-	192	-	-	-	192
C. Bailey	20	-	-	20	-	-	-	20
M. Broadhurst	55	-	-	55	-	-	-	55
J. Hirst	55	-	-	55	-	-	-	55
Sir Robert Walmsley	53	-	-	53	-	-	-	53
Total	1,462	60	291	1,813	940	-	940	2,753

[1] Benefits comprise: taxable car benefit (in respect of Rakesh Sharma only), company car allowance (in respect of Mary Waldner and Mark Anderson), taxable fuel benefit/fuel allowance (excluding Mary Waldner), life assurance and private medical insurance.

[2] Pensions: Rakesh Sharma's pension is calculated in accordance with the rules of the defined benefit scheme as set out in the policy table on page **71**. Mary Waldner and Mark Anderson were eligible to participate in the defined contribution scheme, receiving pension contributions of up to 18% of basic salary. They could elect to receive cash supplements in lieu of pension contributions on a cash-neutral basis where they have exceeded the annual allowance or the lifetime allowance.

[3] The 2013 LTIP awards which had been due to crystallise in 2016 will not vest and the aggregate gain made by the Directors under the LTIP during the year was £nil.

Annual bonus for year under review – Audited

Annual bonuses in relation to 2016 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 **28** for details.

The bonus targets set by the Committee for 2016 were: a maximum of 20% of salary (subject to the achievement of £117.2m* underlying profit before tax); and a maximum of 60% of salary (subject to achieving an underlying operating cash flow of £118.5m* 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 20% 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	105,480	117,200	120,059	20%
Operating cash flow	66,346	118,500	120,434	42.2%

* These figures reflect amendments to the original targets following the disposal of the ID business in August 2016.

** Both threshold profit and operating cash flow targets needed to be exceeded for any payment to be made.

Remuneration Report (continued)

3. ANNUAL REPORT ON REMUNERATION (CONTINUED)

Annual bonus for year under review – Audited (continued)
In addition, the Committee assessed performance against the strategic goals which were based on the following:

Director	Strategic goals
Rakesh Sharma	• Integration of Herley in accordance with acquisition case proceeding successfully
	• Organic underlying operational profit growth in 2016
	• Successfully manage the finalisation of the Oman Airport IT contract
	• Reduction of indirect costs from 2016 to 2017 of £5m
	• Implementation of Shared Services centre for S3 fully functional by the end of 2016
Amitabh Sharma	• Successful implementation of pilot ERP programme
	• Reduction of indirect costs from 2016 to 2017 of £5m
	• Manage investor relations to foster a positive view of the Group and city expectations
	• Develop and launch a Treasury Strategy
Mark Anderson	• Achieve a book to bill of 1.08 (excluding acquisitions and divestments)
	• Complete game plan workshops across the Group and all major and medium opportunities to have a game plan
	• Reduction of indirect costs from 2016 to 2017 of £5m
	• All 2016 strategy plans to be supported by a robust market analysis

The Committee determined that bonuses of 19.5%, 18.8% and 15.0% of salary (max 20%) should be payable to Rakesh Sharma, Amitabh Sharma and Mark Anderson respectively.

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.

LTIP vesting for year under review – Audited
The LTIP awards granted in 2014 were based on performance to the year ended 31 December 2016. 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	2014: (3.1%) 2015: 0.6% 2016: 8.6%	n/a
Total					**0%**

The award details for those Executive Directors granted 2014 LTIP awards are therefore as follows:

Executive	Number of shares at grant	Number of shares to vest	Number of shares to lapse	Total	Estimated value £'000
R. Sharma	32,234	-	32,234	-	-
M. Waldner[1]	16,430	-	16,430	-	-
M. Anderson	12,240	-	12,240	-	-

[1] Grant made to Mary Waldner lapsed on her departure.

Share awards granted during the year – Audited

	Scheme	Date of grant	Basis of award	Face value	Vesting at threshold	Vesting at maximum	Performance period
				£			
R. Sharma[1]	LTIP*	14 March 2016	125% of salary	652,487	20%	100%	3 years to 31 December 2018
M. Anderson[1]	LTIP*	14 March 2016	100% of salary	247,992	20%	100%	3 years to 31 December 2018

*Structured as a conditional award

[1] In addition, Rakesh Sharma purchased 99 partnership shares, Amitabh Sharma purchased 50 partnership shares and Mark Anderson purchased 99 partnership shares under the AESOP during 2016.

For awards presented above, 20% of award vest for a median TSR ranking, increasing to 100% vesting for an upper quartile TSR ranking, measured against the constituents of the FTSE 250 (excluding investment trusts). In addition to the TSR target, there is an "underpin" requiring total growth of underlying EPS* of 15% over the three-year performance period.

Change in Chief Executive's remuneration

The following table illustrates the change (as a percentage) in elements of the Chief Executive's remuneration from 2015 to 2016, 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 2015 and 1 January 2016. This group best reflects the remuneration environment of the Chief Executive.

	Chief Executive % change	All UK employees % change
Salary	2.8	3.2
Taxable benefits	4.7	3.3
Bonus	-5.0	9.6

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:

	2016 £m	2015 £m	Change %
Staff costs[1]	**255.0**	240.2	6.2
Dividends[2]	**33.5**	32.3	3.7
Revenue[3]	**785.8**	726.3	8.2
Statutory profit before tax[3]	**67.6**	34.8	94.3

[1] £2.2m (2015: £2.4m) 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 number.

Total defined benefit pension entitlements – Audited

The defined benefit scheme closed to future accrual on 5 April 2016. 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.

No Executives accrued direct benefits under defined benefit schemes during the year. 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. As explained earlier in this Report, Rakesh Sharma's pension provision is fixed at the rate of 36.4% as from 1 April 2016.

Payments to past Directors – Audited

Mary Waldner tendered her resignation in November 2015 and left on 16 March 2016. She was paid up to that date and no further payments were or are due to her. As explained elsewhere in this Report, she was not eligible for a 2016 bonus payment and was not granted an LTIP award in 2016.

Loss of office payments – Audited

There were no loss of office payments made to Directors during 2016.

*see footnote on page **144**

Remuneration Report (continued)

3. ANNUAL REPORT ON REMUNERATION (CONTINUED)

Statement of Directors' shareholdings – Audited

	Legally owned		LTIP awards [1]	AESOP		SAYE		Total	% Share ownership guidelines	Share ownership met Y/N
	2016	2015	Unvested	Restricted [2]	Unrestricted	Under option	Exercised			
Executive Directors										
R. Sharma	**41,688**	41,510	**106,406**	**3,100**	-	**830**	-	**152,024**	**152%**	**Y**
A. Sharma	**4,966**	-	-	**50**	-	**794**	-	**5,810**	**33%**	**N**
M. Waldner	-	57	-	-	-	-	-	-	**n/a%**	**n/a**
M. Anderson	**546**	442	**40,431**	**276**	-	**610**	-	**41,863**	**4%**	**N**
Non-Executive Directors										
D. Caster	**300,000**	300,000	-	-	-	-	-	**300,000**	-	-
M. Broadhurst	**1,000**	1,000	-	-	-	-	-	**1,000**	-	-
J. Hirst	**2,000**	2,000	-	-	-	-	-	**2,000**	-	-
Sir Robert Walmsley	**1,600**	1,600	-	-	-	-	-	**1,600**	-	-

[1] There were no vested LTIP share awards within the period. In addition, the interest in LTIP awards as at 31 December 2016 includes the 2014 award (32,234 shares under award for Rakesh Sharma and 12,240 shares under award for Mark Anderson) which, as a result of not meeting performance conditions to 31 December 2016, will lapse in 2017. All of Mary Waldner's outstanding LTIP awards lapsed on her departure, including 16,430 shares under the 2014 award.

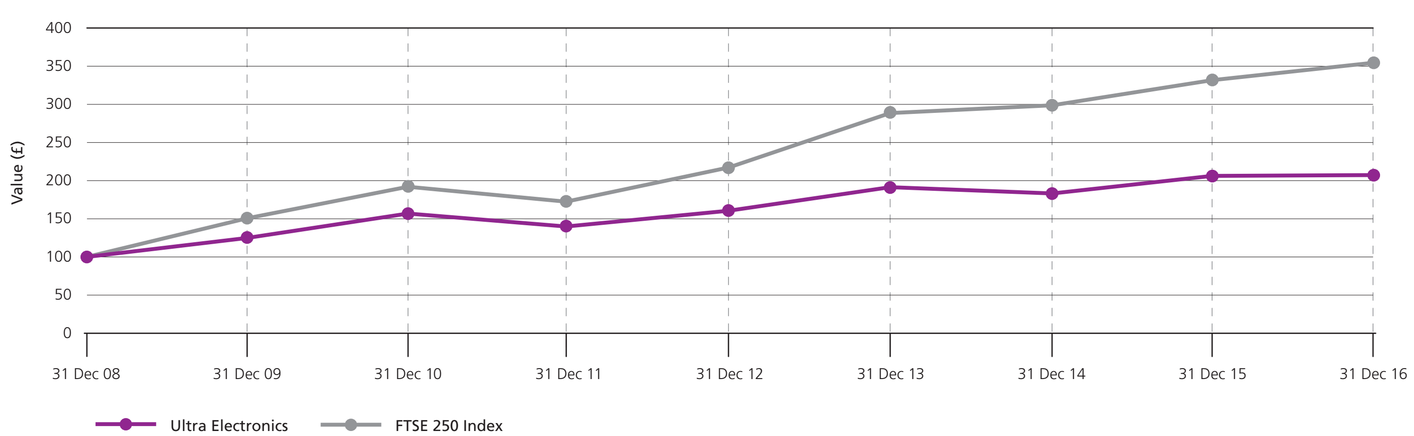
[2] The restricted shares under the AESOP are held in the Ultra Electronics Holdings plc Employee Benefit Trust.

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 eight years. The graph shows the value at the end of 2016 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



The table below presents single-figure remuneration for the Chief Executive over the past eight years, together with past annual bonus payouts and relevant LTIP vesting figures.

	Year ended	Total remuneration £'000	Annual bonus % max. payout	LTIP % max. payout
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 [1]	31 December 2011	722	76	-
D. Caster [2]	31 December 2011	141	-	-
D. Caster	31 December 2010	1,068	46	81
D. Caster	31 December 2009	1,512	67	100

[1] Chief Executive from 21 April 2011.

[2] Chief Executive to 21 April 2011.

Shareholder voting at the last AGM

At the 2016 Annual General Meeting, the 2015 Directors' 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**	

At the 2015 Annual General Meeting, the 2014 Director's Remuneration Policy received the following votes from shareholders:

	Total number of votes	% of votes cast
Votes for	**58,779,001**	97.03
Votes against	**1,802,054**	2.97
Total votes cast (for and against)	**60,581,055**	100
Votes withheld	**10,353**	
Total votes cast (including withheld votes)	**60,591,408**	

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

	M. Anderson	R. Sharma	A. Sharma	M. Waldner	Market price of shares granted	Crystallising dates of outstanding awards
2013 March award	11,908	26,722	-	-	£17.21	March 2016
2013 August award	-	5,909	-	11,775	£19.46	March 2016
2014 award	12,240	32,234	-	16,430	£18.38	March 2017
2015 award	14,207	37,379	-	18,159	£17.45	March 2018
Interests at 1 January 2016	38,355	102,244	-	46,364		
2013 award lapsed during the year	(11,908)	(32,631)	-	(11,775)		
2014 award lapsed during the year	-	-	-	(16,430)		
2015 award lapsed during the year	-	-	-	(18,159)		
2016 award	13,984	36,793	-	-	£17.73	March 2019
Interests at 31 December 2016	**40,431**[1]	**106,406**[1]	**-**	**-**[1]		

[1] This interest in LTIP awards as at 31 December 2016 includes the 2014 award (32,234 shares under award for Rakesh Sharma 12,240 shares under award for Mark Anderson) which, as a result of not meeting performance conditions to 31 December 2016, will lapse in 2017. All of Mary Waldner's outstanding LTIP awards lapsed on her departure.

The 2013 award lapsed during the year as a result of the performance targets not being met. Ultra's share price on 30 December 2016 was £19.52. The range during 2016 was £15.73 to £20.49.

Directors' interests under the All-Employee arrangements

Name of Director	Interests as at 1 January 2016	Shares acquired during year	Interests as at 31 December 2016	Shares acquired from 1 January 2017 to 3 March 2017	Interests as at 3 March 2017
R. Sharma	2,922	**178**	**3,100**	**24**	**3,124**
A. Sharma	-	**50**	**50**	**23**	**73**
M. Waldner	57	**12**	**-**	**-**	**-**
M. Anderson	172	**104**	**276**	**24**	**300**

During the year, the Share Ownership Plan Trust, established and operated in connection with the AESOP, purchased 30,648 (2015: 33,691) Ultra Electronics Holdings plc shares, with a nominal value of £1,532 (2015: £1,685) for £594,895 (2015: £593,178). Mary Waldner, after her departure, sold 69 AESOP shares in the year.

Remuneration Report (continued)

3. ANNUAL REPORT ON REMUNERATION (CONTINUED)

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; and
- 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. Sharon Harris continued to act as Secretary to the Committee. Although not Committee members, the Chairman, Chief Executive and Group HR Director normally attend Committee meetings by invitation, except where matters directly relating to their own remuneration are discussed.

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 review of Ultra's remuneration policy (including an update on market and best practice), the operation of Ultra's LTIP and other share schemes, remuneration benchmarking services and below board remuneration schemes. During 2016, 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 2016 amounted to £58,696 (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 2016 amounted to £51,435 (excluding VAT), of which 8% was related to the closure of the defined benefit pension scheme (see page **26**). In addition, the Committee consults the Chief Executive 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 2017 ANNUAL GENERAL MEETING

The Committee is of the view that the revised Directors' Remuneration Policy is fair and balanced between employees and shareholders and that there is strong alignment to the Group's strategy. As such, the Committee encourages shareholders to vote in favour of the Remuneration Policy and Directors' Remuneration Report resolutions at the 2017 AGM. The Remuneration Policy and Directors' Remuneration Report were approved by the Board on 3 March 2017 and signed on its behalf by:

Martin Broadhurst, Chairman of the Remuneration Committee

Directors' Report

For the year ended 31 December 2016

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 2016.

Sharon Harris, Company Secretary & General Counsel

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 2016. 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 **44-53** of the Strategic Report. The Corporate Governance Report on pages **57-66** forms part of this report, and the financial risk management objectives and policies can be found on pages **36-43**.

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 **36-43**.

Results and dividends

The Group results and dividends are as follows:

	2016 £'000
Balance on retained earnings, beginning of year	238,728
Total comprehensive income for the year	18,933
Dividends: 2015 final paid of 32.3p per share	(22,631)
2016 interim paid of 14.2p per share	(9,952)
Equity-settled employee share schemes	1,027
Non-controlling interest's investment made in subsidiary	1,929
Balance on retained earnings, end of year	**228,034**

The final 2016 dividend of 33.6p per share is proposed to be paid on 4 May 2017 to shareholders on the register of members on 7 April 2017. The interim dividend was paid on 23 September 2016, making a total of 47.8p (2015: 46.1p) per share in the year.

Future developments

A review of the activities and future developments of the Group is contained in the Chief Executive's review on pages **4-7**.

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 £146.9 million (2015: £146.6 million) was spent on engineering and business development of which £112.8 million (2015: £110.6 million) was funded by customers and £34.1 million (2015: £36.0 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 2016 were 65 days (2015: 60 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 **50**).

Political expenditure

Neither the Company nor any of its subsidiaries have made any political donations during the year (2015: £nil).

Appointment and replacement of Directors

All the Directors will stand for re-election at the Annual General Meeting on 28 April 2017.

Directors and their interests

The Directors who served throughout the year and to the date of signing these financial statements (see biographies on page **55**), and their interests in the shares and share options of Ultra at 3 March 2017 are shown in the Annual Report on Remuneration (see pages **81-88**).

Directors' Report (continued)

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 2016.

Directors' indemnities

The Group has made qualifying third-party indemnity provisions for the benefit of its Directors which were made during the year and remain in force at the date of this report.

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 (2015: nil) ordinary shares and no (2015: nil) ordinary shares were distributed following vesting of awards under the Ultra Electronics Long-Term Incentive Plan. At 31 December 2016, 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 2016).

Substantial shareholdings

As at 3 March 2017, 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
Royal London Asset Management Limited	Direct	3.08	2,171,768	28 February 2017
BlackRock, Inc.	Direct & Indirect	5.74	4,049,319	10 February 2017
Aberdeen Asset Managers Limited	Direct	9.98	7,026,920	12 December 2016
Artemis Investment Management LLP	Direct	4.69	3,299,530	9 August 2016
FIL Limited	Direct	9.49	6,672,460	4 July 2016
Kames Capital Plc	Direct & Indirect	3.07	2,162,080	17 March 2016
J O Hambro Capital Management Limited	Direct	5.02	3,528,628	11 March 2016
Ameriprise Financial, Inc.	Direct	4.56	3,192,374	30 June 2015

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 27. 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 27. 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 28 April 2017 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 3 March 2017 and signed on its behalf by:

Sharon Harris, Company Secretary & General Counsel
Registered Office: 417 Bridport Road, Greenford, Middlesex UB6 8UA
Registered Number: 2830397

Executives and advisors

Executive Team members

Rakesh Sharma
Chief Executive

Amitabh Sharma
Group Finance Director

Mark Anderson
Group Marketing Director

Sharon Harris
Company Secretary & General Counsel

Keith Thomson
Group Human Resources Director

Carlos Santiago
Chief Operating Officer

Graeme Stacey
Divisional Managing Director
Aerospace & Infrastructure

Mike Baptist
Divisional Managing Director
Communications & Security

William Terry
Divisional Managing Director
Maritime & Land

Business MDs and Presidents

Olugbenga Erinle
President
3eTI

Bob Judd
President
3 Phoenix

Tim Stanley
Interim 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

Pete Crawford
President
EMS

Paul Fardellone
President
Flightline Systems

René Bélanger
President
Forensic Technology

Howard Eckstein
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

Joe Peters
President
USSI

External auditor

Deloitte LLP
Abbots House
Abbey Street
Reading RG1 3BD

Principal bankers

The Royal Bank of Scotland plc
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Solicitors

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One Bunhill Row
London EC1Y 8YY

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Financial advisors

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London EC4M 8AL

JPMorgan Cazenove Limited
25 Bank Street, Canary Wharf
London E14 5JP

Stockbrokers

JPMorgan Cazenove Limited
25 Bank Street, Canary Wharf
London E14 5JP

Investec Bank plc
26 Gresham Street
London EC2V 7QP

Registrars

Equiniti
Aspect House
Spencer Road, Lancing
West Sussex BN99 6DA

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 2016 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.

The financial statements that we have audited comprise:

- the Consolidated Income Statement;
- the Consolidated Statement of Comprehensive Income;
- the Consolidated and Parent Company Balance Sheets;
- the Consolidated Cash Flow Statement;
- the Consolidated Statements of Changes in Equity;
- the Statement 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 IFRS 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 (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

Summary of our audit approach

Key risks	The key risks that we identified in the current year were: • Revenue recognition; • Ithra related provisions; • Goodwill and other intangible assets; and • Defined benefit pension scheme liabilities valuation. These risks are in line with the risks we reported in the prior year. There was also an additional risk in the prior year relating to an acquisition that occurred that year.
Materiality	The materiality that we used in the current year was £6 million which was determined on the basis of 7% of adjusted underlying profit before taxation. We have determined adjusted underlying profit before tax to be underlying profit before tax less amortisation of acquired intangible assets.
Scoping	We focused our Group audit scope primarily on the audit work at 20 locations, 12 of these were subject to full audit, whilst the remaining 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 87% of Group revenue and 94% of group underlying profit before tax.
Significant changes in our approach	The acquisition accounting risk has not been included in our audit scope in the current year given there were no acquisitions made in 2016.

Going concern and the Directors' assessment of the principal risks that would threaten the solvency or liquidity of the Group

As required by the Listing Rules we have reviewed the Directors' statement regarding the appropriateness of the going concern basis of accounting in the statement of accounting policies on page **131** and the Directors' statement on the longer-term viability of the Group contained within the strategic report on page **43** of the Annual Report.

We are required to state whether we have anything material to add or draw attention to in relation to:

- the directors' confirmation on page **43** 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;
- the disclosures on pages **36** to **42** that describe those risks and explain how they are being managed or mitigated.

Going concern and the Directors' assessment of the principal risks that would threaten the solvency or liquidity of the group (continued)

- the Directors' statement in the statement of accounting policies on page **131** of 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 ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and
- the Directors' explanation on page **43** 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 confirm that we have nothing material to add or draw attention to in respect of these matters.

We agreed with the Directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Independence

We are required to comply with the Financial Reporting Council's Ethical Standards for Auditors and confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards.

We confirm that we are independent of the Group and we have fulfilled our other ethical responsibilities in accordance with those standards. We also confirm we have not provided any of the prohibited non-audit services referred to in those standards.

Our assessment of risks of material misstatement

The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

The acquisition accounting risk has not been included in our audit report in the current year given there were no acquisitions made in 2016. Excluding this risk, the risks referred to in our audit report remain in line with prior year.

Risk description	How the scope of our audit responded to the risk
Revenue recognition Refer to page **137** (critical accounting judgements and key sources of estimation uncertainty – assessment of contract accounting); and page **133** (accounting policies – revenue recognition). The Group recognised revenue of £785.8m in 2016 (2015: £726.3m) of which £443.5m (2015: £371.6m) related to revenue recognised on long-term contracts accounted for under IAS 11. There is a risk that revenue and profit is recognised incorrectly based on judgements within the cost to complete estimate for significant long-term contracts. Given the bespoke nature and the length of time to develop and manufacture some of Ultra's products, 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.	Our audit work assessed the adequacy of the design and implementation of controls over long-term contract accounting. To confirm that revenue and profit recognised to date are based on the current best estimate of the degree of work performed under the contract, for the sample of significant contracts we reviewed the evidence for the progress made against the contract, such as milestone completion, and reviewed the contract risk registers to provide evidence over the judgement taken when providing for the cost of mitigating technical risks and meeting future milestones. We also sought to verify the costs to complete the contract 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 understood and challenged management's judgements by referring to evidence including signed contract terms and 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 each contract selected for testing, 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.

Our assessment of risks of material misstatement (continued)

Risk description	How the scope of our audit responded to the risk
Ithra related provisions Refer to page **137** (critical accounting judgements and key sources of estimation uncertainty – assessment of Ithra related provisions); and page **69** (Audit Committee report – significant judgements considered). In 2015 the Oman Airport IT Contract was terminated and subsequently Ithra (a jointly owned subsidiary in Oman) was placed into voluntary liquidation. Significant provisions to cover estimated claims, settlement costs and legal fees were recorded in respect of this event. The provisions in place at the beginning of 2016 of £17.1m were largely utilised in the year leaving a provision as at 31 December 2016 of £3.5m. The liquidator appointed for Ithra is pursuing claims against the customer on behalf of interested parties, consequently there remains significant uncertainty regarding the likely outcome of the negotiations. The material and uncertain nature of these balances means that we consider the accuracy of these estimated values to be a key audit risk.	Our audit work assessed the adequacy of the design and implementation of controls over the accuracy of Ithra related provisions. To challenge management's judgements we have reviewed correspondence with the liquidator appointed for Ithra together with legal correspondence between the Group and its external legal counsel. We have obtained third-party evidence for all known costs to be incurred including specific legal and supplier liabilities. For costs incurred during the year, we have traced a sample back to supporting third-party evidence, and used these actual costs incurred to challenge the accuracy of anticipated costs to come. We have continued to assess the recoverability of contract balances and associated costs of recovering these contract balances through our review of correspondence relating to the negotiations and the likely timing of any receipt or agreed settlement process.
Goodwill and other intangible assets Refer to page **137** (critical accounting judgements and key sources of estimation uncertainty – goodwill impairment); page **134** (accounting policies – intangible assets); page **69** (Audit Committee report – significant judgements considered); and page **110** and **111** (note 14 and 15 of the Financial Statements). The Group held £415.6m of goodwill arising on its acquisitions made and £173.6m of acquired intangibles as at 31 December 2016. There is a risk that inappropriate judgements relating to future cashflow forecasts and discount rates are used which lead to the overstatement of the value of these assets, which would have otherwise resulted 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 significant future cashflow forecast growth assumed we have focused this risk on the following goodwill and acquired intangible asset balances: • goodwill attributable to the Infrastructure cash generating unit • the government customer relationship acquired intangible asset held at GigaSat	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 assumptions used by management in their impairment assessment by using valuation specialists within the audit team to benchmark the discount rate against independently available data, together with peer group analysis, our understanding of the secured orders underpinning the Group's cashflow forecasts, and the historical performance of the businesses. Having audited 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 under a sensitised scenario.

Our assessment of risks of material misstatement (continued)

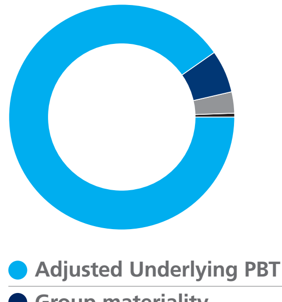
Risk description	How the scope of our audit responded to the risk
Defined benefit pension scheme liabilities valuation Refer to page **137** (critical accounting judgements and key sources of estimation uncertainty – pensions); page **137** (accounting policies – pensions); and page **69** (Audit Committee report – significant issues considered). The Group operates defined benefit pension schemes in the UK, Switzerland and Canada. At 31 December 2016 the defined benefit pension scheme obligation was £400.5m which resulted in a net IAS 19 "Employment Benefits" deficit of £113.2m. The UK scheme accounted for 98% of this net deficit. The scheme closed to future accrual in 2016, and a £15.5m curtailment gain was recognised in respect of this closure. 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 key assumptions that impact the obligation valuation are the discount rate, inflation rates and life expectancy rates.	Our audit work assessed the adequacy of the design and implementation of controls over the accounting for defined benefit pension scheme. We included a pension specialist within our audit team to assess the appropriateness of the assumptions through benchmarking to industry data, and accepted methodology used to value the defined benefit pension scheme obligation. We also assessed whether the £15.5m curtailment gain recognised in the year, was appropriately calculated and presented within the financial statements.

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.

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:



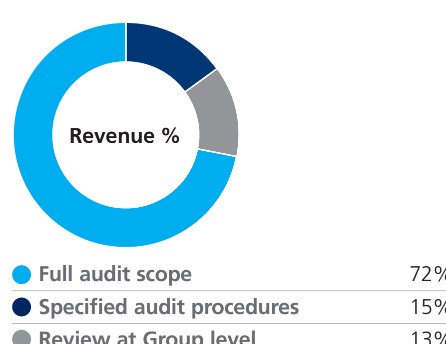
Adjusted Underlying PBT	£87m
Group materiality	£6m
Component materiality	£3m
Audit Committee reporting threshold	£0.3m

Group materiality	£6,000,000 (2015: £5,700,000)
Basis for determining materiality	We have used 7% (2015: 7%) of adjusted underlying profit as the basis for determining materiality.
Rationale for the benchmark applied	Underlying pre-tax profit is a key performance measure for the Group and it is therefore an appropriate basis on which to determine materiality. However we do adjust underlying pre-tax profit as presented by management, by deducting amortisation of acquired intangible assets. The Group has established a track record of making acquisitions and hence we consider amortisation of acquired intangibles to be relevant when considering our basis for determining materiality. Underlying pre-tax profit is reconciled to statutory pre-tax profit in note 2 of the financial statements.

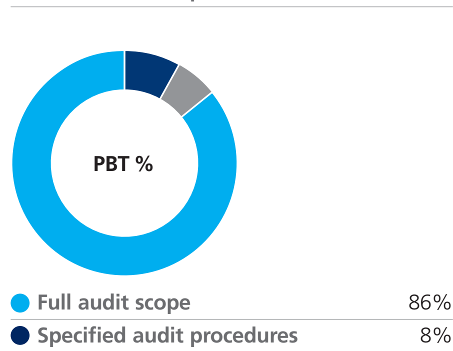
We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £300,000 (2015: £114,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. The increase in our reporting threshold to the Committee reflects a reassessment of market practice and the low levels of prior year misstatements. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

Independent auditor's report
to the members of Ultra Electronics Holdings plc (continued)

An overview of the scope of our audit



Full audit scope	72%
Specified audit procedures	15%
Review at Group level	13%



Full audit scope	86%
Specified audit procedures	8%
Review at Group level	6%

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 (2015: 24) locations, 12 (2015: 14) of these were subject to a full audit, whilst the remaining 8 (2015: 10) 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. The decrease in the number of locations visited reflects the disposal of the ID business as well as the merger of certain business units in the period.

These 20 (2015: 24) locations, which are largely located in the UK and USA, represent the principal business units and account for 87% (2015: 90%) of the Group's revenue and 94% (2015: 85%) of the Group's 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 (2015: 24) units was executed at levels of materiality applicable to each individual entity which did not exceed 50% of Group materiality (£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 components 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 2016, a senior member of the Group audit team visited all of the UK components as well as the following overseas components: USSI, ATS, NSPI, 3 Phoenix and Herley Lancaster.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- 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 company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and 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 arising from these matters.

Corporate Governance Statement
Under the Listing Rules we are also required to review part of the Corporate Governance Statement relating to the company's compliance with certain provisions of the UK Corporate Governance Code.

We have nothing to report arising from our review.

Our duty to read other information in the Annual Report
Under International Standards on Auditing (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- otherwise misleading.

We confirm that we have not identified any such inconsistencies or misleading statements.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

Respective responsibilities of Directors and auditor

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. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). We also comply with International Standard on Quality Control 1 (UK and Ireland). Our audit methodology and tools aim to ensure that our quality control procedures are effective, understood and applied. Our quality controls and systems include our dedicated professional standards review team and independent partner reviews.

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.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Alexander Butterworth FCA, Senior statutory auditor
for and on behalf of **Deloitte LLP**
Chartered Accountants and Statutory Auditor
Reading, United Kingdom
3 March 2017

Group highlights
for the year ended 31 December 2016

	2016 £'000	2015 £'000	Change %
Revenue	**785,764**	726,286	+8.2
Underlying operating profit*	**131,134**	119,972	+9.3
Operating profit	**89,725**	66,425	+35.1
Underlying profit before tax*	**120,059**	112,425	+6.8
Profit before tax	**67,621**	34,761	+94.5

	2016 pence	2015 pence	Change %
Underlying earnings per share*	**134.6**	123.9	+8.6
Basic earnings per share	**82.8**	35.7	+131.9
Dividend per share	**47.8**	46.1	+3.7

* Ultra uses underlying figures as key performance indicators. Underlying figures are stated before the Oman contract termination and liquidation related costs, amortisation charges relating to acquired intangibles, the S3 programme, impairment charges, adjustments to deferred consideration net of acquisition and disposal related costs, defined benefit pension curtailment gain and interest charges, unwinding of discounts on provisions and the revaluation of financial instruments based on their fair values. A reconciliation between operating profit and underlying operating profit, and between profit before tax and underlying profit before tax is shown in note 2 to the accounts. A reconciliation between basic earnings per share and underlying earnings per share is shown in note 13.

Consolidated income statement
for the year ended 31 December 2016

	Note	2016 £'000	2015 £'000
Revenue	3	785,764	726,286
Cost of sales		(536,561)	(499,510)
Gross profit		249,203	226,776
Other operating income	4	1,770	2,198
Distribution costs		(1,081)	(1,604)
Administrative expenses		(144,893)	(143,007)
Share of loss from associate	17	-	(581)
Other operating expenses	5	(8,777)	(2,931)
Contingent consideration charge		-	(1,101)
Impairment charges	6	-	(8,462)
S3 programme	2	(6,497)	(4,863)
Operating profit	6	89,725	66,425
Loss on disposals (net)	32	(4,076)	-
Deemed disposal of Ithra	7	-	(16,447)
Retirement benefit scheme curtailment gain	31	15,500	-
Investment revenue	9	197	190
Finance costs	10	(33,725)	(15,407)
Profit before tax		67,621	34,761
Tax	11	(9,363)	(9,772)
Profit for the year		58,258	24,989
Attributable to:			
Owners of the Company		58,260	24,989
Non-controlling interests		(2)	-
Earnings per ordinary share (pence)			
Basic	13	82.8	35.7
Diluted	13	82.8	35.6

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 2016

	Note	2016 £'000	2015 £'000
Profit for the year		58,258	24,989
Items that will not be reclassified to profit or loss:			
Actuarial loss on defined benefit pension schemes	31	(49,343)	(2,530)
Tax relating to items that will not be reclassified	11	9,973	478
Total items that will not be reclassified to profit or loss		(39,370)	(2,052)
Items that may be reclassified to profit or loss:			
Exchange differences on translation of foreign operations		99,349	11,995
Reclassification of exchange differences on disposals	32/7	(1,895)	2,696
Loss on loans used in net investment hedges		(43,078)	(12,578)
Tax relating to items that may be reclassified	11	43	12
Total items that may be reclassified to profit or loss		54,419	2,125
Other comprehensive income for the year		15,049	73
Total comprehensive income for the year	28	73,307	25,062
Attributable to:			
Owners of the Company		73,309	25,190
Non-controlling interests		(2)	(128)

The accompanying notes are an integral part of this consolidated statement of comprehensive income.

Consolidated balance sheet
31 December 2016

	Note	2016 £'000	2015 £'000
Non-current assets			
Goodwill	14	**415,593**	375,885
Other intangible assets	15	**173,637**	193,123
Property, plant and equipment	16	**66,195**	68,183
Deferred tax assets	25	**21,377**	5,935
Derivative financial instruments	23	**3**	426
Trade and other receivables	20	**16,352**	15,239
		693,157	658,791
Current assets			
Inventories	18	**78,177**	81,816
Trade and other receivables	20	**215,731**	197,387
Tax assets		**9,444**	9,169
Cash and cash equivalents		**74,625**	45,474
Derivative financial instruments	23	**251**	921
Assets classified as held for sale	32	**-**	8,795
		378,228	343,562
Total assets		**1,071,385**	1,002,353
Current liabilities			
Trade and other payables	21	**(193,243)**	(199,942)
Tax liabilities		**(7,339)**	(7,149)
Derivative financial instruments	23	**(12,507)**	(3,530)
Liabilities classified as held for sale	32	**-**	(3,011)
Short-term provisions	26	**(16,633)**	(24,363)
		(229,722)	(237,995)
Non-current liabilities			
Retirement benefit obligations	31	**(113,177)**	(84,819)
Other payables	21	**(9,972)**	(6,996)
Deferred tax liabilities	25	**(6,555)**	(7,168)
Derivative financial instruments	23	**(11,594)**	(2,561)
Borrowings	22	**(331,325)**	(341,046)
Long-term provisions	26	**(5,469)**	(4,925)
		(478,092)	(447,515)
Total liabilities		**(707,814)**	(685,510)
Net assets		**363,571**	316,843
Equity			
Share capital	27	**3,523**	3,514
Share premium account	28	**64,020**	61,052
Own shares	28	**(2,581)**	(2,581)
Hedging reserve	28	**(68,986)**	(25,908)
Translation reserve	28	**139,492**	42,038
Retained earnings	28	**228,034**	238,728
Equity attributable to owners of the company		**363,502**	316,843
Non-controlling interest	28	**69**	-
Total equity		**363,571**	316,843

The financial statements of Ultra Electronics Holdings plc, registered number 2830397, were approved by the Board of Directors and authorised for issue on 3 March 2017.

On behalf of the Board
R. Sharma, Chief Executive
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 2016

	Note	2016 £'000	2015 £'000
Net cash flow from operating activities	29	**92,834**	47,778
Investing activities			
Interest received		**197**	190
Dividends received from equity accounted investments		**-**	5,343
Purchase of property, plant and equipment		**(4,645)**	(4,597)
Proceeds from disposal of property, plant and equipment		**293**	1,466
Expenditure on product development and other intangibles		**(2,728)**	(1,761)
Disposal of subsidiary undertakings		**22,040**	-
Acquisition of subsidiary undertakings	32	**(5,199)**	(172,539)
Net cash acquired with subsidiary undertakings		**-**	724
Net cash from/(used in) investing activities		**9,958**	(171,174)
Financing activities			
Issue of share capital		**2,976**	4,937
Dividends paid		**(32,583)**	(31,332)
Loan syndication costs		**-**	(1,347)
Repayments of borrowings		**(114,419)**	(160,532)
Proceeds from borrowings		**60,000**	317,586
Minority investment		**2,000**	-
Net cash (used in)/from financing activities		**(82,026)**	129,312
Net increase in cash and cash equivalents	29	**20,766**	5,916
Cash and cash equivalents at beginning of year		**45,474**	41,259
Effect of foreign exchange rate changes		**8,385**	(1,701)
Cash and cash equivalents at end of year		**74,625**	45,474

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 2016

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 2015	**3,498**	**56,131**	**(2,581)**	**(13,330)**	**27,219**	**246,132**	**(13,623)**	**303,446**
Profit for the year	-	-	-	-	-	24,989	-	24,989
Other comprehensive income for the year	-	-	-	(12,578)	14,819	(2,040)	(128)	73
Total comprehensive income for the year	**-**	**-**	**-**	**(12,578)**	**14,819**	**22,949**	**(128)**	**25,062**
Deemed disposal of Ithra	-	-	-	-	-	-	13,751	13,751
Equity-settled employee share schemes	16	4,921	-	-	-	967	-	5,904
Dividend to shareholders	-	-	-	-	-	(31,332)	-	(31,332)
Tax on share-based payment transactions	-	-	-	-	-	12	-	12
Balance at 31 December 2015	**3,514**	**61,052**	**(2,581)**	**(25,908)**	**42,038**	**238,728**	**-**	**316,843**
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**

Notes to accounts – Group
31 December 2016

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 Chief Executive. Each segment includes businesses with similar operating and market characteristics.

	2016			2015		
	External revenue £'000	**Inter segment £'000**	**Total £'000**	External revenue £'000	Inter segment £'000	Total £'000
Revenue						
Aerospace & Infrastructure	**204,685**	**8,114**	**212,799**	193,224	8,880	202,104
Communications & Security	**258,975**	**2,807**	**261,782**	239,261	5,692	244,953
Maritime & Land	**322,104**	**21,869**	**343,973**	293,801	21,351	315,152
Eliminations	**-**	**(32,790)**	**(32,790)**	-	(35,923)	(35,923)
Consolidated revenue	**785,764**	**-**	**785,764**	726,286	-	726,286

All inter-segment trading is at arm's length.

				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**

The S3 programme is the Group's Standardisation & Shared Services programme.

				2015
	Aerospace & Infrastructure £'000	Communications & Security £'000	Maritime & Land £'000	Total £'000
Underlying operating profit	28,641	40,424	50,907	119,972
Amortisation of intangibles arising on acquisition	(3,129)	(22,130)	(5,547)	(30,806)
Adjustments to contingent consideration net of acquisition and disposal related costs	(91)	(9,306)	(19)	(9,416)
S3 programme	(460)	(3,895)	(508)	(4,863)
Impairment charges *(see note 6)*	(2,693)	(5,769)	-	(8,462)
Operating profit/(loss)	22,268	(676)	44,833	66,425
Deemed disposal of Ithra *(see note 7)*				(16,447)
Investment revenue				190
Finance costs				(15,407)
Profit before tax				34,761
Tax				(9,772)
Profit after tax				24,989

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	
	2016 £'000	2015 £'000	**2016 £'000**	2015 £'000
Aerospace & Infrastructure	**1,647**	2,498	**5,894**	7,074
Communications & Security	**3,460**	1,915	**34,127**	27,815
Maritime & Land	**2,266**	1,945	**9,512**	10,697
Total	**7,373**	6,358	**49,533**	45,586

The 2016 depreciation and amortisation expense includes £38,034,000 of amortisation charges (2015: £34,627,000) and £11,499,000 of property, plant and equipment depreciation charges (2015: £10,959,000).

Total assets by segment

	2016 £'000	2015 £'000
Aerospace & Infrastructure	**233,110**	233,949
Communications & Security	**463,713**	460,980
Maritime & Land	**268,862**	245,499
	965,685	940,428
Unallocated	**105,700**	61,925
Consolidated total assets	**1,071,385**	1,002,353

Unallocated assets represent current and deferred tax assets, derivatives at fair value and cash and cash equivalents.

Total liabilities by segment

	2016 £'000	2015 £'000
Aerospace & Infrastructure	**55,751**	79,791
Communications & Security	**71,832**	71,162
Maritime & Land	**104,042**	92,573
	231,625	243,526
Unallocated	**476,189**	441,984
Consolidated total liabilities	**707,814**	685,510

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:

	2016 £'000	2015 £'000
United Kingdom	**185,135**	211,641
Continental Europe	**82,818**	74,592
Canada	**18,617**	16,690
USA	**391,754**	323,883
Rest of World	**107,440**	99,480
	785,764	726,286

During the year there was one direct customer (2015: two) that individually accounted for greater than 10% of the Group's total turnover. Sales to this customer in 2016 were £141.9m (2015: £134.0m and £80.6m) 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)	
	2016 £'000	2015 £'000	**2016 £'000**	2015 £'000	**2016 £'000**	2015 £'000
United Kingdom	**205,253**	223,076	**344,157**	373,408	**3,213**	4,031
USA	**362,313**	341,943	**478,083**	453,780	**3,356**	1,834
Canada	**96,449**	84,238	**126,995**	105,755	**767**	413
Rest of World	**7,762**	3,173	**16,450**	7,485	**37**	80
	671,777	652,430	**965,685**	940,428	**7,373**	6,358
Unallocated	**21,380**	6,361	**105,700**	61,925	**-**	-
	693,157	658,791	**1,071,385**	1,002,353	**7,373**	6,358

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:

	2016 £'000	2015 £'000
Operating profit	**89,725**	66,425
Amortisation of intangibles arising on acquisition *(see note 15)*	**32,655**	30,806
Impairment charges *(see note 6)*	**-**	8,462
Adjustments to contingent consideration net of acquisition and disposal related costs	**2,257**	9,416
S3 programme	**6,497**	4,863
Underlying operating profit	**131,134**	119,972
Profit before tax	**67,621**	34,761
Amortisation of intangibles arising on acquisition *(see note 15)*	**32,655**	30,806
Impairment charges *(see note 6)*	**-**	8,462
Adjustments to contingent consideration net of acquisition and disposal related costs	**2,257**	9,416
Unwinding of discount on provisions *(see note 10)*	**367**	641
Loss on fair value movements of derivatives *(see note 23)*	**19,103**	3,988
Net interest charge on defined benefit pensions *(see note 10)*	**2,983**	3,041
S3 programme	**6,497**	4,863
Loss on disposals (net) *(see note 32)*	**4,076**	-
Deemed disposal of Ithra *(see note 7)*	**-**	16,447
Retirement benefit scheme curtailment gain *(see note 31)*	**(15,500)**	-
Underlying profit before tax	**120,059**	112,425
Cash generated by operations *(see note 29)*	**112,002**	71,339
Purchase of property, plant and equipment	**(4,645)**	(4,597)
Proceeds on disposal of property, plant and equipment	**293**	1,466
Expenditure on product development and other intangibles	**(2,728)**	(1,761)
Dividend from equity accounted investment	**-**	5,343
Ithra performance bond	**8,230**	-
S3 programme	**5,613**	2,233
Acquisition and disposal related payments	**1,669**	7,291
Underlying operating cash flow	**120,434**	81,314

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 **136** for further details.

3 Revenue

An analysis of the Group's revenue is as follows:

	2016 £'000	2015 £'000
Sales of goods	**342,284**	354,719
Revenue from long-term contracts	**443,480**	371,567
	785,764	726,286

4 Other operating income

Amounts included in other operating income were as follows:

	2016 £'000	2015 £'000
Foreign exchange gains	**1,770**	2,198
	1,770	2,198

5 Other operating expenses

Amounts included in other operating expenses were as follows:

	2016 £'000	2015 £'000
Amortisation of development costs	**2,876**	1,220
Foreign exchange losses	**5,901**	1,711
	8,777	2,931

6 Operating profit

Operating profit is stated after charging/(crediting):

	2016 £'000	2015 £'000
Raw materials and other bought in inventories expensed in the year	**201,221**	220,379
Staff costs *(see note 8)*	**254,956**	240,243
Depreciation and amounts written off property, plant and equipment	**11,499**	10,959
Amortisation of internally generated intangible assets	**2,876**	1,220
Amortisation of acquired intangible assets (and other intangibles)	**35,158**	33,407
Impairment of acquired intangible assets *(see note 15)*	**-**	5,769
Impairment of loan to associate *(see note 17)*	**-**	2,693
Government grant income *(see note 24)*	**(1,663)**	(3,714)
Net foreign exchange gain	**(6,634)**	(2,509)
Loss/(profit) on disposal of property, plant and equipment	**291**	(559)
Operating lease rentals		
– plant and machinery	**1,269**	1,518
– other	**13,022**	12,139
Research and development costs	**32,639**	35,126
Auditor's remuneration for statutory audit work (including expenses)	**893**	915

The Company-only audit fee included in the Group audit fee shown above was £20,000 (2015: £20,000).

Analysis of auditor's remuneration

	2016 £'000	2015 £'000
Fees payable for the audit of the annual accounts	**204**	206
Fees payable for the audit of subsidiaries	**689**	709
Total for statutory Group audit services	**893**	915
Analysis of non-audit services:		
Audit related services	**13**	24
Tax compliance	**4**	3
Corporate finance services – due diligence	**107**	360
Other advisory	**330**	-
Total for non-audit services	**454**	387

7 Deemed disposal of Ithra

In the prior year '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 and is pursuing claims against the customer on behalf of the interested parties. Ithra, upon liquidation, no longer met the IFRS 10 criteria for consolidation as a subsidiary of the Group and was a deemed disposal as at 4 March 2015.

	2016 £'000	2015 £'000
Non-controlling interest elimination	-	13,751
Release of translation reserve	-	2,696
Oman termination-related costs	-	16,447

8 Staff costs

Particulars of employees (including Executive Directors) are shown below.
Employee costs during the year amounted to:

	2016 £'000	2015 £'000
Wages and salaries	**223,823**	209,228
Social security costs	**21,099**	19,796
Pension costs	**10,034**	11,219
	254,956	240,243

The average monthly number of persons employed by the Group during the year was as follows:

	2016 Number	2015 Number
Production	**1,917**	2,149
Engineering	**1,579**	1,746
Selling	**300**	322
Support services	**670**	626
	4,466	4,843

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

	2016 £'000	2015 £'000
Bank interest	**197**	190
	197	190

10 Finance costs

	2016 £'000	2015 £'000
Amortisation of finance costs of debt	**848**	649
Interest payable on bank loans, overdrafts and other loans	**10,424**	7,088
Total borrowing costs	**11,272**	7,737
Retirement benefit scheme finance cost	**2,983**	3,041
Unwinding of discount on provisions	**367**	641
Fair value movement on derivatives	**19,103**	3,988
	33,725	15,407

11 Tax

	2016 £'000	2015 £'000
UK taxes		
Corporation tax	5,549	6,555
Adjustment in respect of prior years	(1,848)	(2,245)
	3,701	4,310
Overseas taxes		
Current taxation	10,879	9,435
Adjustment in respect of prior years	326	(620)
	11,205	8,815
Total current tax	14,906	13,125
Deferred tax		
Origination and reversal of temporary differences	(7,124)	(6,505)
Derecognition of deferred tax assets	1,576	1,799
UK tax rate change	5	1,353
Total deferred tax credit	(5,543)	(3,353)
Total tax charge	9,363	9,772

Corporation tax in the UK is calculated at 20.0% (2015: 20.25%) 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.

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:

	2016 £'000	2015 £'000
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Actuarial loss on defined benefit pension schemes	9,973	478
Total income tax charge recognised directly in other comprehensive income	9,973	478

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:

	2016 £'000	2015 £'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	167	12
Total income tax recognised directly in equity	43	12

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:

	2016 £'000	2015 £'000
Group profit before tax	67,621	34,761
Tax on Group profit at standard UK corporation tax rate of 20.0% (2015: 20.25%)	13,524	7,039
Tax effects of:		
Income/expenses that are not taxable/allowable in determining taxable profits	2,405	3,360
Effect of change in UK tax rate	5	1,353
Losses for which no deferred tax asset recognised	1,576	1,237
Change in unrecognised deferred tax assets	-	1,799
Different tax rates of subsidiaries operating in other jurisdictions	2,683	528
CFC exemption	(4,327)	(2,763)
Non-taxable gain on disposal	(1,835)	-
Patent Box	(813)	-
Adjustments in respect of prior years	(3,855)	(2,781)
Tax expense for the year	9,363	9,772

11 Tax (continued)

Included within the tax reconciliation are a number of non-recurring items, principally the non-taxable gain on the disposal of the ID business and the non-recognition of deferred tax assets for certain UK expenses. In addition, a deferred tax asset was not recognised for certain expenses in our Canadian business and this will continue to be assessed annually. The differences attributable to the UK CFC exemption, Patent Box and higher overseas tax rates are expected to recur in the future.

Prior year adjustments arise in all the major territories where the Group operates and for a variety of reasons. Factors contributing to the increased prior year tax credit in 2016 include the identification of additional tax deductions and new claims for reliefs in the UK, the release of provisions against expiring uncertain tax positions and adjustments to deferred tax balances.

12 Dividends

Amounts recognised as distributions to equity holders in the year:

	2016 £'000	2015 £'000
Final dividend for the year ended 31 December 2015 of 32.3p (2014: 31.1p) per share	22,631	21,695
Interim dividend for the year ended 31 December 2016 of 14.2p (2015: 13.8p) per share	9,952	9,637
	32,583	31,332
Proposed final dividend for the year ended 31 December 2016 of 33.6p (2015: 32.3p) per share	23,597	22,625

The 2016 proposed final dividend of 33.6p per share is planned to be paid on 4 May 2017 to shareholders on the register at 7 April 2017. It was approved by the Board after 31 December 2016 and has not been included as a liability as at 31 December 2016.

13 Earnings per share

	2016 pence	2015 pence
Basic underlying *(see below)*	134.6	123.9
Diluted underlying *(see below)*	134.5	123.8
Basic	82.8	35.7
Diluted	82.8	35.6

The calculation of the basic, underlying and diluted earnings per share is based on the following data:

	2016 £'000	2015 £'000
Earnings		
Earnings for the purposes of basic earnings per share being profit for the year	58,260	24,989
Underlying earnings		
Profit for the year	58,260	24,989
Loss on fair value movements on derivatives (net of tax)	16,008	3,180
Amortisation of intangibles arising on acquisition (net of tax)	22,419	21,195
Unwinding of discount on provisions (net of tax)	367	641
Acquisition and disposal related costs net of contingent consideration (net of tax)	2,100	8,403
Net interest charge on defined benefit pensions (net of tax)	2,386	2,425
Retirement benefit scheme curtailment gain (net of tax)	(12,400)	-
Impairment charges (net of tax)	-	6,270
S3 programme (net of tax)	5,503	3,281
Deemed disposal of Ithra (net of tax)	-	16,447
Disposals (net of tax)	48	-
Earnings for the purposes of underlying earnings per share	94,691	86,831

The adjustments to profit are explained in note 2.

	2016 Number of shares	2015 Number of shares
The weighted average number of shares is given below:		
Number of shares used for basic earnings per share	70,330,384	70,056,025
Effect of dilutive potential ordinary shares – share options	73,320	89,021
Number of shares used for fully diluted earnings per share	70,403,704	70,145,046

	2016 £'000	2015 £'000
Underlying profit before tax	120,059	112,425
Tax rate applied for the purposes of underlying earnings per share	21.13%	22.77%

14 Goodwill

	2016 £'000	2015 £'000
Cost		
At 1 January	428,166	348,598
Exchange differences	55,577	8,627
Recognised on acquisition of subsidiaries	-	70,579
Derecognised on disposal *(see note 32)*	(8,305)	-
Other changes	3,127	362
At 31 December	478,565	428,166
Accumulated impairment losses		
At 1 January	(52,281)	(49,638)
Exchange differences	(10,691)	(2,643)
Carrying amount at 31 December	415,593	375,885

Other changes in 2016 and 2015 relate to the re-assessment of initial fair values. In 2016 this relates to Herley adjustments predominantly 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:

	2016 Discount rate %	2015 Discount rate %	2016 £'000	2015 £'000
Aerospace	10.1	10.4	32,784	32,310
Infrastructure	10.1	10.4	28,159	28,971
Nuclear	10.1	10.4	19,411	17,305
Aerospace & Infrastructure			80,354	78,586
Communications	10.1	10.4 to 12.9	93,182	87,393
C2ISR	10.1	10.4 to 12.9	124,926	107,524
Communications & Security			218,108	194,917
Maritime	10.1	10.4	36,025	31,690
Underwater Warfare	10.1	10.4 to 12.9	81,106	70,692
Maritime & Land			117,131	102,382
Total – Ultra Electronics			415,593	375,885

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 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.

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 plan, 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% 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 and underlying operating profit*. 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 2016 was 10.1% (2015: 10.4% to 12.9%). 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-2021 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 **144**

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 £5.2m. Sensitivity (ii) results in a £1.5m 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 £'000	Software, patents and trademarks £'000	Total £'000
	Customer relationships £'000	Intellectual property £'000	Profit in order book £'000	Other acquired £'000			
Cost							
At 1 January 2015	202,154	91,468	26,941	4,847	30,120	25,572	381,102
Foreign exchange differences	5,893	2,741	621	(33)	632	532	10,386
Acquired on acquisition of subsidiary undertakings	42,789	19,115	3,321	2,832	-	-	68,057
Additions	-	-	-	-	939	822	1,761
Reclassified as held for sale	-	-	-	-	(5,264)	-	(5,264)
Disposals	-	-	-	-	(3,192)	(397)	(3,589)
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 31 December 2016	**222,459**	**117,588**	**34,957**	**8,765**	**26,989**	**30,022**	**440,780**
Accumulated amortisation							
At 1 January 2015	(112,788)	(46,356)	(25,961)	(1,650)	(15,105)	(16,730)	(218,590)
Foreign exchange differences	(3,691)	(1,577)	(442)	(47)	(270)	(244)	(6,271)
Reclassified as held for sale	-	-	-	-	2,338	-	2,338
Impairment charges	(5,769)	-	-	-	-	-	(5,769)
Disposals	-	-	-	-	3,192	397	3,589
Charge	(19,710)	(8,828)	(1,460)	(808)	(1,220)	(2,601)	(34,627)
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 31 December 2016	**(125,692)**	**(65,389)**	**(33,422)**	**(4,024)**	**(14,988)**	**(23,628)**	**(267,143)**
Carrying amount							
At 31 December 2016	**96,767**	**52,199**	**1,535**	**4,741**	**12,001**	**6,394**	**173,637**
At 31 December 2015	108,878	56,563	3,020	5,141	12,170	7,351	193,123

Of the £6,394,000 (2015: £7,351,000) net book value within the software, patents and trademarks category, £417,000 (2015: £448,000) 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:	3 to 5 years
Software	3 to 5 years
Patents and trademarks	10 to 20 years

16 Property, plant and equipment

	Land and buildings Freehold £'000	Land and buildings Short leasehold £'000	Plant and machinery £'000	Total £'000
Cost				
At 1 January 2015	34,416	21,220	100,225	155,861
Foreign exchange differences	(275)	531	2,056	2,312
Acquisitions	5,146	376	7,144	12,666
Additions	134	1,408	3,055	4,597
Reclassified as held for sale	-	-	(1,751)	(1,751)
Disposals	(2,398)	(43)	(2,782)	(5,223)
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 31 December 2016	**41,561**	**25,909**	**114,840**	**182,310**
Accumulated depreciation				
At 1 January 2015	(6,727)	(10,000)	(76,565)	(93,292)
Foreign exchange differences	246	(305)	(1,361)	(1,420)
Charge	(1,623)	(2,037)	(7,299)	(10,959)
Reclassified as held for sale	-	-	827	827
Disposals	1,891	(1)	2,675	4,565
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 31 December 2016	**(8,389)**	**(16,010)**	**(91,716)**	**(116,115)**
Carrying amount				
At 31 December 2016	**33,172**	**9,899**	**23,124**	**66,195**
At 31 December 2015	30,810	11,149	26,224	68,183

Freehold land amounting to £7,070,000 (2015: £6,464,000) has not been depreciated. Included within Land and Buildings is £nil (2015: £nil) of assets in the course of construction.

17 Interest in associate

	2016 £'000	2015 £'000
Total revenue of associate	-	3,511
Group's share of loss recognised	-	(581)

The Group's interest in associate was represented by its 49% holding of ordinary shares in Al Shaheen Adventure LLC ("ASA"), a company incorporated in the UAE. The Group had significant influence over the entity but did not control it, consequently ASA was accounted for using the equity method of accounting. On 30 December 2015, the Group reached agreement to transfer the whole of its 49% equity interest in ASA to Emirates Advanced Investments Group ("EAI"). During 2015 Ultra received an interim cash dividend of £5,343,000 and received a further final dividend of £3,111,000 in January 2017 which will be accounted for in 2017.

A non-underlying impairment charge of £2,693,000 was recorded in 2015 as disclosed in note 6.

18 Inventories

	2016 £'000	2015 £'000
Raw materials and consumables	48,147	51,561
Work in progress	21,452	19,598
Finished goods and goods for resale	8,578	10,657
	78,177	81,816

The amount of any write-down of inventory recognised as an expense in the year was £4,912,000 (2015: £3,168,000).

19 Long-term contract balances

	2016 £'000	2015 £'000
Contracts in progress at the balance sheet date:		
Amounts receivable from contract customers included in trade and other receivables	112,271	96,856
Amounts due to contract customers included in trade and other payables	(52,456)	(59,729)
	59,815	37,127
Contract costs incurred plus recognised profits less recognised losses to date	1,480,046	1,568,778

Advances received from customers for contract work amounted to £48,378,000 (2015: £56,643,000).

20 Trade and other receivables

Non-current	2016 £'000	2015 £'000
Amounts receivable from contract customers	16,352	15,239
	16,352	15,239

Current	2016 £'000	2015 £'000
Trade receivables	98,977	93,016
Provisions against receivables	(1,307)	(959)
Net trade receivables	97,670	92,057
Amounts receivable from contract customers	95,919	81,617
Other receivables	11,891	9,328
Prepayments and accrued income	10,251	14,385
	215,731	197,387

Trade receivables do not carry interest. The average credit period on sale of goods is 36 days (2015: 28 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:

	2016 £'000	Related provision £'000	Total £'000	2015 £'000	Related provision £'000	Total £'000
1 to 3 months	15,765	(157)	15,608	20,039	(315)	19,724
4 to 6 months	1,968	(56)	1,912	1,067	(76)	991
7 to 9 months	434	(72)	362	591	(276)	315
Over 9 months	1,666	(1,022)	644	292	(292)	-
Total overdue	19,833	(1,307)	18,526	21,989	(959)	21,030

The Group provides 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.

20 Trade and other receivables (continued)

Movement in the provision for trade receivables was as follows:

Current	2016 £'000	2015 £'000
Balance at beginning of year	**959**	1,043
Foreign exchange differences	**105**	(24)
Increase in provision for trade receivables regarded as potentially uncollectable	**633**	217
Decrease in provision for trade receivables recovered during the year	**(390)**	(277)
Balance at end of year	**1,307**	959

Non-current	2016 £'000	2015 £'000
Balance at beginning of year	**-**	6,884
Decrease in provision for trade receivables regarded as potentially uncollectable	**-**	(6,884)
Balance at end of year	**-**	-

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 counter parties 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 23)* net of any allowances for losses represents the Group's maximum exposure to credit risk.

21 Trade and other payables

	2016 £'000	2015 £'000
Amounts included in current liabilities:		
Trade payables	**68,341**	70,701
Amounts due to contract customers *(note 19)*	**46,310**	58,104
Other payables	**30,207**	27,157
Accruals and deferred income	**48,385**	43,980
	193,243	199,942
Amounts included in non current liabilities:		
Amounts due to contract customers *(note 19)*	**6,146**	1,625
Other payables	**243**	570
Accruals and deferred income	**3,583**	4,801
	9,972	6,996

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

22 Borrowings

	2016 £'000	2015 £'000
Amounts due after more than one year:		
Bank loans	**268,120**	289,521
Unsecured loan notes	**56,897**	47,236
Loans from government	**6,308**	4,289
	331,325	341,046
Total borrowings:		
Amount due for settlement within 12 months	**-**	-
Amount due for settlement after 12 months	**331,325**	341,046
	331,325	341,046

23 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 includes 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.

Fair value measurements recognised in the balance sheet

	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		
Foreign exchange derivative financial instruments (through profit and loss)	**24,101**	**24,101**

	Level 2 £'000	2015 Total £'000
Financial assets at fair value		
Foreign exchange derivative financial instruments (through profit and loss)	1,347	1,347
Financial liabilities at fair value		
Foreign exchange derivative financial instruments (through profit and loss)	6,091	6,091

	Current assets/(liabilities)		Non-current assets/(liabilities)	
	2016 £'000	2015 £'000	**2016 £'000**	2015 £'000
Financial assets/(liabilities) carried at fair value through profit or loss				
Foreign exchange currency liabilities	**(12,507)**	(3,530)	**(11,594)**	(2,561)
Foreign exchange currency assets	**251**	921	**3**	426

Financial assets

The financial assets of the Group were as follows:

	2016 £'000	2015 £'000
Cash and cash equivalents	**74,625**	45,474
Currency derivatives used for hedging	**254**	1,347
Amounts receivable from contract customers	**112,271**	96,856
Other receivables	**11,891**	9,328
Trade receivables	**97,670**	92,057
Prepayments and accrual income	**10,251**	14,385

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:

	2016 £'000	2015 £'000
Currency derivatives used for hedging	**24,101**	6,091
Bank loans and overdrafts	**268,120**	289,521
Loan notes	**56,897**	47,236
Government loans	**6,308**	4,289
Trade payables	**68,341**	70,701
Amounts due to contract customers	**52,456**	59,729
Deferred consideration	**3,956**	4,676
Other payables	**30,450**	27,727
Accruals	**33,595**	29,153

The Directors consider that the carrying amount for all financial liabilities approximates to their fair value.

23 Financial instruments and financial risk management (continued)

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. During the year there were three facilities in place. The first provides £100 million of revolving credit and expires in August 2019. The second facility, which was put in place in August 2014, provides £200 million of revolving credit which expires in August 2019. Both facilities are denominated in Sterling, US Dollars, Canadian Dollars, Australian Dollars and Euros and are used for balance sheet and operational needs. A US$225m term loan facility, which expires in August 2019, was put in place at the time of the Herley acquisition. The same covenants are in place across the three facilities.

A further £15 million overdraft is available for short-term working capital funding.

All bank loans are unsecured. Interest was predominantly charged at 1.35% (2015: 1.00%) over base or contracted rate.

At 31 December 2016, the Group had available £213,000,000 (2015: £159,756,000) 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 (UETCS), 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 24.

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.

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**
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	**31,132**	**1,038**	**1,100**	**325**	**33,595**
2015					
Bank loans and overdrafts	4,923	4,242	299,095	-	308,260
Loan notes	1,701	1,701	48,902	-	52,304
Government loans	-	-	-	4,289	4,289
Trade payables	70,701	-	-	-	70,701
Currency derivatives used for hedging	3,530	1,634	927	-	6,091
Deferred consideration	869	3,221	586	-	4,676
Accruals	27,178	842	860	273	29,153

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 22, 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 2016, the net fair value of the Group's currency derivatives is estimated to be a liability of approximately £23,847,000 (2015: liability £4,744,000), comprising £254,000 assets (2015: £1,347,000) and £24,101,000 liabilities (2015: £6,091,000). The loss on derivative financial instruments included in the Group's consolidated income statement for the period was £19,103,000 (2015: loss £3,988,000).

23 Financial instruments and financial risk management (continued)

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**
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**
2015				
US Dollars/Sterling	49,682	73,379	-	123,061
Euro/other currencies	4,590	7,745	1,740	14,075
Total	54,272	81,124	1,740	137,136

Net investment hedges

At the year end the Group had net investments in US companies where the associated foreign currency translation risk is 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$295m (2015: US$325m).

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$120m (2015: US$120m). The hedging contracts fix US$120m of borrowings to 30 December 2016, reducing to US$90m by December 2017, US$60m by December 2018 and US$45m by July 2019.

The interest rate swaps were designated effective cash flow hedges and the change in fair value is charged to equity. At 31 December 2016, the net fair value of interest rate swaps was £315,000 (2015: £198,000). The amount recycled from the income statement during the year was £495,000 and has been charged to interest cost in the year (2015: £nil).

The fair value will be realised in the income statement on a quarterly basis over the next 2.5 years. The Group also has US$70m of fixed rate debt with Pricoa at an interest rate of 3.60%, due for repayment in July 2018 and 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**
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**
2015						
Cash and cash equivalents	0.43%	45,474	45,474	-	-	-
Loan notes	3.60%	47,236	-	-	47,236	-
Unsecured bank loans	1.69%	289,521	-	-	289,521	-
Government loans	4.43%	4,289	-	-	-	4,289

Market risk sensitivity analysis

Interest rate risk

During 2016 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 2016. There is no significant difference between the amount recharged to the income statement and equity in the year.

	Profit before tax £'000
2016	**1% change**
Interest rate sensitivity	**(2,455)**
2015	
Interest rate sensitivity	(1,870)

23 Financial instruments and financial risk management (continued)

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
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**
2015								
Transaction	5,792	5,792	(5,792)	(5,792)	14,481	14,481	(14,481)	(14,481)
P&L translation	1,734	415	(1,734)	(415)	4,334	1,037	(4,334)	(1,037)
Foreign exchange derivatives	(12,825)	(12,825)	11,307	11,307	(36,043)	(36,043)	27,665	27,665
Total foreign exchange	(5,299)	(6,618)	3,781	5,100	(17,228)	(20,525)	8,850	12,147

24 Government grants and loans

The Group through its Canadian subsidiaries Ultra Electronics Tactical Communication Systems (UETCS) 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 $32m will be provided to UETCS and reimbursed at favourable rates of interest. Up to $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. The fair value of the loans has been calculated using a market interest rate for a similar instrument. Following delays on some of the UETCS programme, a two-year extension of the project competition date to December 2017 and related repayments to 2032 has been agreed with Industry Canada. The revised repayment profile and reassessment of the discount rate resulted in a reduction of the loan element and an increase in the grant element during 2015 and a reduction in capitalised development in 2015.

UETCS 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 $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:

	2016 £'000	2015 £'000
Fair value of SADI loan brought forward	**4,289**	5,728
Contributions	**262**	662
Reassessment as grant income	**-**	(2,249)
Reduction in capitalised development	**-**	(784)
Interest charged to finance costs	**837**	953
Foreign exchange differences	**920**	(21)
Fair value of SADI loan carried forward	**6,308**	4,289

Government grants credited to profit in the year

	2016 £'000	2015 £'000
SADI	**1,663**	3,551
Other†	**-**	163
	1,663	3,714

†Ultra Electronics Limited received a £163,000 grant from the Technology Strategy Board in 2015.

25 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 2015	(21,737)	419	151	17,607	(1,736)	3,598	(1,698)
Credit/(charge) to income	9,595	140	808	(2,715)	(5,452)	1,063	3,439
Credit to other comprehensive income	-	-	-	478	-	-	478
Credit direct to equity	-	12	-	-	-	-	12
Exchange differences	499	-	-	-	(380)	-	119
Arising on acquisition	(3,416)	-	-	-	(167)	-	(3,583)
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 tax rate	1,189	(15)	(143)	(1,789)	42	699	(17)
Arising on acquisition	-	-	-	-	2,152	-	2,152
At 31 December 2016	**(3,596)**	**589**	**4,054**	**19,517**	**(12,629)**	**6,887**	**14,822**

	2016 £'000	2015 £'000
Non-current assets	**21,377**	5,935
Non-current liabilities	**(6,555)**	(7,168)
	14,822	(1,233)

†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 deferred tax liabilities, are recognised for tax loss carry forwards and deductible temporary differences to the extent that utilisation against future taxable profits is probable. UK deferred tax assets of £1.4m and Canadian deferred tax assets of £12.0m have not been recognised (2015: £11.3m) because their recovery is uncertain. The absence of any consolidated or group basis of taxation in Canada contributes significantly to the uncertainty over the recovery of the Canadian deferred tax asset.

26 Provisions

	Warranties £'000	**Contract related provisions £'000**	**Other £'000**	**Total £'000**
At 1 January 2016	3,785	2,349	23,154	29,288
Created	2,012	5,779	3,457	11,248
Reversed	(467)	(22)	-	(489)
Utilised	(1,229)	(1,780)	(17,252)	(20,261)
Unwinding of discount	-	-	367	367
Exchange differences	343	413	1,193	1,949
At 31 December 2016	**4,444**	**6,739**	**10,919**	**22,102**
Included in current liabilities	2,325	6,046	8,262	16,633
Included in non-current liabilities	2,119	693	2,657	5,469
	4,444	**6,739**	**10,919**	**22,102**

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 will be utilised over the period as stated in the contract to which the specific provision relates. Other provisions include re-organisation costs, contingent consideration, dilapidation costs and provisions associated with the Oman Airport IT contract termination. 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: £1,598,000 of the provision was utilised in the year when the final Forensic Technology earn-out target was met.

27 Share capital and share options

	2016		2015	
	No.	£'000	No.	£'000
Authorised:				
5p ordinary shares	**90,000,000**	**4,500**	90,000,000	4,500
Allotted, called-up and fully paid:				
5p ordinary shares	**70,463,092**	**3,523**	70,281,146	3,514

181,946 ordinary shares having a nominal value of £9,097 were allotted during the year under the terms of the Group's various share option schemes. The aggregate consideration received was £2,977,000.

Share options

During the year to 31 December 2016, 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 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 2016, share options outstanding under the Savings-Related Share Option Schemes were as follows:

Options granted	Number of shares 2016	2015	Option price (£)	Exercise dates
2013 – US scheme	-	41,145	17.16	September 2015 - December 2015
2014 – US scheme	**19,156**	34,611	15.94	September 2016 - December 2016
2015 – US scheme	**44,306**	45,195	14.85	September 2017 - December 2017
2016 – US scheme	**48,843**	-	15.98	September 2018 - December 2018
2012 – Canadian scheme	-	15,196	13.79	September 2015 - March 2016
2013 – Canadian scheme	**2,723**	2,918	16.80	October 2016 - April 2017
2014 – Canadian scheme	**7,195**	8,649	16.13	October 2017 - April 2018
2015 – Canadian scheme	**10,884**	11,684	16.12	December 2018 - June 2019
2016 – Canadian scheme	**8,047**	-	15.98	December 2019 - June 2020
2010 – UK 5 year scheme	-	2,777	15.54	December 2015 - June 2016
2011 – UK 5 year scheme	**3,831**	15,685	13.33	December 2016 - June 2017
2012 – UK 3 year scheme	-	4,849	13.85	December 2015 - June 2016
2012 – UK 5 year scheme	**24,613**	28,159	13.85	December 2017 - June 2018
2013 – UK 3 year scheme	**9,456**	22,418	16.80	December 2016 - June 2017
2013 – UK 5 year scheme	**13,267**	15,657	16.80	December 2018 - June 2019
2014 – UK 3 year scheme	**13,217**	15,915	16.13	December 2017 - June 2018
2014 – UK 5 year scheme	**8,517**	11,320	16.13	December 2019 - June 2020
2015 – UK 3 year scheme	**13,551**	15,303	16.12	December 2018 - June 2019
2015 – UK 5 year scheme	**7,025**	7,936	16.12	December 2020 - June 2021
2016 – UK 3 year scheme	**64,479**	-	15.10	December 2019 - June 2020
2016 – UK 5 year scheme	**38,415**	-	15.10	December 2021 - June 2022

27 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 grant. This is an approved scheme and vesting is unconditional. Options vest after three years and lapse after ten years from the date of grant.

At 31 December 2016, share options outstanding under the Company Share Option Plan were as follows:

Options granted	Number of shares 2016	2015	Option price (£)	Exercise dates
2006	-	968	10.32	February 2009 - February 2016
2007	-	3,858	12.07	May 2010 - May 2017
2008	-	2,261	12.00	March 2011 - March 2018
2009	-	2,564	11.90	March 2012 - March 2019
2010	3,054	9,386	14.83	March 2013 - March 2020
2011	5,902	13,902	16.97	March 2014 - March 2021
2012	5,042	12,237	17.10	March 2015 - March 2022
2013	20,621	45,095	17.18	March 2016 - March 2023
2014	23,546	29,289	18.29	March 2017 - March 2024
2015	14,674	16,070	17.31	March 2018 - March 2025
2016	30,623	-	17.90	March 2019 - March 2026

3. Executive Share Option Scheme

The Executive Share Option Scheme provides share options for nominated employees in the UK, US and Canada. The purchase price is set at a mid-market price on the date of grant. This is an unapproved scheme and vesting is unconditional. Options vest after three years and lapse after seven years from the date of grant.

At 31 December 2016, share options outstanding under the Executive Share Option Scheme were as follows:

Options granted	Number of shares 2016	2015	Option price (£)	Exercise dates
2009	-	21,759	11.90	March 2012 - March 2016
2010	11,037	40,555	14.83	March 2013 - March 2017
2011	33,880	76,160	16.97	March 2014 - March 2018
2012	46,209	112,255	17.10	March 2015 - March 2019
2013	82,431	141,767	17.18	March 2016 - March 2020
2014	129,536	176,015	18.29	March 2017 - March 2021
2015	126,657	152,819	17.31	March 2018 - March 2022
2016	130,448	-	17.90	March 2019 - March 2023

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 **74** to **88**. In April 2016 LTIPs were awarded to nominated employees. The awards will vest in March 2019 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 (£) 2016	Number of options 2016	Weighted average exercise price (£) 2015	Number of options 2015
Beginning of year	12.45	1,553,412	13.10	1,573,266
Granted during the year	10.53	524,772	9.21	467,218
Forfeited during the year	12.57	(260,477)	7.38	(232,588)
Expired during the year	9.56	(188,553)	15.62	(94,066)
Exercised during the year	16.27	(178,609)	14.89	(160,418)
Outstanding at the end of the year	11.64	1,450,545	12.45	1,553,412
Exercisable at the end of the year	16.82	243,342	16.11	359,872

The Group recognised total expenses of £984,000 (2015: £967,000) 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 £18.07. The fair value of options granted during the year that are expected to vest was £2,969,796 (2015: £2,878,631).

27 Share capital and share options (continued)

The Group's 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. 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*†**
				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	5	3
Risk-free interest rate %	0.7	1.5	1.7	0.6
Expected dividends %	2.5	2.4	2.3	0.0

	Share save*	CSOP*	ESOS*	LTIP*
				2015
Weighted average share price (£)	17.04	17.40	17.41	17.10
Weighted average exercise price (£)	15.89	17.36	17.38	n/a
Expected volatility %	22.4	25.0	24.2	18.7
Expected option life (years)	3.5	6	5	3
Risk-free interest rate %	0.8	1.6	1.2	0.7
Expected dividends %	2.4	1.8	2.3	0.0

*Figures in the above table show an average across the invested schemes at year end.
†April 2016 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 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:

	2016	2015
Exercise price (£)	**n/a**	n/a
Share price at grant (£)	**17.63**	17.79
Expected option life (years)	**3.0**	3.0
Expected volatility %	**20.5**	21.9
Risk-free interest rate %	**0.6**	0.7

Figures in the above table show an average across the schemes.

The weighted average fair value of options granted during the year was £6.81 (2015: £6.57).

The weighted average remaining contractual life of share options was 4.6 years (2015: 3.6 years).

28 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 2015	3,498	56,131	(2,581)	(13,330)	27,219	246,132	(13,623)	303,446
Total comprehensive income for the year	-	-	-	(12,578)	14,819	22,949	(128)	25,062
Deemed disposal of Ithra	-	-	-	-	-	-	13,751	13,751
Equity-settled employee share scheme	16	4,921	-	-	-	979	-	5,916
Dividends to shareholders	-	-	-	-	-	(31,332)	-	(31,332)
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 31 December 2016	**3,523**	**64,020**	**(2,581)**	**(68,986)**	**139,492**	**228,034**	**69**	**363,571**

The share premium account represents the premium arising on the issue of equity shares.

28 Equity (continued)

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 2016, the number of own shares held was 235,245 (2015: 235,245).

29 Notes to the cash flow statement

	2016 £'000	2015 £'000
Operating profit	89,725	66,425
Adjustments for:		
Depreciation of property, plant and equipment	11,499	10,959
Amortisation of intangible assets	38,034	34,627
Impairment charges	-	8,462
Cost of equity-settled employee share schemes	984	967
Adjustment for pension funding	(8,468)	(8,015)
Profit on disposal of property, plant and equipment	291	(559)
Share of loss from associate	-	581
Decrease in provisions	(8,975)	(2,073)
Operating cash flow before movements in working capital	123,090	111,374
Decrease in inventories	8,295	6,607
Increase in receivables	(339)	(2,261)
Decrease in payables	(19,044)	(44,381)
Cash generated by operations	112,002	71,339
Income taxes paid	(9,012)	(17,252)
Interest paid	(10,156)	(6,309)
Net cash from operating activities	92,834	47,778

Reconciliation of net movement in cash and cash equivalents to movements in net debt.

	2016 £'000	2015 £'000
Net increase in cash and cash equivalents	20,766	5,916
Cash inflow from movement in debt and finance leasing	54,419	(157,054)
Change in net debt arising from cash flows	75,185	(151,138)
Loan syndication costs	-	1,347
Amortisation of finance costs of debt	(848)	(649)
Other non-cash movements	-	(872)
Translation differences	(35,465)	(14,765)
Movement in net debt in the year	38,872	(166,077)
Net debt at start of year	(295,572)	(129,495)
Net debt at end of year	(256,700)	(295,572)

Net debt comprised the following:

	2016 £'000	2015 £'000
Cash and cash equivalents	74,625	45,474
Borrowings	(331,325)	(341,046)
	(256,700)	(295,572)

Cash and cash equivalents comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less.

30 Other financial commitments

a) Capital commitments

At the end of the year capital commitments were:

	2016 £'000	2015 £'000
Contracted but not provided	430	515

b) Lease commitments

At 31 December 2016, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2016 £'000	2015 £'000
Within one year	13,360	12,475
Between one and five years	34,154	35,001
After five years	10,576	10,096
	58,090	57,572

31 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 is a final salary scheme with the majority of members accruing 1/60th of their final pensionable earnings for each year of pensionable service. The scheme was closed to new members in 2003. 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. Following a consultation period and discussions with the Trustee, the UK defined benefit scheme was closed to future benefit accrual from 5 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 £8,837,000 (2015: £7,610,000).

Defined benefit schemes

All the defined benefit schemes were actuarially assessed at 31 December 2016 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 interest 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. Members who leave service before retirement are entitled to a deferred pension.

Active members of the scheme pay contributions via salary sacrifice and the Company pays the balance of the cost as determined by regular actuarial valuations. 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.

The scheme is subject to regular actuarial valuations, which are usually carried out every three years. The last actuarial valuation of the scheme was at 6 April 2016. This valuation has been finalised and will result in an increase in the additional deficit payment required to £9.5m in 2017, £10.0m in 2018, £10.5m in 2019 and £11.0m per annum for the following five years. 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 2016 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 2016	Canada 2016	Switzerland 2016	UK 2015	Canada 2015	Switzerland 2015
Discount rate	2.55%	3.50%	0.35%	3.75%	3.75%	0.80%
Inflation rate – RPI	3.30%	3.30%	0.80%	3.05%	3.05%	0.80%
Inflation rate – CPI	2.30%	2.30%	0.80%	2.05%	2.05%	0.80%
Expected rate of salary increases	n/a	3.55%	1.00%	3.30%	3.30%	1.00%
Future pension increases (pre 6/4/08)	3.05%	n/a	n/a	2.85%	n/a	n/a
Future pension increases (post 6/4/08)	1.95%	n/a	n/a	1.90%	n/a	n/a

31 Retirement benefit schemes (continued)

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 3.40% and a 0.1% decrease in the discount rate to 2.45% would increase the scheme's liabilities by 1.8% and 2.0% respectively. If the members' life expectancy were to increase by 1 year, the scheme liabilities would increase by 3.9%. The average duration of the scheme liabilities is 20 years (2015: 20 years).

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 2015 1.25% imps from 2007 (UK only)
Future pensioners	100% SAPS S2PMA_L/84% SAPS S2PFA_L c2007 CMI 2015 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:

	2016	2015
Current pensioners (at 65) – males	**23 years**	22 years
Current pensioners (at 65) – females	**26 years**	24 years
Future pensioners (at 65) – males	**25 years**	24 years
Future pensioners (at 65) – females	**28 years**	26 years

Amounts recognised in the income statement in respect of the Group's defined benefit schemes were as follows:

	UK 2016 £m	**Canada 2016 £m**	**Switzerland 2016 £m**	**Total 2016 £m**	UK 2015 £m	Canada 2015 £m	Switzerland 2015 £m	Total 2015 £m
Current service cost	**1.3**	**0.1**	**0.2**	**1.6**	4.9	0.1	0.3	5.3
Administration expenses	**0.6**	**0.2**	**-**	**0.8**	0.5	0.1	-	0.6
Interest on pension scheme liabilities	**11.4**	**0.3**	**0.1**	**11.8**	11.2	0.3	0.1	11.6
Curtailment gain	**(15.5)**	**-**	**-**	**(15.5)**	-	-	-	-
Expected return on pension scheme assets	**(8.4)**	**(0.4)**	**-**	**(8.8)**	(8.2)	(0.3)	(0.1)	(8.6)
Charge/(credit)	**(10.6)**	**0.2**	**0.3**	**(10.1)**	8.4	0.2	0.3	8.9

Of the current service cost for the year, £1.0 million (2015: £3.9 million) has been included in cost of sales, and £0.6 million (2015: £1.4 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 2016 £m	**Canada 2016 £m**	**Switzerland 2016 £m**	**Total 2016 £m**	UK 2015 £m	Canada 2015 £m	Switzerland 2015 £m	Total 2015 £m
Fair value of scheme assets	**271.2**	**10.4**	**5.7**	**287.3**	224.5	8.6	4.5	237.6
Present value of scheme liabilities	**(382.4)**	**(11.1)**	**(7.0)**	**(400.5)**	(307.7)	(9.3)	(5.4)	(322.4)
Scheme deficit	**(111.2)**	**(0.7)**	**(1.3)**	**(113.2)**	(83.2)	(0.7)	(0.9)	(84.8)
Related deferred tax asset	**19.1**	**0.1**	**0.3**	**19.5**	15.1	0.1	0.2	15.4
Net pension liability	**(92.1)**	**(0.6)**	**(1.0)**	**(93.7)**	(68.1)	(0.6)	(0.7)	(69.4)

Movements in the present value of defined benefit obligations during the year were as follows:

	UK 2016 £m	**Canada 2016 £m**	**Switzerland 2016 £m**	**Total 2016 £m**	UK 2015 £m	Canada 2015 £m	Switzerland 2015 £m	Total 2015 £m
Present value of obligation at 1 January	**(307.7)**	**(9.3)**	**(5.4)**	**(322.4)**	(306.5)	(11.1)	(4.1)	(321.7)
Current service cost	**(1.3)**	**(0.1)**	**(0.2)**	**(1.6)**	(4.9)	(0.1)	(0.3)	(5.3)
Interest cost	**(11.4)**	**(0.3)**	**(0.1)**	**(11.8)**	(11.2)	(0.3)	(0.1)	(11.6)
Actuarial gains and losses	**(89.2)**	**(0.3)**	**(0.5)**	**(90.0)**	5.9	0.1	(0.6)	5.4
Exchange difference	**-**	**(2.2)**	**(1.0)**	**(3.2)**	-	1.3	(0.3)	1.0
Curtailment gain	**15.5**	**-**	**-**	**15.5**	-	-	-	-
Benefits paid	**11.7**	**1.1**	**0.2**	**13.0**	9.0	0.8	-	9.8
Present value of obligation at 31 December	**(382.4)**	**(11.1)**	**(7.0)**	**(400.5)**	(307.7)	(9.3)	(5.4)	(322.4)

31 Retirement benefit schemes (continued)

Movements in the fair value of scheme assets during the year were as follows:

	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m	UK 2015 £m	Canada 2015 £m	Switzerland 2015 £m	Total 2015 £m
Fair value at 1 January	224.5	8.6	4.5	237.6	220.8	9.9	3.7	234.4
Expected return on scheme assets	8.4	0.4	-	8.8	8.2	0.3	0.1	8.6
Actuarial gains and losses	40.3	0.2	0.2	40.7	(8.0)	-	0.1	(7.9)
Exchange differences	-	2.0	0.8	2.8	-	(1.3)	0.3	(1.0)
Employer contributions	10.3	0.5	0.4	11.2	13.0	0.5	0.3	13.8
Administration expenses	(0.6)	(0.2)	-	(0.8)	(0.5)	-	-	(0.5)
Benefits paid	(11.7)	(1.1)	(0.2)	(13.0)	(9.0)	(0.8)	-	(9.8)
Fair value at 31 December	271.2	10.4	5.7	287.3	224.5	8.6	4.5	237.6

Scheme assets were as follows:

	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m	UK 2015 £m	Canada 2015 £m	Switzerland 2015 £m	Total 2015 £m
Fair value:								
Equities	87.0	3.4	1.8	92.2	74.3	3.5	1.3	79.1
Bonds	-	6.4	2.4	8.8	-	4.5	2.2	6.7
Property	16.4	-	0.6	17.0	14.0	-	0.5	14.5
Other assets	38.4	0.5	0.9	39.8	0.4	0.6	0.5	1.5
Other investment funds	129.4	0.1	-	129.5	135.8	-	-	135.8
	271.2	10.4	5.7	287.3	224.5	8.6	4.5	237.6

The analysis of the actuarial loss in the consolidated statement of comprehensive income was as follows:

	UK 2016 £m	Canada 2016 £m	Switzerland 2016 £m	Total 2016 £m	UK 2015 £m	Canada 2015 £m	Switzerland 2015 £m	Total 2015 £m
Actual return less expected return on pension scheme assets	40.3	0.2	0.2	40.7	(8.0)	-	0.1	(7.9)
Experience gains arising on scheme liabilities	4.0	0.2	(0.2)	4.0	0.2	(0.1)	(0.1)	-
Changes in assumptions underlying the present value of the scheme liabilities	(93.2)	(0.5)	(0.3)	(94.0)	5.7	0.2	(0.5)	5.4
	(48.9)	(0.1)	(0.3)	(49.3)	(2.1)	0.1	(0.5)	(2.5)

Cumulative actuarial losses, net of deferred tax, recognised in the consolidated statement of comprehensive income at 31 December 2016 were £93.5 million (2015: £54.1 million).

The five-year history of experience adjustments is as follows:

	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Present value of defined benefit obligations	(400.5)	(322.4)	(321.7)	(280.4)	(246.5)
Fair value of scheme assets	287.3	237.6	234.4	194.3	163.4
Scheme deficit	(113.2)	(84.8)	(87.3)	(86.1)	(83.1)
Experience adjustments on scheme liabilities	(4.0)	-	(2.5)	2.3	(3.1)
Percentage of scheme liabilities	1.0%	-	0.8%	(0.8%)	1.3%
Experience adjustment on scheme assets	40.7	(7.9)	21.8	21.2	2.8
Percentage of scheme assets	14.2%	(3.3%)	9.3%	10.9%	1.7%

The amount of contributions expected to be paid to defined benefit schemes during the 2017 financial year is £10.4m. For the UK scheme this includes an additional deficit payment of £9.5m agreed with the Trustee. This will be followed by £10.0m in 2018, £10.5m in 2019 and £11.0m per annum for the following five years.

32 Acquisitions and disposals

Acquisitions

In aggregate, cash consideration of £5.2m was paid in respect of final payments and deferred consideration for acquisitions made in prior years.

Fair value adjustments, with respect to prior year acquisitions, totalling net £3.1m have been debited to goodwill. The prior year acquisition fair values are now final.

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

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 the year. Further proceeds could be received over the following 24 months based on agreed targets; any such proceeds will be accounted for in the year of receipt. The net loss on disposal is £4,076,000.

ID	2016 £'000
Intangible assets	3,384
Property, plant and equipment	722
Inventories	2,020
Receivables	3,875
Payables	(2,797)
Total	7,204
Gain on disposal before disposal of attributable goodwill	14,796
Less attributable goodwill	(8,305)
Release of translation reserve	1,895
Gain on disposal	8,386
Satisfied by:	
Cash	22,000
Net cash flow arising on disposal:	
Consideration received in cash	22,000
Less: cash and cash equivalents disposed of	-

Legal intercept	2016 £'000
Intangible assets	10,303
Property, plant and equipment, inventories and receivables	2,199
Total	12,502
Loss on disposal	(12,462)
Satisfied by:	
Cash	40
Net cash flow arising on disposal:	
Consideration received in cash	40
Less: cash and cash equivalents disposed of	-

Assets classified as held for sale in prior year

The major classes of assets and liabilities, comprising the operations classified as held for sale relating to the ID business on the 31 December 2015 balance sheet, were as follows:

	2015 £'000
Intangible fixed assets	**2,926**
Property, plant and equipment	**924**
Inventories	**1,374**
Trade and other receivables	**3,571**
Total assets classified as held for sale	**8,795**
Trade and other payables	**(2,784)**
Provisions	**(227)**
Total liabilities classified as held for sale	**(3,011)**
Net assets of disposal group	**5,784**

33 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 **74** to **88**.

	2016 £'000	2015 £'000
Short-term employee benefits	**4,628**	4,927
Post-employment benefits	**410**	422
Share-based payments	**1,042**	1,016
	6,080	6,365

34 Non-controlling interests

In November 2016 the Group sold a 5% share of its recently established Corvid Holdings Limited subsidiary for cash consideration of £2,000,000. Before any intra-group eliminations the consolidated revenue of the subsidiary in the period was £1,214,000, the loss was £40,000 and the net assets at 31 December 2016 were £3,466,000. Sales to Group companies were £496,000.

The following table summarises the information, before any intra-group eliminations, relating to the Group's former subsidiary "Ultra Electronics in Collaboration with Oman Investment Corporation", incorporated in the Sultanate of Oman, that had a material non-controlling interest held by Oman Investment Corporation ('OIC'). On 4 March 2015 the entity was placed into voluntary liquidation and no longer meets the IFRS 10 criteria for consolidation as a subsidiary of the Group *(see note 7)*.

Ithra	**2016 £'000**	2015 £'000
Non-controlling interest percentage	**-%**	-%
Profit allocated to non-controlling interest	**-**	-
Loss incurred by Ultra upon deemed disposal of Ithra	**-**	13,751
Other comprehensive income allocated to non-controlling interest	**-**	(128)

35 Contingent liabilities

The Group has entered into a number of guarantee and performance bond arrangements in the normal course of business totalling £40.3m (2015: £70.6m).

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, as set out in note 7, 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.

36 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 27*
- Election of independent directors – *see Corporate Governance Report on page 62*
- Contractual arrangements – *see Directors' Report on page 90*
- Details of independent directors – *see Corporate Governance Report on page 55*
- Substantial shareholders – *see Directors' Report on page 90*

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).

37 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)
Aardvark Electronic Components Limited	United Kingdom	100%	Indirect (Group interest)
AEP Networks Asia Pacific SDN BHD	Malaysia	100%	Indirect (Group interest)
AEP Networks Australia Pty Ltd	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)

37 Related undertakings (continued)

Company name	Country incorporated	% owned	Direct/Indirect (Group interest)
Audiosoft Limited	United Kingdom	100%	Indirect (Group interest)
Blue Sky Group (International) Limited	United Kingdom	100%	Direct
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)
Extec Integrated Systems Limited	United Kingdom	100%	Direct
Flightline Electronics Inc.	United States	100%	Indirect (Group interest)
Forensic Technology (Europe) Limited	Ireland	100%	Direct
Forensic Technology AEC Thailand Ltd	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 Ltd	Australia	100%	Indirect (Group interest)
Herley Industries Inc.	United States	100%	Indirect (Group interest)
Herley-CTI Inc.	United States	100%	Indirect (Group interest)
Power Magnetics and Electronic Systems Limited	United Kingdom	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)
Transmag Power Transformers Limited	United Kingdom	100%	Direct
UE Dormant One	United Kingdom	100%	Direct
Ultra Electronics (Qatar) LLC	Qatar	49%	Direct
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)
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 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)

37 Related undertakings (continued)

Company name	Country incorporated	% owned	Direct/Indirect (Group interest)
Ultra Electronics in collaboration with Oman Investment Corporation LLC	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 (CAD) B.V.	Netherlands	100%	Indirect (Group interest)
Ultra Electronics Netherlands B.V.	Netherlands	100%	Indirect (Group interest)
Ultra Electronics Netherlands Finance Coöperatief W.A.	Netherlands	100%	Direct
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 Ltd.	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.

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.

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:

- Annual Improvements to IFRS: 2012-2014 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):

- Amendments to IFRS 7 Financial Instruments: Disclosures: enhancing disclosures about the Transfers of Financial Assets, enhancing disclosures about offsetting of financial assets and financial liabilities and disclosures about the initial application of IFRS 9
- 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 – the standard is effective from 1 January 2018 and is expected to revise the timing of revenue recognised on some of the Group's contracts. There will be no impact to the timing of cash flows. The Group has an on-going project to assess the impact to its financial statements. This project has involved reviews of the Group's key contracts and the use of questionnaires and detailed contract discussions with finance and commercial teams to identify the most likely areas of change across the Group's business units and differing revenue streams. From the work performed to date, it is expected that the most significant changes relative to current accounting treatments will 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 accounted for as sales of goods; and
  (iv) the accounting for long-term support arrangements or maintenance contracts.

  The following areas are also expected to result in some, potentially less significant, change in approach: (i) the treatment of contract penalties which are currently booked to costs of sales, (ii) the treatment of warranties and (iii) licenses of software. Other areas of change could be identified as the project continues and as more detailed work is undertaken to quantify the financial impact on individual contracts.

  At the current time it is not possible to quantify the impact of IFRS 15 on the Group's future revenues and profits. The next stage of the project will develop new internal revenue recognition accounting policies and guidance, roll out further training across the Group, and undertake further detailed contract reviews and analysis to allow the impact of the transition to IFRS 15 to be quantified.
- 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.

The consolidated financial information has been prepared on the historical cost basis except for derivatives and assets held for sale which are measured at fair value.

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 **43**.

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.

Basis of consolidation (continued)

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 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 FRS 39 Financial Instruments: Recognition and Measurement or, when applicable, the cost on initial recognition of an investment in an associate or jointly controlled entity.

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.

Investments in associates

An associate is an entity over which the Group is in a position to exercise significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Investments in associates are carried in the balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate) are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

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 goods are delivered and title has passed.

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.

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.

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.

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.

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
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.

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.

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.

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 measured at fair value. 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.

Trade payables
Trade payables are stated at their fair value.

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 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.

Taxation (continued)
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 and after the share of results of associates 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 performance measures
In the analysis of the Group's operating results, earnings per share and cash flows, information 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. 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 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.

Critical accounting judgements and key sources of estimation uncertainty

When applying the Group's accounting policies, management must make a number of key judgements involving estimates and assumptions concerning the future. These estimates and judgements are based on factors considered to be relevant, including historical experience, that may differ significantly from the actual outcome. The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year include:

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.

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 requires significant judgement and is carried out using the experience of the Group's engineers, project managers and finance and commercial professionals. Because of the level of judgement required, 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.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense.

Where services are rendered, sales are recognised when the stage of completion of the services and the related revenue and costs can be measured reliably.

Where goods are delivered under arrangements not considered to fall under the scope of IAS 11 Construction Contracts, revenue is recognised when substantially all of the risks and rewards of ownership have transferred to the customer.

RETIREMENT BENEFIT PLANS

The Group accounts for its post-retirement pension plans in accordance with IAS 19 Employee Benefits.

For defined benefit retirement plans, the cost of providing benefits is determined periodically by independent actuaries and charged to the income statement in the period in which those benefits have been earned by the employees. Actuarial gains and losses are recognised in full in the period in which they arise and are recognised in the statement of comprehensive income.

The retirement benefit obligation recognised in the balance sheet represents the present value of the scheme liabilities as reduced by the fair value of the scheme assets.

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 salary inflation, 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 of 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 has no impact on short-term cash contributions since these are based upon separate independent actuarial valuations.

Details of the pension scheme assumptions and obligation at 31 December 2016 are provided in note 31.

INTANGIBLE ASSETS

IFRS 3 (revised) Business Combinations requires that goodwill arising on the acquisition of subsidiaries is capitalised and included in intangible assets. IFRS 3 (revised) also requires the identification of other intangible assets at acquisition. The assumptions involved in valuing these intangible assets requires the use of estimates and judgements, that may differ from the actual outcome. These estimates and judgements cover future growth rates, expected inflation rates and the discount rate used.

GOODWILL

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 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.

INCOME TAXES

In determining the Group's provisions for income tax and deferred tax it is necessary to consider transactions in a small number of key tax jurisdictions for which the ultimate tax determination is uncertain. To the extent that the final outcome differs from the tax that has been provided, adjustments will be made to income tax and deferred tax provisions held in the period the determination is made.

OMAN AIRPORT IT CONTRACT TERMINATION AND DEEMED DISPOSAL OF ITHRA

The Oman Airport IT contract was terminated in February 2015.

As set out in note 7, 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 and is pursuing claims against the customer on behalf of the interested parties. Ithra, upon liquidation, no longer met the IFRS 10 criteria for consolidation as a subsidiary of the Group and was, consequently, a deemed disposal as at 4 March 2015.

There remains significant uncertainty regarding the likely outcome of proceedings with the Sultanate of Oman, Ministry of Transport & Communications.

The Group continues to provide for all known remaining liabilities as at 31 December 2016. Material items have been disclosed separately within the financial statements. Disclosure is provided on the consolidated income statement and in note 7 regarding the 2015 deemed disposal of Ithra.

Company balance sheet
31 December 2016

	Note	2016 £'000	2015 £'000
Fixed assets			
Property, plant and equipment	38	**1,038**	571
Investments	39	**939,943**	865,336
		940,981	865,907
Current assets			
Debtors: Amounts falling due within one year	40	**16,678**	21,858
		16,678	21,858
Creditors: Amounts falling due within one year	42	**(180,722)**	(111,453)
Net current liabilities		**(164,044)**	(89,595)
Total assets less current liabilities		**776,937**	776,312
Creditors: Amounts falling due after more than one year	43	**(325,017)**	(336,757)
Net assets		**451,920**	439,555
Capital and reserves			
Share capital	45	**3,523**	3,514
Share premium account	46	**64,020**	61,052
Profit and loss account	46	**386,958**	377,570
Own shares	46	**(2,581)**	(2,581)
Shareholders' funds		**451,920**	439,555

The financial statements of Ultra Electronics Holdings plc, registered number 02830397, were approved by the Board of Directors and authorised for issue on 3 March 2017.

On behalf of the Board
R. Sharma, Chief Executive
A. Sharma, Group Finance Director

The accompanying notes are an integral part of this balance sheet.

Company statement of changes in equity
31 December 2016

	Share capital £'000	Share premium account £'000	Profit and loss account £'000	Own shares £'000	Total £'000
Balance at 1 January 2015	3,498	56,131	366,548	(2,581)	423,596
Retained profit for the year	-	-	41,387	-	41,387
Total comprehensive income for the year	-	-	41,387	-	41,387
Dividends paid	-	-	(31,332)	-	(31,332)
Issue of new shares	16	4,921	-	-	4,937
Share-based payments	-	-	967	-	967
Balance at 31 December 2015	3,514	61,052	377,570	(2,581)	439,555
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**
Dividends paid	-	-	(32,583)	-	**(32,583)**
Issue of new shares	9	2,968	-	-	**2,977**
Share-based payments	-	-	984	-	**984**
Balance at 31 December 2016	**3,523**	**64,020**	**386,958**	**(2,581)**	**451,920**

Notes to accounts – Company
31 December 2016

38 Property, plant and equipment

	Plant and machinery £'000
Cost	
At 1 January 2015	2,034
Additions	5
At 1 January 2016	2,039
Additions	534
At 31 December 2016	**2,573**
Accumulated depreciation	
At 1 January 2015	1,323
Charge	145
At 1 January 2016	1,468
Charge	67
At 31 December 2016	**1,535**
Net book value	
At 31 December 2016	**1,038**
At 31 December 2015	571

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 37.

b) Investment in subsidiary undertakings

	Total £'000
At 1 January 2016	**865,336**
Additions	**646,740**
Disposals	**(539,635)**
Impairments	**(32,498)**
At 31 December 2016	**939,943**

The additions and disposals in the year related to transactions with intermediate holding companies. The impairments arose at the same time, following review of the recoverability of investments within the corporate Company structure.

40 Debtors

	2016 £'000	2015 £'000
Amounts falling due within one year:		
Amounts due from subsidiary undertakings	**15,199**	20,906
Deferred tax assets	**30**	37
Other receivables	**1,146**	694
Prepayments and accrued income	**303**	221
	16,678	21,858

41 Deferred tax

Movements in the deferred tax asset were as follows:

	2016 £'000	2015 £'000
Beginning of year	**37**	43
Charge to the profit and loss account	**(7)**	(6)
End of year	**30**	37

The deferred tax balances are analysed as follows:

	2016 £'000	2015 £'000
Other temporary differences relating to current assets and liabilities	**30**	37
Deferred tax asset	**30**	37

These balances are shown as follows:

	2016 £'000	2015 £'000
Debtors: Amounts falling due within one year	**30**	37

At the balance sheet date the Company had nil unprovided deferred tax (2015: nil).

42 Creditors: amounts falling due within one year

	2016 £'000	2015 £'000
Bank loans and overdraft	**52,025**	33,844
Amounts owed to subsidiary undertakings	**119,116**	64,579
Other payables	**4,062**	9,980
Accruals and deferred income	**5,519**	3,050
	180,722	111,453

The bank loans are unsecured. Interest was predominantly charged at 1.35% (2015: 1.00%) over base or contracted rate.

43 Creditors: amounts falling due after more than one year

	2016 £'000	2015 £'000
Borrowings	**325,017**	336,757
	325,017	336,757

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:

	2016 £'000	2015 £'000
Bank loans and overdraft		
In one year or less, or on demand	**52,025**	33,844
	52,025	33,844
Less: included in creditors: amounts falling due within one year	**(52,025)**	(33,844)
Amounts due after more than one year		
Bank loans	**268,120**	289,521
Unsecured loan notes	**56,897**	47,236
	325,017	336,757

The loan notes are unsecured and due for repayment in 2018 and 2019. Interest was charged at 3.60% (2015: 3.60%).

45 Called-up share capital

The movements are disclosed in note 27.

46 Equity reserve

The profit and loss account includes £175,157,000 (2015: £179,642,000) which is not distributable. A net foreign exchange gain of £58,513,000 was taken to reserves in the year. Further details in respect of dividends are presented in note 12 and share-based payments in note 27.

The Company holds 235,245 own shares (2015: 235,245).

47 Related parties

Transactions with Corvid Holdings Limited and "Ultra Electronics in collaboration with Oman Investment Corporation" are set out in note 34.

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 31. 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.

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 **43**.

Foreign currency

Transactions denominated in foreign currencies are recorded in the local currency at the actual exchange rates at the date of the transactions (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 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 27.

Related parties

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 **82** to **87**.

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.

Five-year review

Financial highlights

	2012 £m	2013 £m	2014 £m	2015 £m	**2016 £m**
Revenue					
Aerospace & Infrastructure	226.6	230.4	198.6	193.2	**204.7**
Communications & Security	268.9	237.7	224.4	239.3	**259.0**
Maritime & Land	265.3	277.1	290.7	293.8	**322.1**
Total revenue	760.8	745.2	713.7	726.3	**785.8**
Underlying operating profit[1]					
Aerospace & Infrastructure	45.1	46.2	29.6	28.7	**32.4**
Communications & Security	32.9	27.5	37.0	40.4	**39.7**
Maritime & Land	43.8	48.0	51.5	50.9	**59.0**
Total underlying operating profit[1]	121.8	121.7	118.1	120.0	**131.1**
Margin[1]	16.0%	16.3%	16.5%	16.5%	**16.7%**
Profit before tax	79.8	49.3	21.5	34.8	**67.6**
Profit after tax	61.3	38.2	6.5	25.0	**58.3**
Operating cash flow[2]	89.6	79.0	83.1	81.3	**120.4**
Free cash flow before dividends, acquisitions and financing[3]	57.4	43.8	51.2	43.1	**86.0**
Net debt at year-end[4]	(43.0)	(42.2)	(129.5)	(295.6)	**(256.7)**
Underlying earnings per share (p)[5]	125.5	127.1	123.1	123.9	**134.6**
Dividend per share (p)	40.0	42.2	44.3	46.1	**47.8**
Average employee numbers	4,430	4,274	4,787	4,843	**4,466**

[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 performance bond.

[3] Free cash flow before dividends, acquisitions and financing has been adjusted to include the purchase of LTIP shares, which are included in financing activities.

[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

underlying operating profit before Oman liquidation related costs, amortisation of intangibles arising on acquisition, impairment of goodwill and adjustments to contingent consideration net of acquisition and disposal related costs. IFRS operating profit was £89.7m (2015: £66.4m).

organic growth (of revenue or profit) is the annual rate of increase in revenue or profit that was achieved, assuming that acquisitions made during the prior year were only included for the same proportion of the current year at constant currencies.

underlying operating margin is the underlying operating profit as a percentage of revenue.

finance charges exclude fair value movements on derivatives, defined benefit pension interest charges and discount on provisions.

underlying profit before tax before Oman liquidation related costs, amortisation of intangibles arising on acquisition, impairment of goodwill, 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 82.8p (2015: 35.7p).

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.

operating cash conversion is underlying operating cash flow as a percentage of underlying operating profit.

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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