Ultra Electronics Holdings plc
Annual Report & Accounts

2018

WHO WE ARE AND WHAT WE DO

Ultra is a specialist international electrical and electronics engineering company. The Group operates mainly, but not solely, in defence and other highly regulated markets and is focused on providing mission-specific, bespoke solutions and capability.

HOW WE OPERATE

Ultra has historically reported through three divisions:

AEROSPACE & INFRASTRUCTURE

COMMUNICATIONS & SECURITY

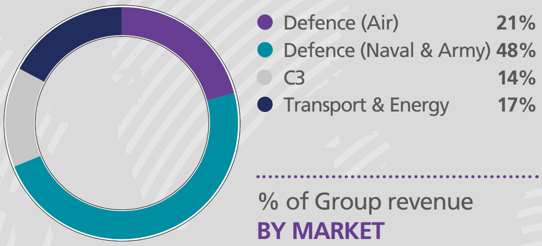
MARITIME & LAND

Ultra has a strong reputation with customers for solving challenges and complex customer problems and needs.

WHAT WE DO

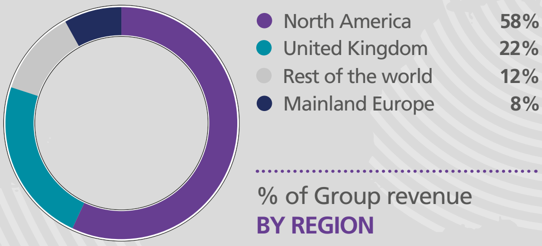
The Group operates as a Tier 3 (sub-system) and occasionally a Tier 2 systems provider, with particular expertise in the maritime, C3 (command, communication, and control) and cyber, military and commercial aerospace, nuclear and industrial sensors markets.

The Group uses both own- and customer-funded research and development, tailoring its solutions to meet changing customer needs and budgets to maintain its reputation as an innovative supplier of enabling technology.



WHERE WE OPERATE

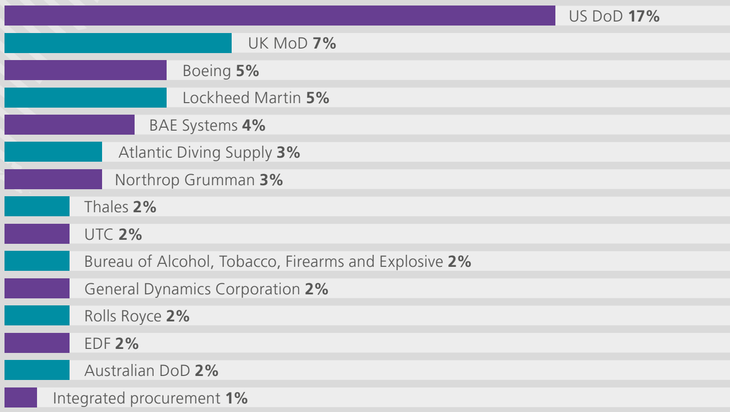
Ultra's core markets are North America, the UK and Australia. These core markets plus a small number of targeted strategic regions allow Ultra to access the largest addressable security and defence budgets in the world, positioning for long-term growth through partnerships and government relationships.



OUR CUSTOMERS

Our market position, together with Ultra's independence, allows the Group to work closely with the world's prime contractors. Ultra's major customers include Tier 1 primes such as Boeing and Lockheed Martin as well as international government procurement offices.

TOP CUSTOMERS



WHY INVEST IN ULTRA

Ultra has some great underlying strengths but also a huge opportunity to optimise the Group of individual businesses to an integrated, disciplined and focused business.

Opportunity to make a good business great

- Ultra is a good business that has lost its way in recent years. The new management team are investing in people, innovation and infrastructure to bring Ultra back to growth

World-leading technology and intellectual property

- Pockets of fundamental knowledge excellence in areas such as sensors and transducers, signal transmission, processing and interpretation and specialist encryption and information assurance

New management team to bring the business back to growth

- "Focus, Fix, Grow" journey launched with further details to be announced later in the year

Exceptionally bright people

- Ultra has a strong reputation with customers for applying its fundamental knowledge to solving challenging and complex customer problems and needs

Strong and stable margins

- Consistently delivering operating margins above 14%

Progressive dividend policy

- Final proposed dividend of 51.6p per share and dividend cover of 2.12 times in 2018

Agile and flexible with 16 different businesses

- Individual business structure gives the autonomy to be nimble and work with customers to meet their demands

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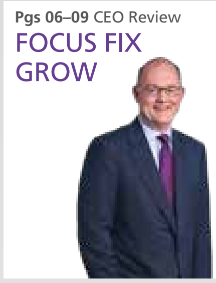


2018 Year in review

JUNE
Ultra appoints Simon Pryce as Chief Executive Officer.

"There is much work to be done as we enter Ultra's next phase of development. The Group has a solid platform from which to grow and many exciting opportunities to take advantage of."

SEPTEMBER
Ocean Systems awarded $42m contract to supply US Navy with MK 54 torpedo arrays.

This contract includes options which, if exercised, would bring the cumulative contract value to $336m.

NOVEMBER
Ultra announces the divestment of its Airport Systems business to ADB SAFEGATE for £22m.

Airport Systems provides specialised IT software solutions to improve the operational performance of airports and airlines. These solutions are installed in approximately 150 airports and are in-service with 100 airlines internationally.

OCTOBER
Maritime Systems awarded multi-million dollar contract as part of the Royal Canadian Navy's Underwater Warfare Suite Upgrade.

This contract will see Maritime Systems team with prime contractor General Dynamic Systems – Canada by supplying the new in-line transmitter and receiver array.

DECEMBER
Ultra announces that Tony Rice will succeed Douglas Caster as Chair of the Board.

"I am excited to be joining the Board of Ultra, and to be working with Simon, his team and the Board to build the business and deliver Ultra's potential for all our stakeholders."

2018 Highlights

AN ENCOURAGING SET OF RESULTS

FINANCIAL

REVENUE
£766.7m
2017: £775.4m
-1.1%

UNDERLYING OPERATING PROFIT
£112.7m
2017: £120.1m
-6.2%

IFRS OPERATING PROFIT
£65.3m
2017: £61.5m
+6.2%

UNDERLYING PROFIT BEFORE TAX
£101.4m
2017: £110.0m
-7.8%

UNDERLYING EARNINGS PER SHARE
109.5p
2017: 116.7p
-6.2%

STATUTORY BASIC EARNINGS PER SHARE
43.6p
2017: 66.2p
-34.1%

DIVIDEND PER SHARE
51.6p
2017: 49.6p
+4.0%

CASH CONVERSION
79%
2017: 97%
-18%

GROUP ORDER BOOK
£983.9m
2017: £897.4m
+9.6%

OPERATIONAL

PCS awarded multiple contracts worth £60m to provide various subsystems to both Tier 1 and 2 original equipment manufacturers for the US Air Force Joint Strike Fighter programme.

ATS awarded $46m contract for US Army Data Link Systems. This Indefinite Delivery/Indefinite Quantity (IDIQ) contract will provide engineering, cybersecurity, and logistics for the Air Defense Systems Integrator (ADSI®). The ADSI has been maintained and supported by Ultra for the Army under contracts spanning the past 14 years.

USSI awarded US Navy sonobuoy contracts valued at $70m through their joint venture ERAPSCO with Sparton Corporation. The award is an IDIQ contract release for sonobuoy requirements under ERAPSCO's five-year contract.

Chair's Statement

THE NEXT PHASE OF ULTRA'S JOURNEY

"This is a very exciting time for Ultra, but there is more we can do to deliver the Group's potential."

TONY RICE
Chair

This is my first report as Chair of Ultra Electronics after taking over from Douglas Caster in January 2019, and so I will be commenting on the previous year's performance on his behalf.

Firstly, I would like to highlight Douglas' significant contribution to Ultra over the past 31 years. Douglas has played a pivotal role in the growth and development of Ultra into the specialist international electrical and electronics engineering company it is today. Douglas was with the business from 1988 until his retirement at the start of this year, and was part of the original management buyout from Dowty that formed Ultra Electronics in 1992. He joined the Board in October 1993, and in April 2000, was appointed Chief Operating Officer, becoming Chief Executive in April 2005. He was appointed Deputy Chair in April 2010 and became Chair of Ultra in April 2011. Without his tremendous personal commitment and leadership, the Group would not be what it is today. Douglas leaves the Group in good shape and with an exciting future. On behalf of all of Ultra's stakeholders, I would like to thank Douglas for all he has done for Ultra and wish him the very best for the future.

I agreed to become Chair of Ultra because I think this is a very exciting time for the Group. It is clear to me that Ultra has a number of strengths, including a remarkable engineering heritage, exceptional IP and positions on a broad range of programmes and platforms. However, as Simon explains in his report, there is more we can do to deliver Ultra's potential in the next phase of the Company's development.

Realising that potential through our "Focus, Fix, Grow" journey will be an accelerated but evolutionary process that will take time and some reinvestment. This builds on the already strong Ultra platform, and we are confident that Ultra can deliver above average growth as well as strong and sustainable value creation over the medium and long term. I look forward to working with Simon and the team to realise that potential.

2018 performance

The Group achieved a satisfactory financial performance in 2018, and having taken account of a number of legacy issues, it is particularly pleasing to see a return to organic revenue growth and a good number of material contract wins that will be delivered in the years ahead. The Group's cash performance improved in the closing stages of the year and resulted in a better than expected outturn for underlying operating cash conversion at 79% for 2018 (2017: 97%). The Group ended the year with a strong order book of £984m and 2019 opening order cover of 66%, which sets us up well for the year ahead.

Shareholders will note a higher number of non-underlying costs than in previous years. Some of these relate to legacy issues, such as the self-report made by Ultra to the SFO investigation, where we continue to cooperate with the SFO, the abandoned acquisition of Sparton, and the final part of the S3 programme. Whilst we don't envisage future significant non-underlying expenditure at this scale, the Board will ensure it is transparent and open about any such issues.

Board changes and succession planning

Over a year ago the Board started the process to recruit a new Chief Executive Officer, which resulted in the appointment of Simon Pryce in June 2018. Simon has a wealth of experience, a proven track record and is well-placed to lead Ultra through its next phase of development. I am very encouraged by his initial impressions. He has already taken steps to enhance the senior management team (with the hire of a new Chief Human Resources Officer and, a permanent General Counsel and Company Secretary, as well as a number of other appointments) and they are already having an impact on the Group.

Douglas Caster, who performed the role of Executive Chair during the process of recruiting the new CEO, stepped back to being Chair upon Simon's appointment. Reflecting Douglas' length of service, and in accordance with the Board's succession planning process, the Board commenced a search for a new Non-Executive Director and Chair Designate, resulting in my joining the Board in December 2018, and taking over as Chair on 28 January 2019. Details of the process by which I was appointed are set out in the Report from the Chair of the Nomination Committee set out on pages 54–56.

As announced on 6 March 2019, due to his increasing other commitments and his recent appointment as Chair of the British Standards Institution, John Hirst has indicated that he intends to step down as a Non-Executive Director and Chair of the Audit Committee later this year, once a suitable replacement has been found. John will step down from the Remuneration Committee after the 2019 Annual General Meeting. We thank him for his wise counsel and support over the past five years and wish him all the best for his future endeavours.

Sir Robert Walmsley's term as a Non-Executive Director was due to expire in April 2018. Given the changes to the Board, on 10 November 2017, it was announced that the Board had asked Sir Robert to remain on the Board for a further year as Senior Independent Director to provide non-executive continuity and leadership.

Following the further changes to the Board, the Board has again requested Sir Robert to continue as Senior Independent Director until, at the latest, January 2020, to ensure a degree of continuity and business knowledge. Further details of these Board changes can be found in my Governance statement on page 46.

Dividend and buy-back

The total dividend per share for 2018 increased to 51.6p from 49.6p last year, an increase of 4.0%, and will be paid to shareholders on the register as at 12 April 2019 on 9 May 2019. The Board has stated its commitment to a progressive dividend policy, signalling our confidence in the future of the business.

In March 2018 we announced that, following discussions with the US Department of Justice and competition concerns raised by it, Ultra and Sparton had mutually agreed to terminate the merger, and that the Group therefore intended to undertake, over time, a share buy-back through on-market purchase in order to return the £134m net proceeds of the earlier equity issue to its shareholders.

To date we have bought back most of the 7,047,168 new ordinary shares issued under the placing. We see good medium-term opportunities to invest the remaining capital in a value-creative way in the businesses as part of our "Focus, Fix, Grow" journey. It is therefore our intention to formally close the buy-back, whilst retaining the opportunity to buy-back our shares in the normal way should it make economic sense to do so.

Outlook

Ultra entered 2019 with good visibility and an opening order cover of 66%. The Group is well-positioned in growth markets with significant exposure to the strengthening US defence budget. We plan to build on this momentum by increasing investment in the Group's own Research and Development (R&D) and systems, as well as focusing on improved execution and delivery.

We remain on track to achieve increased organic revenue growth in 2019. There is a lot of work to do as the "Focus, Fix, Grow" journey is designed and implemented, and there will be additional costs associated with it in the short term. However, we are confident that these improvements will benefit the Group in the medium and long term. I look forward to keeping you updated on the progress we are making in due course.

TONY RICE
Chair
6 March 2019

Chief Executive Officer's Review

FOCUS, FIX, GROW

"Our goal is to deliver long-term, sustainable value creation for all our stakeholders."

SIMON PRYCE
Chief Executive Officer

I was appointed Chief Executive Officer on 18 June 2018. I am pleased that I am able to report that I have very much enjoyed my first few months at the Company and am excited by the opportunity I see at Ultra for performance improvement, growth and value creation over the medium to long term.

2018 was a year of significant change at Ultra; but before commenting on our satisfactory 2018 performance, my findings and our future direction, I would like to add to the comments made by the Chair and express my personal thanks to Douglas for his extraordinary commitment to Ultra over the last 31 years, in sometimes difficult circumstances. He has helped to create a Group with great potential and whilst I only worked with him for a short time, I have valued his insight and continuing support and I wish him the very best for the future. I am delighted that Tony has joined the Group and look forward to working with him. He is an extremely capable businessman with successful executive careers in the international engineering, aerospace and technology businesses, a strong track record and extensive Non-Executive and Chair experience which will be of enormous benefit to me and Ultra going forward.

Since I joined the Group in June 2018, I have spent most of my time familiarising myself with the Ultra businesses. My initial impressions very much support the due diligence I did before joining, and I have been impressed by the quality of technology and the capabilities across the Group.

2018 Highlights

Ultra achieved some notable successes in 2018 on new and existing programmes including multiple contracts on the F-35 Joint Strike Fighter programme, further awards from the US Army for data links and tactical radios and a range of large orders in the underwater warfare segment from the UK MoD, Royal Canadian Navy and the US Navy. Only the firm element of these wins is reflected in our order book which grew strongly and at the end of 2018 was almost 10% higher than in 2017 at £983.9m (2017: £897.4m).

Revenues of £766.7m (2017: £775.4m) represented a welcome return to organic growth for the first time since 2011 with organic sales up 2.2% compared to a 3.3% decline in 2017. This growth reflected better conditions in defence markets, especially in the US, increases in our US and international sonobuoy revenues and demand for our radio and Air Defense Systems Integrator (ADSI®) products by the US military. Underlying operating profit declined 6.2% to £112.7m (2017: £120.1m), largely reflecting the £6.3m impact of previously disclosed development contract cost overruns at our Herley business, which led to a decline in operating margin to 14.7%. Cash generated by operations was £102.4m (2017: £97.4m), which represented an underlying operating cash conversion of 79% (2017: 97%), a better than expected performance.

The positive performance in 2018 could not have been achieved without the exceptional efforts of Ultra's 4,100 employees who have worked hard and effectively in delivering the 2018 outturn. We are privileged to have a capable, often long-serving and highly committed workforce, who have performed diligently despite challenging internal and external market conditions over the last few years and I thank

them for their continuing efforts. I am confident that, with the right direction, investment and support, we have the team to deliver positive and collaborative change and realise Ultra's exciting future.

Business overview

Ultra is a specialist international electrical and electronics engineering company. The Group operates mainly, but not solely, in defence and other highly regulated markets with particular expertise in the maritime, and C3 (command, communication, and control including cyber) domains. Ultra is a Tier 3 equipment/sub-system and occasionally a Tier 2 systems provider, focused on providing mission specific, bespoke solutions.

Ultra's strengths include:

- Good technology with pockets of excellence in areas such as sensors and transducers, signal transmission, processing and interpretation, specialist encryption and information assurance;
- A wide range of physical capabilities;
- Limited product, platform or customer dependency with generally, although not always, relatively small shipset values;
- Experience in designing products for operation in extreme environments where low size weight and/or power are important;

- A strong reputation with customers for solving challenging and complex customer problems and needs; and
- Talented and committed people, who have a close technical engagement with their customers.

However, Ultra today is an aggregation of different and independent companies and business models which is reflected in the Group operating model and its management and governance. A lack of common process, systems and infrastructure makes collaboration and the sharing of knowledge and best practice challenging. It also means that some of the Group's commercial processes and practices are sub-optimal. Most importantly, it also prevents Ultra leveraging the Group's combined strengths.

In recent years, against a back-drop of challenging core markets and some poorly performing businesses, a number of which were acquired, the Group has also tended to behave tactically rather than strategically. Whilst this has not impacted core technology strengths, which continued to benefit from customer-funded development, it has led to a need to invest, particularly in Ultra's own R&D, processes, systems, IT infrastructure and most notably its highly capable and committed people.

GROUP ORDER BOOK

£983.9m

+9.6%

2018	983.9
2017	897.4
2016	799.3
2015	753.8
2014	787.3

DIVIDEND PER SHARE

51.6p

+4.0%

2018	51.6
2017	49.6
2016	47.8
2015	46.1
2014	44.3

Chief Executive Officer's Review continued

"FOCUS, FIX, GROW"

Ultra is fundamentally a good business but one that is not yet optimised. 2019 marks the start of our evolutionary journey to realise improvement opportunities at Ultra through "Focus, Fix, Grow".

Focus

Over time, we intend to migrate Ultra from an aggregation of small, independent, loosely associated companies to a collaborative federation of connected businesses through:

- Focusing on the things we are good at;
- Collaborating better, particularly in technologies, capabilities, strategic positioning; and
- Better leveraging Group-wide capability.

Fix

To fully realise Ultra's exciting potential, we need to fix and strengthen our core processes and better share best practice. We also need to support our people to evolve our culture to better support the next phase of our development. We have the opportunity to leverage the combined strengths of Ultra. Areas of particular focus will be:

- Cultural evolution and investment in talent to:
  - Recognise, support and reward the behaviours needed to drive greater coordination and collaboration; and
  - Enhance, develop and empower the considerable talent already in the Group.
- Key process and practice:
  - Programme management;
  - Commercial: improve delivery on time, to cost and at a price that reflects the value of our products and services to our customers; and
  - Technology: better assess and price contract and engineering risk.
- Operating model, structure and footprint where there is significant opportunity for Ultra to:
  - Pool resources and realise synergies across businesses; and
  - Increase the non-value-added process standardisation and centralisation. This was originally envisaged as part of the Standardisation and Shared Services (S3) programme. However, the cost savings delivered were achieved principally through restructuring, onerous lease provisions and indirect procurement in the UK.
- Connectivity and IT infrastructure enabling:
  - Better collaboration and information sharing across businesses and functions; and
  - The standardisation of selected tools and processes across the Group.

Grow

Ultra is well positioned in key technology with its major markets projected to deliver good growth. Evolving defence delivery practices as well as the need to support our growth potential means we also need to increase investment in our own R&D. This is in part to meet the needs of existing customers, and in part to ensure we continue to maintain technology and capability leadership to win key positions on future platforms and programmes.

This requires a targeted, disciplined and Group-wide approach to innovation and investment. There may well be opportunities in the future to acquire technologies and capabilities to support more rapid execution of our strategy, but we will only consider these once we have the right capabilities in place and then only where it makes clear strategic, commercial and financial sense.

"We intend to migrate Ultra from an aggregation of small, independent, loosely associated companies to a collaborative federation of connected businesses."

Immediate priorities

Focus – The team has already completed the process of mapping and analysing our key technologies, capabilities and identifying our core competencies. We are well advanced in:

- Developing a revised corporate strategy, reviewing our operating model and structure, including footprint and capability; and
- Identifying and scaling the unrealised parenting opportunities within Ultra from greater collaboration, cooperation and focus.

During 2019, we will be finalising the corporate strategy, developing long-term corporate goals, developing detailed and value creative strategic plans to support delivery of those objectives and ensuring the Group operating model is fit for purpose. We will also cease some unsatisfactory working capital management practices that were driven by focusing cash at period ends.

Fix – We have already made progress with a number of the areas we need to fix, including:

- Two new senior leadership roles have been created including a Commercial & Corporate Affairs Executive Vice President, to lead the review and enhancement of our programme management and commercial processes;
- Appointment of significant new external hires at a senior level including Chair, CEO, General Counsel and Company Secretary and Chief HR Officer. Work is underway to upgrade the performance management practices, systems and other people processes and rewards structures to support, develop, retain and focus our talent;
- Increasing investment in 2019 and beyond in IT infrastructure and our own R&D; and
- Ceasing inefficient working capital management practices and optimising working capital throughout the year to improve business practices and culture.

We will keep you regularly informed and updated as our 'Focus, Fix, Grow' journey develops and we plan to provide additional KPIs to measure our progress and success later this year. However, we are confident that over time and with effective execution of our strategic and operational improvement plans, Ultra has the potential to achieve strong long-term, sustainable, value creation from organic growth in excess of its major defence markets, with at least mid-teens operating margins, 80–85% cash conversion, a progressive dividend policy and within a prudent capital structure.

Summary

After a good second half and having addressed a number of legacy issues, we delivered an encouraging set of results in 2018. While there is much work to be done in the next phase of Ultra's development, we now have a solid platform from which to grow and deliver against our goal of creating long-term, sustainable value for all our stakeholders.

Ultra enters the current year well-positioned in strong markets with significant exposure to US defence spending. We have won good positions on a number of major new programmes, our order book is strong, improvement actions have commenced and we are focused on delivery.

Significant additional potential exists in Ultra through focusing the Group on where we add value, improving core processes and better leveraging the Group's combined strengths and capabilities. We anticipate that 2019 will be a year of good underlying progress and we look forward to an exciting future with confidence.

SIMON PRYCE
Chief Executive Officer
6 March 2019

HOW WE MEASURE SUCCESS

Our ultimate goal is to deliver long-term, sustainable, value creation for all our stakeholders. There is much work to be done as we enter into Ultra's next phase of development but there are also many opportunities.

We are currently midway through a review of the business and strategy, we plan to provide additional KPIs to measure our progress later in the year, and to link these with our remuneration policies.

OUR KEY PERFORMANCE INDICATORS

THROUGH OUR FOCUS

FINANCIAL

REVENUE GROWTH

Year	Revenue growth
2018	-1.1%
2017	-1.3%
2016	+8.2%
2015	+1.8%
2014	-4.2%

DESCRIPTION

Growth in total Group revenue compared to the prior year.

Revenue of £766.7m represented a return to organic growth for the first time since 2011. The organic revenue growth of 2.2% was offset by a negative foreign exchange impact of 2.4% from the translation of overseas revenue, and a 0.9% reduction arising from IFRS 15.

UNDERLYING PROFIT BEFORE TAX

Year	Underlying profit before tax
2018	-7.8%
2017	-8.4%
2016	+6.9%
2015	+0.4%
2014	-4.1%

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

Underlying profit before tax declined 7.8% to £101.4m (2017: £110.0m), reflecting the impact of development cost overruns at our Herley business, the impact of IFRS 15 and a slight increase in financing charges

UNDERLYING EARNINGS PER SHARE

Year	Underlying earnings per share
2018	-6.2%
2017	-2.0%
2016	+2.0%
2015	0%
2014	+1.0%

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

Underlying earnings per share decreased to 109.5p (2017: 116.7p), reflecting the reduction in profit. The weighted average number of shares in issue was 74.4m (2017: 74.0m).

UNDERLYING OPERATING CASH CONVERSION

Year	Underlying operating cash conversion
2018	79%
2017	97%
2016	92%
2015	68%
2014	70%

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.

The Group achieved a 79% cash conversion. This result was better than originally expected.

* See footnote on page 145.

HOW WE MANAGE RISK Pgs 34–43 For more information

OUR BUSINESS MODEL

HOW WE DELIVER VALUE FOR OUR STAKEHOLDERS:

TOTAL SHAREHOLDER RETURN

2018	-5.0%
2017	-2.0%
2016	+8.0%
2015	+6.0%
2014	+8.0%

DESCRIPTION

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

NON-FINANCIAL

YOURVIEWS EMPLOYEE ENGAGEMENT SURVEY

2018	82%
2017	82%
2016	82%
2015	82%
2014	81%

The level of engagement remains strong at 82%. Results are analysed and discussed at the local level from which a number of actions are put in place to either address any areas that require improvement or to continue to support areas of strength. Going forward, in 2019 we have invested in a new global platform for our engagement surveys which will enable us to generate more analytics and to provide greater focus on driving actions at the Group, Division and local Business level to continue to drive organisational health and employee engagement. The new platform will enable us to survey the organisation at regular points in the year through 'pulse' surveys whilst also being used for on-boarding and exit surveys to give us a more holistic view of engagement.

HEALTH AND SAFETY

2018	0.6%
2017	0.7%
2016	0.7%
2015	0.5%
2014	0.4%

The number of reportable accidents per 100 employees.

The number of externally reportable accidents decreased in 2018. Ultra continues its efforts to drive a health and safety aware culture.

Defined market segments
Ultra operates mainly but not solely in defence and other highly regulated markets, with particular expertise in the maritime, and C3 (communications, command and control) and cyber domains. The Group operates mainly as a Tier 3 sub-system and occasionally a Tier 2 systems provider, focused on providing mission specific, bespoke solutions and capability.

Understanding our customers
Ultra's understanding of customer's needs allows us to develop effective and innovative solutions whilst creating value through becoming a key partner in the customer's design process. We have an established history of partnering and teaming in order to offer the best-of-breed technologies that meet our customers' requirements.

Innovative solutions
Ultra invested 3.7% of revenue in R&D to develop new offerings in 2018. Our customers invested a further 15.3%. This R&D is focused on enhancing our portfolio of capabilities that underpin further growth. Where the Group has complementary capabilities, we can combine these to offer more comprehensive and innovative solutions. This positions us to meet more complex and demanding system and subsystem requirements.

Agility
A key differentiator for Ultra is the agility that our businesses exhibit in their customer relationships. The businesses retain a level of autonomy which enables them to provide a nimble and responsive level of support to customers and partners that is normally associated with a smaller business. This agility is enhanced through access to wider and complementary technologies and sharing of best practices and technology within the Group.

Unique Intellectual Property and talented people
Ultra has a solid commitment to developing people and securing talent pipeline, employing a number of engineers and graduates each year. This considerable talent and past Intellectual Property is a key part of our success. During 2019 we plan to upgrade our performance management system, rewards system and internal communications to improve employee engagement and success.

WE OPERATE RESPONSIBLY Pgs 22–27 For more information

STRONG APPROACH TO GOVERNANCE Pgs 46–53 For more information

Divisional Review

GRAEME STACEY
Divisional Managing Director
Aerospace & Infrastructure

AEROSPACE & INFRASTRUCTURE

Covering aerospace and nuclear, this division provides military and civil aerospace systems and sub-systems as well as control systems and instrumentation that ensure the safe operation of energy generating plants.

Divisional performance

This division's revenue declined due to lower demand for nuclear temperature products and delayed orders in information processing at Airport Systems, which were partially offset by an increase in the build rate of our high pressure pure air generating (HiPPAG) units. Profits declined due to lower revenue as well as product mix, with reduced high margin nuclear temperature revenues. As a result, the underlying operating margin was 15.3%.

The division's order book increased £39.1m since December 2017 (IFRS 15: £294.6m) owing in part to the orders noted below, which will underpin the division's future performance:

- Multiple contract awards of over £60m to provide various subsystems to both Tier 1 and 2 OEMs for the Lockheed Martin F-35 Joint Strike Fighter programme; and
- Orders received worth £18.1m to provide B787 electro-thermal wing ice protection systems (WIPS) to Boeing as part of an ongoing long-term agreement contract.

Markets

The defence aerospace market is showing good signs of growth, with North American, European, Middle Eastern and Asian countries looking to acquire new aircraft, upgrade ageing fleets and develop indigenous platforms. Civil aerospace also continues to grow, particularly in developing nations where there is a need to meet growing air passenger traffic, as well as in the demand for regional jets in North America and Europe. Ultra's long-standing positions on both military and a number of civil platforms position us well for this growth.

REVENUE BY DIVISION	REVENUE	UNDERLYING OPERATING PROFIT
26% Group revenue	£196.2m -3.4% (2017 IFRS 15*: -2.9%)	£30.0m -8.0% (2017 IFRS 15*: -6.3%)
GROUP UNDERLYING OPERATING PROFIT	**ORDER BOOK**	**NUMBER OF EMPLOYEES**
27%	£333.7m +17.8% (2017 IFRS 15*: +13.3%)	1,245 +0.1%

BUSINESSES WITHIN THIS DIVISION
- Energy
- Precision Control Systems

* See footnote on page 145.

Case Study
US Air Force Order Wins

PCS received orders worth over £60m in 2018 for subsystems relating to the US Air Force Joint Strike Fighter Aircraft. These Low Rate Initial Production (LRIP) contracts are bid on a programme by programme basis and see Ultra provide capabilities including the HiPPAG (high pressure pure air generating units), engine ice protection systems and harness sets. These orders underpin Ultra's established position on this aircraft and the value of Ultra's solutions which will be provided over the life of the programme.

Divisional Review continued

MIKE BAPTIST
Divisional Managing Director
Commmunications & Security

COMMUNICATIONS & SECURITY

The provision of mission critical solutions including secure communications, encryption solutions as well as capabilities related to command and control, security and surveillance solutions and military electronic warfare ("EW").

Divisional performance

This division's revenue grew, benefitting from Orion radio systems for the US Army's Network Modernisation programme, as well as growth in airborne platform sales and airborne EW and strategic missile programmes. This followed on from the strong order intake at the end of 2017. In the UK, revenues were impacted by continued uncertainty and government contracting delays within the secure comms and information assurance markets. Our US cyber solutions revenues also reduced as discretionary US Naval funding was allocated elsewhere. The overall revenue growth more than offset the foreign exchange reduction to the division's reported results.

Cost overruns incurred on specific development contracts at our Herley division resulted in an underlying divisional margin of 11.8%. Margin improvements were driven by increased Air Defense Systems Integrator (ADSI®) and Orion radio deliveries in the year.

The division won a number of contracts during the year including two larger ones, which are noted below. Relative to the strong closing order book at the end of 2017, the division's 2018 closing order book was £27.9m lower at £230.2m (2017 IFRS 15: £258.1m). The larger orders won in the year were:

- A $46m five-year IDIQ support contract to provide Ultra's ADSI to the US Army Data Link Systems; and
- The award of a $24m contract to provide military tactical radios to the US Department of Defense.

Markets

Increased demand for greater bandwidth and broader connectivity, coupled with a need for multi-platform and multi-user interoperability across global defence markets continues. The US continues to be the largest spender in these markets, however countries in Asia-Pacific and European regions are ramping up their investments as they continue to face territorial disputes, domestic unrest and terrorism. Growing border disputes also call for higher critical infrastructure protection, surveillance and border control, particularly in the Asia-Pacific and Middle East regions. Ultra remains well positioned on a broad range of markets, spanning defence applications, cyber security, physical infrastructure & data security, surveillance command & control systems and forensic analysis markets.

REVENUE BY DIVISION	REVENUE	UNDERLYING OPERATING PROFIT
33% Group revenue	£252.6m +4.1% (2017 IFRS 15*: +3.7%)	£29.9m +6.0% (2017 IFRS 15*: +4.5%)

GROUP UNDERLYING OPERATING PROFIT	ORDER BOOK	NUMBER OF EMPLOYEES
26%	£230.2m -11.0% (2017 IFRS 15*: -10.8%)	1,295 +0%

BUSINESSES WITHIN THIS DIVISION

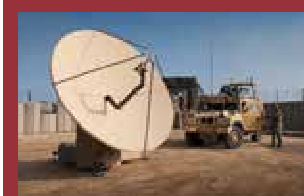
- 3eTI
- Advanced Tactical Systems (ATS)
- Communications & Integrated Systems (CIS)
- Forensic Technology
- Herley
- TCS

* See footnote on page 145.

Case Study

CIS Contract Win

Communications and Integrated Systems (CIS) was awarded a multi-million pound contract to support the provision of Strategic Deployable Terminals to General Dynamics Mission Systems, Canada. General Dynamics will provide the Canadian Armed Forces (CAF) with the Strategic Deployable Terminals (SDTs) to expand its Mercury Global In-Service Support as part of the final stage of the Mercury Global Project to deliver military satellite communications (SATCOM) wideband capabilities. The terminals will allow the CAF to deliver voice, image and data between deployed operations and commanders back in Canada.



Divisional Review continued

THOMAS LINK
Interim Divisional President
Maritime & Land

MARITIME & LAND

Covering underwater warfare and maritime systems for surface, sub-surface and unmanned platforms for military, paramilitary and civil domains, as well as the provision of modern military manned and unmanned vehicles.

Divisional performance

This division's revenue grew organically, but declined overall due to the impact of foreign exchange. Demand for Ultra's international and US sonobuoys remains healthy and our ERAPSCO JV continues to have a strong working relationship with the US Navy. Revenues on the maritime propulsion system order that was won in 2017 also contributed to revenue in the year. However, there have been delays to some programmes resulting in lower revenue on receivers, as well as reduced datacom and sonar shipments where a number of projects completed in 2017.

Profits were impacted principally due to additional costs on the Health and Usage Monitoring System (HUMS) programme and receiver development programmes and this resulted in a reduction in the division's underlying operating margin to 16.6%.

The division's order book increased £58.3m since December 2017 (IFRS 15: £361.7m) owing in part to the orders noted below:

- A $42m contract award to supply the US Navy with MK 54 torpedo arrays;
- The award of a multi-million dollar contract as part of the Royal Canadian Navy's Underwater warfare suite upgrade; and
- The award of a £24.5m order to provide sonobuoys to the UK MoD – the first multi-year sonobuoy order received by Ultra from the UK.

Markets

Global underwater warfare budgets continue to grow as geopolitical disputes in Europe and Asia-Pacific have led to an increased investment in naval platforms and underwater warfare systems. The US, UK, Australia and Canada have all adopted national shipbuilding strategies to stimulate long-term new ship construction to meet evolving threats. Ultra is strongly positioned in this area of growth, securing a number of positions on long-term programmes.

REVENUE BY DIVISION
41%
Group sales

REVENUE
£317.9m
-3.5% (2017 IFRS 15*: -1.5%)

UNDERLYING OPERATING PROFIT
£52.8m
-11.0% (2017 IFRS 15*: -7.5%)

GROUP UNDERLYING OPERATING PROFIT
47%

ORDER BOOK
£420.0m
+18.1% (2017 IFRS 15*: +16.1%)

NUMBER OF EMPLOYEES
1,579
-3.3%

BUSINESSES WITHIN THIS DIVISION
- Avalon Systems
- Command & Sonar Systems
- EMS
- Flightline Systems
- Maritime Systems
- Ocean Systems
- PMES
- USSI

* See footnote on page 145.

Case Study
UWSU Upgrade Win

Maritime Systems was awarded a multi-million Canadian dollar contract from the Royal Canadian Navy (RCN) as part of the RCN's Halifax Class Frigate Underwater Warfare Suite Upgrade (UWSU) programme.

Teaming with General Dynamics, UWSU will deliver an integrated system that replaces the current towed array sensor and sonobuoy processing system. Maritime Systems will deliver a transmitter solution that enables sound energy to be steered only in the direction of interest.

Our people and culture

Attracting, developing, engaging and retaining talent at Ultra is critically important and fundamental to Ultra being able to deliver sustainable value to all of our stakeholders.

DEVELOPING
OUR PEOPLE

"Underpinning the success of our employees is creating and maintaining the right culture and work environment where employees feel valued."

The right people

Our focus as an organisation is on ensuring that we have the right people, in the right roles, with the right skills, doing the right work, at the right time and to do all of this within a supportive, rewarding and learning culture. This starts at the top with the commitment we have to hiring and developing the right leaders for Ultra, leaders that can set the direction, give the boundaries and provide the right level of space and support to enable our people to do what they do best, which is delivering domain expertise to help our customers solve problems or deliver innovative, winning solutions. By investing in the professional growth and development of all of our existing employees and supplementing this with hiring the best talent into Ultra, we continue to ensure that we meet customer needs via a deep understanding of the specialist capability areas and a deep knowledge of the user's environments.

Culture

Underpinning the success of our employees, and therefore our business, is creating and maintaining the right culture and work environment where employees feel valued, know what is expected of them and feel included and engaged so that they bring their best contributions to work. The Group's values and behaviours are an essential cornerstone to this and are focused around four key areas: Leadership, Entrepreneurship, Audacity and Paranoia. Together, they are known within the Group as LEAP.

Building the talent pipeline

To continue to build the talent pipeline to meet today's and future business needs, we have a holistic approach to attracting talent into the business. In the last 12 months, we have significantly invested in creating internal talent acquisition teams with the right specialist recruitment backgrounds and supported by the right systems and processes to enhance our ability to bring in experienced external professionals into the business. These teams are working closely with the business to directly source and hire candidates from the external market. The talent pipeline is further enhanced through our continued support for and commitment to, a number of programmes that not only bring talent into the organisation but also encourage students to develop careers in engineering and the wider business.

Partnering with schools

Ultra businesses engage and partner with schools in the local communities within which we do business and have office facilities. These relationships encompass a multitude of different initiatives but include offering work experience; longer-term work placements or internships; visits as part of AS-level courses; interview practice sessions; and careers events. Many of Ultra's employees also volunteer time to support both lessons and after school clubs. Examples include:

- PCS continued their relationship with Balcarras School and attended interview preparation sessions, whilst also giving presentations to students on apprenticeships and careers within engineering.
- CIS continue to support a number of STEM* students at local secondary schools and in 2018 supported a "Year of Engineering" STEM event.

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

Partnering through apprenticeships

Many Ultra businesses have well-established and successful apprenticeship programmes, which has historically and continues to provide the Group with engineering leaders. The Group runs apprenticeship schemes at most of its UK businesses and currently has 31 apprentices in training in the UK.

There have been a number of notable successes:

- Energy (NCS) were finalists at the UK Nuclear Skills Awards in the Business Support Apprentice of the Year category; they were also finalists for "Developing the next generation" award from the British Energy Coast Business Cluster.
- CIS continues to work closely with SEPnet by sponsoring eight-week placements alongside others funded internally.

Partnering with 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. These have created win-win solutions in which Ultra is given access to leading research and specialists in their fields collaborating on programmes or innovation whilst also enabling the Group to form early relationships with students well before graduation with a view to bringing these students into the organisation. Ultra sponsors university students and also provides a number of work placements as part of degree courses.

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.

* STEM: Science, Technology, Engineering & Mathematics.

Our people and culture continued

CULTURE
LEAP

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

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

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

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

SUCCESS STORIES

- Maritime Systems works with both Dalhousie University and the Nova Scotia Community College to whom they provide four-month work placements on a continuous basis.
- Energy (NSPI) is on the Lancaster University Industrial steering board and delivers lectures, sponsored research and set MDc/BSc projects.

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

Training and development
Ultra actively invests in, and supports, the training and development of all its employees. As a Group, Ultra has invested in its Learning Academy, an online portal, which is available to all of the Group's businesses to support training. Many of the courses in the Learning Academy are tailored to the specific requirements of Ultra, and include programmes on leadership and management, in addition to core offerings in areas like Ultra's successful competitive strategy, strategic selling, programme management and systems engineering. Specific training programmes are also provided for individuals as necessary and according to individual needs which are identified through personal development conversations through the year.

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.

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

	Total 2018	Total 2017
UK		
Apprentices	31	45
University placement students	13	7
Sponsored university students	6	1
Arkwright scholars	8	11
US		
Undergraduate interns	39	21
New graduates	6	6
Employees working on graduate-level degrees	8	15
Canada		
Undergraduate interns	23	16
New graduates	4	1
Employees working on graduate-level degrees	2	1
Australia		
Undergraduate interns	2	–
New graduates	2	–

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 and that succession candidates are identified and developed to step into new and/or bigger roles as required by the business. Ultra maintains a strong retention rate for those identified as high performers, with a 99% retention rate in 2018.

Identified top talent and high potential talent are developed through critical experiences on the job which is supplemented by access to and participation in a number of leadership programmes offered within the Group. The Maximising Leadership Impact (MLI) programme has been run for several years across the organisation and is targeted at senior managers whilst the Making a Difference (MAD) programme is targeted at middle managers and high potential individuals. Both programmes cover skill builds in Influencing styles, Emotional management, Inspiring others (internally and externally), High performance feedback and Negotiating & resolving differences, Holding difficult conversations, Leading change, Resilience: self and teams, Developing others, and Coaching.

RETENTION OF HIGH PERFORMERS

99%

2018	**99%**
2017	97%
2016	80%
2015	100%
2014	60%

INTERNAL APPOINTMENTS AT EXECUTIVE TEAM, DIVISIONAL AND MD/PRESIDENT LEVEL

38%

2018	**38%**
2017	60%
2016	80%
2015	100%
2014	60%

GROWTH THROUGH ENGAGEMENT

LAUNCH

In addition to these internal behaviours that form the basis of our culture, we have a set of behaviours that have been developed to facilitate external customer engagement and interactions. These help us to generate sustainable long-term customer relationships and have been an integral part of why we continue to create a strong pipeline of opportunities and programmes within the business. These behaviours are known within Ultra as LAUNCH:

LISTEN to customers

ASK the right questions

UNDERSTAND what their "pain" is

identify the customers' NEEDS and get their agreement

CREATE a relationship, opportunity and solution

HOLISTIC Examine the bigger picture; how can Ultra maximise the scope and value of the opportunity?

Responsible business

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

MAKING A DIFFERENCE

"Ultra believes that the right people are its most important asset; the capabilities of its employees allow the Group to innovate continually…"

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 School, College and University 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 in the UK also offers Arkwright scholarships: a scholarship that sponsors A-level students looking to pursue a career in engineering through their education.

Fundraising and volunteer work in the local community or at a national level is something the Group actively encourages. It supports employees who undertake voluntary activities. Some noteworthy examples in 2018 include:

- Energy (NSPI) raised over £9,000 for local charities through activities such as a skydive, cake sales and a "Truck by Truck Snack Box".
- ATS received the Distinguished Partnership Award from Del Valle Independent School District for the fifth consecutive year for outstanding contributions throughout the year to Smith Elementary School.

Shareholders

Ultra's goal is to deliver long-term, sustainable, value creation for all our stakeholders.

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 2018 that highlight Ultra's commitment to its broad customer base are:

- Maritime Systems was awarded a place on the Canadian Combat Ship (CSC) Team led by Lockheed Martin, on which Maritime Systems won the Anti-Submarine Warfare lead role. This success provides Ultra with a place on the CSC "Board of Governors" alongside major industry partners.
- ATS received an Exceptional rating on their Contractor Performance Assessment report for the US Marine Corp programme.

Employees

Ultra believes that the right people are its most important asset; the capabilities of its employees allow the Group to innovate continually and meet customer needs. Ultra has a solid commitment to developing people and securing the talent pipeline and as such, the Group believes that, to ensure its continuing growth and success, these initiatives for talent development and employee retention are crucial. A number of Ultra businesses launched unique initiatives to ensure continuing employee development and engagement in 2018. Examples include:

- Energy (NCS and NSPI) held knowledge transfer talks during lunch breaks throughout the year on subjects including technology skills and personal safety.
- ATS held a wellness day in November 2018 to promote a healthy lifestyle for employees.

Responsible business continued

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.

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

Ultra is committed to maintaining high standards of business ethics as part of being a responsible business. The Group endeavours to uphold the rights of its employees as well as creating an honest and transparent business both internally and externally. The Group's corporate responsibility initiatives are focused 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. Key statements and policies can be found on the Ultra website.

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 antitrust laws and relevant national export control regulations.

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

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

http://www.ultra-electronics.com/aboutus/corporate-responsibility

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 Chair 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 four permanent members, three of whom, including the Chair, are independent.

To maintain the highest degree of impartiality, the independent members of the Committee are self-electing with the appointment of the Chair exclusively within the remit of the independent members. The Committee meets regularly 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. For more information on the Ethics Overview Committee see page 48.

"Ultra's values are embedded into the organisation to ensure each business is truly representative of the environment in which it operates."

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.

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

Health and safety

One of Ultra's most important commitments is to the health and well-being of its employees. A healthy, committed and engaged workforce, working in a safe environment, is necessary to achieve superior business results. Ultra places great emphasis on maintaining high standards of health and safety, not just to employees but also to visitors and local communities in which the Group's businesses operate and engages in continuous safety improvement activities. 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 safety of the products and services provided to users and customers is a key priority for 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/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, with the next audit taking place in 2019. Overall health and safety responsibility at Board level resides with the Chief Executive Officer.

Each business is required to submit an annual report on health and safety performance which is summarised and presented to the Board.

Ultra reports lost time accident rate (being an accident resulting in half a day or more off work) per 1,000 employees, see Figure 1 and externally reportable accidents per 100 employees, see Figure 2.

FIGURE 1: **LOST TIME ACCIDENTS PER 1,000 EMPLOYEES**

3.0

2018	**3.0**
2017	2.8
2016	3.6
2015	3.4
2014	2.5

FIGURE 2: **EXTERNALLY REPORTABLE ACCIDENTS PER 100 EMPLOYEES**

0.6

2018	**0.6**
2017	0.7
2016	0.7
2015	0.5
2014	0.4

Responsible business continued

"One of Ultra's most important commitments is to the health and well-being of its employees."

The environment

Ultra is committed to implementing and applying effective measures to minimise the environmental impact of its activities. All businesses are audited at least biennially. Ultra continues its commitment to investing in manufacturing facilities to offer increased efficiencies and reduce energy consumption, while improving productivity across the Company. The Group also looks for its suppliers to reduce their environmental impact.

Initiatives that have taken place within the Group include:

- PCS and PMES both achieved accreditation to ISO14001:2015.
- USSI retained its registration as a Conditionally Exempt Waste Generator, which no longer requires waste reporting due to efforts in reducing landfill waste.

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 the environment. Businesses work with their suppliers to reduce the impact of their products and to maximise the use of acceptable components.

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

Implementation

The Chief Executive Officer 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 one took place in 2017 and the next will take place in 2019. Where appropriate, individual businesses have ISO 14001 accreditation.

FIGURE 3: **PACKAGING WASTE (T/£M SALES) IN UK BUSINESSES**

0.187

2018	**0.187**
2017	0.098
2016	0.097
2015	0.162
2014	0.164

FIGURE 4A: **TOTAL CRC EMISSIONS (PER 1,000 CO_2 TONNES) IN UK BUSINESSES**

5,067

2018	**5,067**
2017	6,374
2016	7,474
2015	8,178
2014	8,424

FIGURE 4B: **TOTAL CRC EMISSIONS (T/£M) IN UK BUSINESSES**

15.8

2018	**15.8**
2017	19.2
2016	21.0
2015	21.9
2014	23.6

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 2018, continuing the excellent track record of the previous five years. There were no environmental incidents reported in the year.

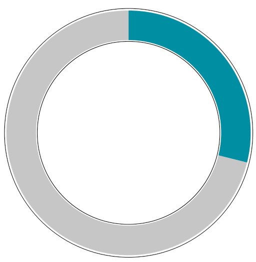
Ultra measures and reports on its packaging waste annually and this is shown in Figure 3. In the UK, businesses are encouraged and incentivised to reduce the net amount of waste they produce.

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

We are registered under the UK Carbon Reduction Commitment ('CRC'). We filed our annual return in July 2018 and paid £90k, which is 18.2% lower than in 2017 (£110k). The cost per tonne of CO_2 increased from £17.20 to £17.70 (2.9%) but our actual UK emissions fell from 6,374t to 5,067t (20.5% reduction).

As part of the CRC programme, Ultra, in the UK, is registered with the Environment Agency. The Group's compliance emissions reported in our annual return in July 2018 were 5,067t CO_2, a 20.5% reduction over the previous year. Historical performance data is shown in Figures 4a and 4b.

FIGURE 5: **TOTAL TONNES OF CO_2 EMITTED BY ALL ULTRA BUSINESSES**



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 16 businesses; 2013 was the first year this was undertaken and serves as the baseline year.

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

Total tCO_2 emitted by all Ultra businesses	18,452
Total tCO_2 from Ultra business activities (scope 1)	2,610
Total tCO_2 purchased by Ultra	15,842
Ultra's annual emissions shown as tCO_2 per £m of revenue	24.07

Methodology

In 2018, each UK business reported on the appropriate greenhouse gas metrics. These metrics were aggregated to produce the figures reported above to which standard DEFRA conversion factors were applied.

Energy Savings Opportunity Scheme

The Energy Savings Opportunity Scheme (ESOS) is a relatively new piece of legislation introduced by the UK Government that applies to Ultra. The scheme is run by an Environment Agency (such as CRC) and its focus is to reduce the demand for energy. Ultra has successfully demonstrated compliance with the requirements using ESOS-compliant energy audits and notified its compliance to the Environment Agency in January 2016. The opportunities for energy savings identified during the ESOS assessment were reviewed and various changes were implemented (e.g. installation of replacement boilers and LED lights). A follow-up audit will take place in 2019.

Additional environmental initiatives

All businesses are audited biennially. In the US in 2017, EMS, 3eTI, Flightline and NSPI all achieved 100% in the audit. Additionally, in the UK, Energy, CSS, PMES and PCS all maintained the ISO 14001 environmental standard. CIS gained it during 2018.

LOUISE RUPPEL
General Counsel and Company Secretary
6 March 2019

Financial Review

2018 RESULTS

"Revenue of £766.7m represented a return to organic growth for the first time since 2011."

AMITABH SHARMA BSC FCA
Group Finance Director

Ultra's 2018 results

Revenue

Revenue of £766.7m represented a return to organic growth for the first time since 2011. The 2.2% organic growth reflected increases in our US and international sonobuoy revenues and demand for our radio and Air Defense Systems Integrator (ADSI®) products by the US military. Reported revenue declined 1.1% to £766.7m compared to prior year revenue of £775.4m (IFRS 15: £768.3m). This was due to the organic revenue growth of 2.2% being offset by the strengthening of sterling during the year, causing a negative foreign exchange impact of 2.4% from the translation of overseas revenue, and a 0.9% reduction arising from IFRS 15. The average US dollar rate in 2018 was $1.34 compared to $1.29 in 2017.

Aerospace & Infrastructure's revenue (see pages 12–13) declined due to lower demand for nuclear temperature products and delayed orders in information processing at Airport Systems, which were partially offset by an increase in the build rate of our high pressure pure air generating (HiPPAG) units.

Communications & Security's revenue (see pages 14–15) grew, benefiting from ORION radio system sales for the US Army's Network Modernisation programme, as well as growth in airborne platform sales and airborne EW and strategic missile programmes. This followed on from the strong order intake at the end of 2017. In the UK, revenues were impacted by continued uncertainty and government contracting delays within the secure comms and information assurance markets. Our US cyber solutions revenues also reduced as discretionary US Naval funding was allocated elsewhere. The overall revenue growth more than offset the foreign exchange reduction to the division's reported results.

Maritime & Land's revenue (see pages 16–17) grew organically, but declined overall due to the impact of foreign exchange. Demand for Ultra's international and US sonobuoys remains healthy and our ERAPSCO JV continues to have a strong working relationship with the US Navy. Revenues on the maritime propulsion system order that was won in 2017 also contributed to revenue in the year. However, there have been delays to some programmes resulting in lower revenue on receivers, as well as reduced datacom and sonar shipments where a number of projects completed in 2017.

Orders

At the end of 2018 the order book was 9.6% higher at £983.9m (2017: £897.4m, IFRS 15: £914.4m), reflecting improving defence budgets, notably in the US, and some key wins on new and existing programmes. The organic increase was 5.2%, once the impact of foreign exchange and IFRS 15 adoption have been excluded. Opening order cover for 2019 is 66% (2018: 66%).

Underlying operating profit and margins

Underlying operating profit was £112.7m (2017: £120.1m, IFRS 15: £117.7m), a decrease of 6.2% on the prior year. There was an organic decline of 4.3%, due to the previously announced £6.3m cost overruns at our Herley business on specific development contracts, a 0.1% impact of foreign exchange and IFRS 15 accounted for

Alternative Performance Measures
In the analysis of the Group's operating results, earnings per share and cash flows, 'underlying' information is presented to provide readers and stakeholders with additional performance indicators that are prepared on a non-statutory basis. These non-statutory performance measures are consistent with how business performance is reported within the internal management reporting. See page 138 for further information. A reconciliation is set out in note 2 between operating profit and underlying operating profit, between profit before tax and underlying profit before tax and between cash generated by operations and underlying operating cash flow. The calculation for underlying earnings per share is set out in note 13. The narrative includes two figures for 2017 revenue and underlying operating profit to present the result as stated last year and the result as if presented under IFRS 15. Refer to note 37 for further information.

the remaining 2.0% reduction. The resulting underlying operating margin was 14.7% (2017: 15.5%, IFRS 15: 15.3%). Underlying operating profit also included a £2.9m gain in the period arising from foreign exchange on US dollar assets held in the UK. We have revised our hedging strategy under IFRS 9, with effect from 1 January 2019, as outlined in the financial guidance section on page 33, to reduce income statement volatility from the re-valuation of US dollar assets held on the UK balance sheet and a gain of this nature will not happen in future years.

Aerospace & Infrastructure underlying operating margin reduced to 15.3% (2017: 16.0%, IFRS 15: 15.8%) due to lower revenue as well as product mix, with reduced high margin nuclear temperature revenues.

Communications & Security underlying operating margin improved slightly to 11.8% (2017: 11.6%, IFRS 15: 11.7%). Cost overruns of £6.3m were incurred on specific development contracts at our Herley division, however, despite this, there was a slight overall improvement in divisional operating margin driven by increased Air Defence Systems Integrator (ADSI®) and Orion radio deliveries in the year.

Maritime & Land underlying operating margin declined to 16.6% (2017: 18.0%, IFRS 15: 17.7%) due to additional costs on the Health and Usage Monitoring System (HUMS) program and receiver development programmes.

Ultra continued its programme of R&D, with total spend in 2018 of £145.8m (2017: £161.1m). In 2018, company funded investment was 3.7% of revenue at £28.1m (2017: £29.9m or 3.9%), while customer funding decreased to 15.3% of revenue at £117.7m (2017: £131.2m or 16.9%). The funding required is dependent on the type and timing of engineering contracts awarded, as some require Ultra to fund the development phase while others attract customer funding. The overall level of R&D investment in the year was 19.0% (2017: 20.8%).

Interest and underlying profit before tax

Net financing charges were £11.3m (2017: £10.1m). The increase reflects higher US interest rates and higher average borrowing, compared to the prior year, following the share buyback. The interest on bank debt was covered 10 times (2017: 12 times) by underlying operating profit. The resulting underlying profit before tax was £101.4m (2017: £110.0m).

IFRS profit before tax

As set out in the table on the following page, IFRS profit before tax decreased to £42.6m (2017: £60.6m). There are a higher number of non-underlying items than last year and detail is provided for this as follows:

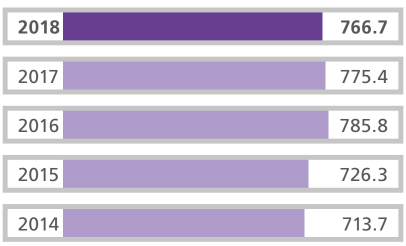
Acquisition and disposal related costs of £2.7m (2017: £12.8m) include those remaining costs associated with the Sparton Corporation transaction that was terminated in March 2018.

The net loss on forward foreign exchange contracts and interest rate swap was £5.6m (2017: £12.0m gain). This includes £11.1m of costs incurred closing out the foreign exchange forward put in place as part of the Sparton transaction. This was partially offset by a gain of £5.5m from the mark-to-market revaluation of the Group's foreign exchange forward contracts.

REVENUE

£766.7m

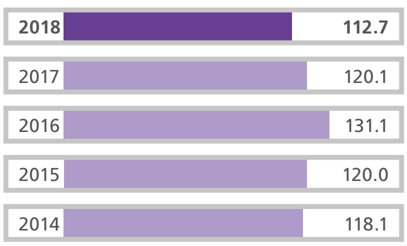
-1.1%



UNDERLYING OPERATING PROFIT

£112.7m

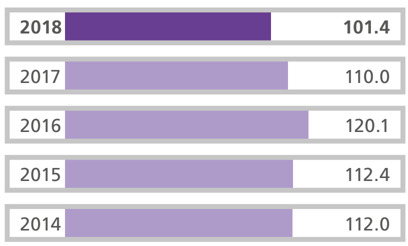
-6.2%



UNDERLYING PROFIT BEFORE TAX

£101.4m

-7.8%



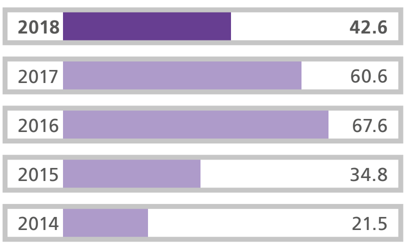
Financial Review continued

£m	2018	2017
Underlying profit before tax	**101.4**	110.0
Amortisation of intangibles arising on acquisition	**(28.3)**	(28.5)
Acquisition and disposal related costs	**(2.7)**	(12.8)
(Loss)/gain on derivatives	**(5.6)**	12.0
Significant legal charges and expenses	**(2.3)**	(8.0)
S3 programme	**(6.5)**	(7.8)
Loss on disposal	**(0.7)**	–
Impairment charges	**(7.6)**	(1.6)
Net finance charge on defined benefit pensions	**(1.9)**	(2.7)
Guaranteed Minimum Pensions (GMP) equalisation	**(3.2)**	–
Reported IFRS profit before tax	**42.6**	60.6

"The 2018 proposed final dividend of 37.0p (2017: 35.0p) per share is proposed to be paid on 9 May 2019 to shareholders on the register at 12 April 2019 subject to approval at the Annual General Meeting."

IFRS PROFIT BEFORE TAX

£42.6m
-29.7%



Significant legal charges and expenses include £2.3m of anti-bribery and corruption investigation costs. £8.0m was incurred in the prior year on legal charges relating to the Ithra (Oman) contract.

Savings from the Group's S3 initiative of £19.7m (2017: £13.5m) were realised in the period, whilst costs on the programme were £6.5m (2017: £7.8m). In 2018 costs were incurred following the decision to close additional facilities and non-core product lines. The S3 initiative has yielded tangible benefits in terms of cost savings, although the operational efficiencies originally envisaged have yet to be fully realised. The below the line costs associated with the S3 programme ceased at the end of 2018, but work remains to simplify our transactional processes; this will continue and there remain opportunities for further operational improvements in the future.

A £0.7m loss on disposal was incurred disposing of our non-core Fuel Cell business from the Maritime & Land division.

Impairment charges of £7.6m (2017: £1.6m) include a £6.6m impairment of the infrastructure cash generating unit goodwill following the previously disclosed agreement to dispose of the Airport Systems business for £22.0m, and a £1.0m impairment of an intangible asset relating to a non-core product line that was closed in the Maritime & Land division in the year.

A £3.2m charge was incurred in relation to Guaranteed Minimum Pensions ("GMP") equalisation of the UK defined benefit pension scheme benefits earned in the period 17 May 1990 to 5 April 1997. This was following a High Court ruling in October 2018 against Lloyds Banking Group that impacts many UK businesses.

Tax, EPS and dividends

The Group's underlying tax rate in the year decreased to 19.7% (2017: 21.6%) owing to the reduction in the federal income tax rate applicable to underlying US profits, offset by the new restriction of tax relief for US interest expenses, for which no deferred tax asset is recognised. The statutory tax rate on IFRS profit before tax was 19.0% (2017: 19.3%).

Underlying earnings per share decreased to 109.5p (2017: 116.7p), reflecting the reduction in profit. The weighted average number of shares in issue was 74.4m (2017: 74.0m). Basic earnings per share decreased to 43.6p (2017: 66.2p). During the period, the Group spent £91.9m, to re-purchase 6.3m ordinary shares at an average of £14.52 per share. At 31 December 2018 the number of shares in issue was 71,470,065. As at 6 March 2019 the Group spent £100m on the share buyback programme.

The Board has implemented a new progressive dividend policy with a through cycle target of circa two times normalised cash and earnings cover. This progressive policy is a signal of confidence in the future of Ultra. The 2018 proposed final dividend of 37.0p (2017: 35.0p) per share is proposed to be paid on 9 May 2019 to shareholders on the register at 12 April 2019 subject to approval at the Annual General Meeting. This will result in a final full year dividend of 51.6p (2017: 49.6p), which will be covered 2.12 times by underlying earnings per share.

Operating cash flow

Cash generated by operating activities was £102.4m (2017: £97.4m), reflecting increases in working capital. Underlying operating cash flow was £89.3m (2017: £116.5m) resulting in underlying operating cash conversion of 79% (2017: 97%). Capital expenditure, including Enterprise Resource Planning ('ERP') systems implementation, increased to £18.3m (2017: £11.2m). Seven Ultra businesses commenced ERP implementations over the year, with two going live in 2018 and the others on track to go live in the first half of 2019. Working capital increased by £7.9m principally due to increases in inventory work-in-progress and raw materials reflecting organic revenues in the year. Specifically, this increase was due to purchases required to supply orders in early 2019 and purchasing requirements on essential long lead-time components. The inventory increase was partially offset by an increase in payables.

Non-operating cash flow

The underlying operating cash flow of £89.3m (2017: £116.5m) funded the Group's various non-operating items. The main non-operating and non-underlying cash items as set out in note 2 and in the statutory cash flow statement were:

- £91.9m spent on the share buy-back with 6.3m shares repurchased. In 2017 there was a £137.3m inflow from the share placing and share options exercised in the year.
- Dividend payments of £36.9m (2017: £35.0m).
- Tax paid of £4.6m (2017: £10.3m).
- A £1.5m outflow on significant legal charges and expenses relating to the anti-bribery and corruption investigation costs. (2017: £9.8m on Ithra (Oman) related legal fees).
- £13.6m on acquisition and disposal related costs (2017: £13.0m), £11.1m of this represented the close out cost of the foreign exchange forward contract taken out to fund the Sparton Corporation acquisition, which was terminated in March 2018.
- £2.6m on the S3 programme (2017: £8.9m).

Consequently, net debt was £157.4m (2017: £74.5m).

Return on Invested Capital (ROIC)

ROIC was 18.8% (2017: 19.8%†) and is calculated as underlying operating profit expressed as a percentage of average invested capital (calculated as an average of the opening and closing balance sheets). Average invested capital is calculated as net assets (after adjusting for exchange rate fluctuations) adjusted for amortisation and impairment charges arising on acquired intangible assets and goodwill, and the add-back of other non-underlying performance items, such as tax, fair value movements on derivatives, the S3 programme, acquisition and disposal related costs and the Ithra (Oman) contract, impacting the balance sheet. The decline relative to the prior year reflects the reduction in underlying operating profit.

Borrowing facilities

Ultra's net debt at the end of the year was £157.4m (2017: £74.5m) and reflected the impact of the £91.9m spent in the year to re-purchase 6.3m ordinary shares.

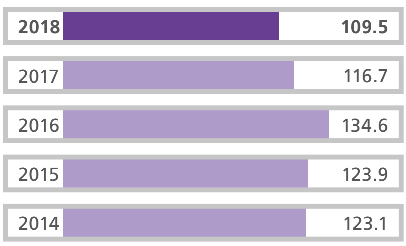
The Group's committed banking facilities amount to £526.4m in total, together with a £5.0m and $10.0m overdraft. The Group's revolving credit facility of £300m is denominated in Sterling, US Dollars, Canadian Dollars, Australian Dollars or Euros. The facility is provided by a group of six international banks and has a committed maturity to November 2023, and may be extended to November 2024 subject to lender consent. The facility agreement permits an additional £150m 'accordion' which is uncommitted and subject to lender consent and can be used in certain acquisition scenarios.

The Group holds $165m of term loan which was established in May 2015; $40m is repayable on 31 March 2019, $40m on 30 June 2019 and the remainder on 1 August 2019. The Group also has loan notes in issue to Pricoa which totalled £50m (with an expiry date of October 2025) and $60m (with an expiry date of 25 January 2019) at 31 December 2018 (2017: $70m). Agreement

"Seven Ultra businesses commenced implementations over the year, with two going live in 2018 and others on track to go live in the first half of 2019."

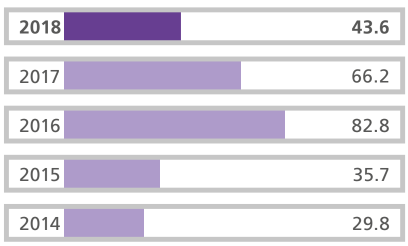
UNDERLYING EPS

109.5p
-6.2%



STATUTORY BASIC EPS

43.6p
-34.1%



† For consistency of comparative, 2017 has been calculated as if the share buy back conducted in 2018 had also similarly impacted the December 2017 balance sheet.

Financial Review continued

"The Group's net debt/EBITDA was 1.25 times (2017: 0.56 times), and net interest payable on borrowings was covered around 10x by underlying operating profit."

was reached with Pricoa in September 2018 to issue new loan notes of $70m. These were issued on 25 January 2019. This debt will expire in January 2026 and January 2029.

As at 31 December 2018, the total borrowings drawn from the revolving facility were £20.0m (2017: £nil), giving headroom of £280.0m (2017: £300.0m) in addition to the £5m and $10m overdrafts. The Group also held £96.3m (2017: £149.5m) of cash for working capital purposes.

As well as being used to fund acquisitions, the financing facilities are also used for other balance sheet and operational needs, including the funding of day-to-day working capital requirements. The US Dollar borrowings also represent natural hedges against assets denominated in that currency. Details of how Ultra manages its liquidity risk can be found in note 22 – Financial Instruments and Financial Risk Management.

The Group's net debt/EBITDA was 1.25 times (2017: 0.56 times), and net interest payable on borrowings was covered 10x 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

To reduce the risks associated with interest rate fluctuations and the associated volatility in reported earnings, Ultra holds a mix of fixed rate and floating rate debt, as well as a $45m interest rate hedging contract that expires on 30 June 2019. The amount of fixed-term debt and the associated interest rate policy is kept under regular review and the Group targets that between 40% and 60% of forecast debt is at a fixed rate of interest at each year end.

Pensions

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

The Ultra Electronics Limited defined benefit scheme was a contributory scheme in which the Company made the largest element of the payments, which were topped up by employee contributions up until the 2016 closure of the scheme to future accrual. The scheme was actuarially assessed using the projected unit method in 31 December 2018 when the net scheme deficit, calculated in accordance with IAS19, was £59.1m (2017: £67.6m). The present value of the liabilities decreased by £18.2m to £353.1m in 2018 primarily due to changes in the discount rate. There was a £8.1m decrease in scheme assets, mainly driven by decreases in investment values in equities.

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

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

Certain employees at TCS in Canada participate in a defined benefit scheme. This scheme is closed to new employees and had an IAS19 net deficit of £0.4m at the end of the year (2017: £0.1m). Regular payments continue to be made, with both Company and employees making contributions, so as to maintain a satisfactory funding position. The Group's remaining Canadian employees participate in a number of defined contribution pension plans. Certain employees at the Swiss subsidiary of Forensic Technology, Projectina, also participate in a defined benefit pension scheme. The scheme had an IAS19 net deficit of £0.9m at 31 December 2018 (2017: £0.9m).

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 2019, 100% of the expected exposure is covered, reducing to 44% of the exposure for 2020 and 33% of the exposure for 2021. Exposure to other currencies is hedged as it arises on specific contracts.

Capital allocation priorities

The Group intends to take a prudent and disciplined approach to capital management with the following priorities:

1. Investing for sustainable growth
2. Progressive dividend policy
3. Efficient balance sheet
4. Longer term strategic investment potential.

AMITABH SHARMA
Group Finance Director
6 March 2019

2019 FINANCIAL GUIDANCE

- We are targeting an increase in our own R&D investment to between 4% and 5% of revenue compared with 3.7% last year. The investment programme in the Group's IT infrastructure and systems will be a three to four-year operational expenditure improvement programme at a cost of c.£5m per year. These costs are partially offset by an improvement in organic profit and we expect operating margin to remain in the mid-teens range.
- The Group will regularise trade debtors and creditors during the year to reflect average working balances rather than those at period ends. This will have a cash impact of about £46m and will be reflected in a reduced cash conversion for the year, and the first half of 2019 will likely see a net cash out-flow for the Group. It is anticipated that cash conversion will return to the Group's historical range of 80–85% in the medium term.
- Year-end net debt/EBITDA is expected to be around 1.2x, reflecting the normalisation of working capital during the year and the disposal of Airport Systems.
- Ultra has forward contracts in place to hedge the net US dollar cash generation of its UK businesses. However, the balance sheet, which has carried increasing US dollar denominated assets from certain long-term programmes, has not been hedged prior to the conversion of those assets into cash. From 1 January 2019 we have revised our hedging strategy under IFRS 9 to reduce income statement volatility from re-valuation of US dollar assets held on the UK balance sheet. The £2.9m gain in FY 2018 will therefore not recur.
- Tax guidance has been updated to c.20% (2018: 21.5%) reflecting changes to US tax structure.
- IFRS 16 will result in a c.£1.5m increase in finance costs, partially offset by a c.£1m increase in operating profit. Net finance charges on defined benefit pensions will move to become an underlying cost from 1 January 2019.
- Capital Expenditure will increase to c.£25m (2018: £18.3m) due to ERP systems implementation.
- 2019 will have a similar second half weighting to 2018 due to the phasing in the Group's revenue from military tactical radios for the US Army's Network Modernisation programme.
- The impact of Brexit is difficult to estimate with the number of different scenarios that could occur. Please see page 35 for more commentary.

2018 Principal risks and uncertainties

ANALYSING AND MANAGING UNCERTAINTY

Effective risk management is a fundamental aspect of Ultra Electronics' operating, financial and governance activities.

The Group continually analyses the risks it faces and assesses the effectiveness of its response to these risks within the control environment. This means that Ultra is able to give early consideration to emerging risks and this helps it to deliver on its commitments, improve long-term performance and enhance its reputation in the market.

Profitable growth cannot be achieved without some degree of considered risk and the Group's objective to generate long-term shareholder value is reflected in Ultra's appetite for risk. Ultra's principal risks reflect the high priority it places on compliance with all legislative and regulatory requirements and the maintenance of high ethical standards across the Group, its supply chain and in its dealings with its customers.

The Group's strategies for growth centre on delivering change programmes that support the agility of Ultra's businesses, encouraging an entrepreneurial culture of innovation in its people by having a diverse range of skills and capabilities amongst the Group's employees. Ultra has a low-risk appetite in situations where its culture, reputation or financial standing may be adversely affected. However, the Group does consider taking higher risks where the opportunity is seen to outweigh the potential negatives, provided appropriate levels of mitigating controls are in place. Where safety may be compromised, Ultra has zero tolerance to risk.

Risk management and internal control

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

In June 2018, we announced that the Herley business was likely to be impacted by cost overruns on development contracts. This was extremely disappointing; management are working to address the issues. Actions include a review of Ultra's programme and contracting approval and management systems, and a specific Internal Audit review across a number of the businesses to assess compliance against the contract management policies. Other than this item, no significant failings or weaknesses have been identified.

Risk management

The approach to risk management across the Group is to focus on the early identification of key risks thereby reducing the likelihood of the risk occurring and mitigating the effect of any

The risk management process

Board and Committees

Executive Team

Divisions
- Aerospace & Infrastructure
- Communications & Security
- Maritime & Land

First Line
- Risk and control processes as part of 'business as usual'
- Group Operating Manual (setting out policies & processes)
- Training and development
- Regulatory and compliance requirements
- Risk registers
- Culture

Second Line
Group and Divisional oversight
- Group Board & Committee oversight and challenge
- Executive Team oversight and challenge
- Divisional business performance reviews
- Divisional Control Review meetings
- Six-monthly Compliance Reports
- Review of monthly Business Performance Reports (including Financial Performance)
- Co-ordination of the implementation of the Risk Management Framework

Third Line
Independent challenge to the levels of assurance provided by management on the effectiveness of governance, risk management and internal controls
- Internal Audit (provided by PwC)
- Other independent assurance activities e.g. health, safety and environment audits

External Audit*

Regulators

* Provided by Deloitte.

potential impacts. Risk Champions are employed at all levels of the business so that they have early visibility of any emerging risks across different market segments and business units. The work of the Risk Champions is supported by the following enhancements which have commenced or been implemented during this reporting period:

- Risk is a standing agenda item at the Board and the Audit Committee, and the culture of openness is enabling emerging risks to be highlighted at Board level.
- A deep dive review was undertaken in respect of innovation and development (see page 42). This included a review of existing controls, comparison to industry benchmarks, consideration of any changes in internal and external factors and the organisation's response to these changes. The output of the reviews was an evaluation of the mitigation measures, reassessment of the risk and its impact on the organisation's strategic objectives.
- A watching brief is being maintained in respect of the economic and political uncertainties (including Brexit) in Ultra's key markets so that it responds effectively to the new realities if there are potential impacts to business.
- The risk appetite metrics were reviewed and updated to reflect measures that provide the organisation with a clear view on how much risk it is exposed to so that risks are taken strategically.
- An assessment of the Group's aggregate risks was undertaken by the Board.

The risk management focus in 2019 will be to:

- Continue to review and improve the effectiveness of the Risk Management Framework and the related processes.
- Recruit a permanent Chief Risk Officer to lead the risk management function and undertake the review noted above.
- Manage the impact of Brexit (if any).
- Manage ongoing GDPR compliance.
- Introduce Programme Management discipline.

Risk Management Framework

The Risk Management Framework governs the approach Ultra takes to managing risk effectively. The cultures and behaviours inherent within Ultra (see pages 18–27) ensure risk consideration and commitment to proactively managing risk is embedded into the way it operates.

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

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

The key components of the Risk Management Framework are:

Oversight structure and accountability

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

Process

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

Escalation, monitoring and reporting

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

BREXIT

Preparing for Brexit is a challenge due to the different possible scenarios. Approaching 29 March 2019 the business focus has been to minimise the Group risks, particularly with No Deal becoming a higher probability scenario. Following review and evaluation across the Group the key risk areas in the context of a No Deal Brexit are supply chain and growth.

Ultra has been working to establish Brexit plans within the supply chain during 2018 and continues to work with our suppliers to proactively manage Brexit interruption risk. Given the typical timeline for project delivery UK businesses are preparing to adopt work arounds such as reworking schedules to mitigate impact where necessary. While these potential work arounds have been identified, a risk remains that any delays to contracted customer deliveries arising from a disorderly Brexit could result in claims from customers. The impact is difficult to estimate with the combination of different scenarios that could occur.

Another growth risk is that of exports to non EU countries when EU originated trade deals expire and are not immediately replaced by UK originated trade deals. Until the UK Government confirms how they will replicate the effects of existing EU free trade agreements from exit day this risk cannot be completely mitigated.

While agreement by the Government of the transitional arrangements will be of enormous value to Ultra to avoid uncertainty, in the short term the impact of Brexit is potentially three to six month delays in deliveries and the time taken to resolve the resultant disruption. The residual risk of additional tariffs and duties and the practicalities of border controls resulting from No Deal require clarification. In the longer term, the implications for UK suppliers into the Eurozone are harder to forecast.

While Ultra will continue to be responsive to changing markets it must be recognised that short-term growth is a risk. While the UK Government is seeking to replicate the effects of existing EU free trade agreements from exit day, or as soon as possible thereafter, details are not currently fully known. With consideration to commercial and contractual arrangements there could be some financial exposure arising from the supply chain being unable to deliver as a result of No Deal related issues. Focus on supply chain management is the best mitigation and the Executive Team will examine impacts and direct Ultra businesses in adapting to changing markets.

Ultra continues to review the numbers of EU nationals, with the number of potentially impacted employees representing no more than 3% of the UK work force.

The Executive Team and the Board will continue to operate a vigilant and tactical approach to managing any periods of uncertainty, whilst adhering to our risk management and internal control systems.

2018 Principal risks and uncertainties continued

Principal risks

The Board has considered the impact of political and economic uncertainties in its major markets including Brexit and the potential risks and opportunities these may have for the Group alongside other applicable risks. Risk Champions at Divisional and Business levels continue to proactively manage risks and these are monitored at a Group level by the Executive Team. The Board remains focused on the effective management of risk and will oversee improvements to policies and processes during 2019. The Group's risk exposure remains largely unchanged.

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

RISK/DESCRIPTION	CHANGES DURING 2018
RISK 1 **GROWTH** 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. TREND: NO SIGNIFICANT CHANGE **Pgs 06–09** Chief Executive Officer's Review	Although the defence market has been challenging in recent years, there are strong indications of a return to growth, particularly in the US, as indicated by the Group's strong order book going into 2019. Political and economic circumstances in some of the Group's key markets mean that it is optimistic about organic growth continuing. The Company's focus in the year continued to be on its market-facing segment strategies, improving its planning for future political and economic developments in its key markets, and exploiting the anticipated market upturn. During the year a deep dive into innovation and development was undertaken (see page 42).
RISK 2 **DELIVERING CHANGE** 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. TREND: NO SIGNIFICANT CHANGE **Pg 08** Focus, Fix, Grow	The S3 programme was completed in 2018 having broadly achieved the savings target of £20m but these savings were delivered principally through restructuring, onerous lease provisions and indirect procurement in the UK, and so there are still significant opportunities here. In 2019 change will be dominated by investment in ERP (as was the case in 2018) and IT networks which represents a higher risk, as is normal for ERP programmes. New actions have been identified to mitigate these risks.
RISK 3 **PEOPLE AND CULTURE** Preserving Ultra's culture and attracting, developing and retaining the right people who have relevant domain expertise and who embrace Ultra's culture is critical to the Group's strategic objectives. TREND: NO SIGNIFICANT CHANGE **Pgs 18–21** People and culture	Ultra's culture and how it is reflected across its businesses has been the subject of discussion at both the Board and Executive levels, throughout 2018. Talent and succession planning remained a focus for the Executive Team and the Board in 2018. The recruitment of a new Chief HR Officer in November 2018 enabled the Executive Team and the Board to increase this focus further. In 2019 work will be undertaken to consider employee engagement and promote diversity.

POTENTIAL IMPACT OF FAILURE	MITIGATIONS (EXAMPLES)	
• 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"	• The Group is offsetting challenges in the UK defence market by expanding in targeted overseas regions that exhibit long-term growth characteristics • The market-facing segments enable Ultra to remain competitive and use the capabilities of its businesses to deliver enhanced solutions more effectively to its customers • Improving the capacity and capability of the Group's sales and marketing teams • Establishment and implementation of rigorous gate reviews of risk appetite for major opportunities so that acceptable margin levels and risk tolerances are maintained	• The Board conducts a rigorous review of acquisition opportunities including commissioning third party market reports and due diligence. Post-acquisition reviews are performed on all acquisitions comprising integration effectiveness, operational performance compared to expectation and lessons learned • A working group reporting to the Executive Team has been established to evaluate the impact of recent geo-political events on Ultra • The recommendations from the deep dive into innovation and development will be implemented
• Expected benefits of change not realised • Significant increase in change programme costs • Senior management distraction from business as usual • Reduction in employee morale • Disruption of business performance	• An Executive Team sponsor is allocated to all major change programmes	• Experienced personnel have been recruited to operate the shared services
• Not recruiting and retaining the right employees in the right roles would result in Ultra being unable to fulfil its contractual obligations and would lead to operational inefficiencies and loss of productivity • Potential loss of future growth opportunities • Staff morale could be impaired resulting in a rise in employee-related issues (e.g. grievances and sickness) • Potential legal, regulatory and employee rights breaches	• Ultra continues to engage in a number of initiatives with local schools, colleges and universities to gain access to the best people for its apprenticeship and graduate recruitment programmes. This enables Ultra to grow a broad range of skills and capabilities and to remain successful at innovating to meet customers' needs • Ultra's people and their development are fundamental to Group success. Employee development needs form part of performance and development reviews and are aligned to employees' specific needs	• Measure Employee engagement and morale through engagement surveys. The leadership team use the survey to address any areas of concern so that Ultra's people remain engaged and committed • Talent and succession planning has been, and will continue to be, a focus for the Board • The annual Organisation, Succession & Development Plan (OSDP) results in high-potential employees being identified and their development monitored

2018 Principal risks and uncertainties continued

RISK/DESCRIPTION	CHANGES DURING 2018
RISK 4 **INFORMATION MANAGEMENT AND SECURITY** The incidence and sophistication of cyber security crime continues to rise. The effective management and protection of information and Ultra's IT systems is necessary to prevent the loss of data and the disruption of operations. TREND: NO SIGNIFICANT CHANGE **Pg 33** Financial guidance – investment programme	The CORVID Protect and Ultra approach to security continues to provide a high level of assurance. The global increase in the incidence and sophistication of cyber security crime means this risk continues to be a priority for the Company. A review of all systems was undertaken in light of the GDPR legislation and new processes are now being embedded.
RISK 5 **SUPPLY CHAIN** The Group relies upon suppliers and subcontractors to deliver upon its customer commitments. Ultra's supply chain needs to be efficient to maintain margins and to be compliant with legislation. The Group's manufacturing facilities are exposed to natural catastrophe risks and the Group is exposed to social, economic, regulatory and political conditions in the countries in which it operates. TREND: SLIGHT INCREASE **Pg 35** Brexit case study	A procurement strategy and SMART objectives are being developed and an assessment of the impact of Brexit has been undertaken. The Brexit risk has meant the supply chain risk has slightly increased.
RISK 6 **GOVERNANCE AND INTERNAL CONTROLS** 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. TREND: SLIGHT INCREASE **Pgs 47–53** Governance and Accountability	A new Chief Executive Officer joined the Company in June 2018 and as a result, the roles of Chief Executive Officer and Chair of the Board were separated again bringing Ultra back into line with the expectations of the Code. As further described on page 52, the The Board undertook a Governance workshop during the year with actions being identified to make improvements to processes. The Board determined that there had been a slight increase in this risk, however, this is expected to reduce as we continue to review and refresh our governance processes and policies following the corporate governance workshop and implement changes necessary as a result of new Corporate Governance Code and statutory reporting requirements during 2019.

POTENTIAL IMPACT OF FAILURE	MITIGATIONS (EXAMPLES)	
• Reduced product differentiation caused by loss of intellectual property • Reputational damage to Ultra as a highly regarded provider of secure data systems • Loss of business opportunity with removal of government approval to work on classified programmes • Disruption of business activity as systems are cleansed and restored	• The Group's information security is provided through its continued investment in Ultra's Cyber Protection Group (part of CORVID Protect). It provides Group-wide monitoring, incident response and continued enhancement of Ultra's IT systems and processes • The Board is kept updated on how CORVID Protect secures Ultra's network, including protecting Ultra from phishing attacks	• Intellectual property is addressed in the bid and contract management process and protected through information security • Security clearance processes are in place for all employees • Established physical security processes are implemented at all sites • Cyber insurance has been evaluated as a risk mitigation over the course of the year.
• Failure to deliver against customer commitments • Reduced profit margins and increased contractual disputes and litigation • Loss of reputation and investor confidence	• Building ongoing partnerships with strategic suppliers and managing major supplier risks and issues (including single source arrangements) through the bid management and contract management policies • Establishment of regional procurement councils to target the optimisation of Ultra's supply chain for Direct Procurement • Evaluation of Brexit risk has identified supply chain as the key area of risk. More detail is included on page 35	• The Board's commitment to compliance with the Modern Slavery Act 2015 is contained in the Anti-Slavery and Human Trafficking Statement (www.ultra-electronics.com/ investors/ anti-slavery-and-human-trafficking-policy.aspx) • Business continuity and disaster recovery plans are in place • The Group has business interruption, property damage, professional indemnity and product liability insurance
• 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	• 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.

2018 Principal risks and uncertainties continued

RISK/DESCRIPTION	CHANGES DURING 2018
RISK 7 **PENSIONS** 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. TREND: NO SIGNIFICANT CHANGE **Pg 32** Pensions	The pension scheme has continued to increase the hedging of its liabilities. There is no change to this risk.
RISK 8 **LEGISLATION/REGULATION** 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. TREND: NO SIGNIFICANT CHANGE **Pgs 57–61** Audit Committee Report	The Company continues to take compliance very seriously and the Board and Executive Team strive to reinforce an ethical culture. For example, all employees are required to undertake anti-bribery training on an annual basis and updated agents' policies are now in place. GDPR processes are being transferred from a change programme to "business as usual".
RISK 9 **HEALTH, SAFETY AND ENVIRONMENT (HS&E)** Ensuring high standards of health and safety of employees and visitors and maintaining commitment to minimise the environmental impact of activities is of paramount importance to the Company. TREND: NO SIGNIFICANT CHANGE **Pg 25** Health and safety	The Board has zero appetite for HS&E reportable incidents. The number of lost time accidents increased slightly however reportable accidents reduced slightly.

POTENTIAL IMPACT OF FAILURE	MITIGATIONS (EXAMPLES)	
• Any increase in the deficit may require additional cash contributions and thereby reduce the available cash for the Group	• Annual accounting and triennial pension valuations are in place and any issues that may arise are highlighted to the Board • The Pension Trustees and the Company actively consider pension risk reduction activities such as liability matching, dynamic de-risking, pension increase exchange and retirement transfer options	• The Pension Trustees and the Company agreed to increased hedging of the scheme's liabilities • The Board undertakes regular Pension Strategy Reviews • Long term scheme funding targets have been agreed
• 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	• The Group Operating Manual is well established and policies and procedures are regularly updated to reflect changing legislative and regulatory requirements • Regular compliance training is undertaken as part of Ultra's commitment to an ethical culture and individual businesses provide compliance statements as part of monthly business performance reporting	• The Ethics Overview Committee provides independent advice and scrutiny of Ultra's business activity. It provides assurance to the Board that the Group's undertakings are transparent and conducted ethically within the legislative environment • Employees have access to a Group-wide confidential hotline to report anonymously any concerns they may have about possible improprieties and other compliance issues • The Board receives regular updates and presentations on the Company's legal and regulatory requirements
• Incidents may occur which could result in harm to employees and visitors, the temporary shutdown of facilities or other business disruption • The Group may be exposed to regulatory action and financial loss • Loss of reputation and investor confidence	• The Board has zero appetite for HS&E risk and the Group's leadership is committed to ensuring that this remains a top priority. Any material incidents are reported to the Board along with a correction or mitigation plan	• 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

2018 Principal risks and uncertainties continued

INNOVATION AND DEVELOPMENT

Innovation and Development is an important cornerstone of organic growth. The Group is both self and customer funded for its R&D activities. Whilst the environment for customer funding is strengthening, Ultra has not increased its internally funded R&D in recent years. This has been due to increased customer funded R&D and the cyclicality of the aerospace R&D cycle. The importance of continuing organic growth results in this risk being a priority for the Company. As such, this risk was the subject of a deep dive review in 2017/18.

Innovation is about creating new differentiating solutions to customers' problems which yield products that satisfy user needs. Ultra is committed to growth in 2019 spending, above the 2018 levels. Current controls include some technology mapping and project approval documentation with proposed internal R&D spend evaluated against future returns followed by a gated project process. Multi-year projects are also re-evaluated annually.

Along with this increase in own funded R&D expenditures will come modifications and enhancements in group governance to improve focus and efficiency of the investment projects. This will include greater use of technology roadmaps, work with academia and the appointment of technology leads where appropriate. Marketing plans should identify technology investment timelines and requirement.

Overall risk exposure

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

Risk appetite statement

Ultra operates in a market that is subject to high levels of scrutiny. Our relationships with our partners, our reputation and our integrity are a key part of our continued success and the trust placed in us by our stakeholders.

Ultra has a very low appetite to take risk where our culture, reputation or financial standing might be adversely affected and as a consequence we seek to implement governance and internal controls to manage risks to quality, safety, regulatory and legal compliance, and financial integrity.

This does not mean however, that we do not take risk. Our objective is to outperform the market in terms of total shareholder return. Although we exercise natural caution through considered assessment, Ultra has an appetite for growth, particularly through product and service innovation and through acquisition where this complements existing markets and our core capability. In addition, we have an appetite to explore and operate in new markets provided we have high levels of confidence in the partners in these markets that we collaborate with.

Ultra's individual business units work in an autonomous manner where being entrepreneurial is encouraged. As a result, we accept a higher level of risk as this is managed in part by the diversity of our product and service portfolio. By leveraging the strength of the individual businesses, Ultra remains an agile organisation that is able to explore opportunities and markets for growth. We have a lower appetite for risk taking in our individual businesses where in aggregate there is a potential to impact the Group as a whole.

The Board will ultimately always consider taking higher risks that benefit our stakeholders where the opportunity is seen to outweigh the risks provided appropriate levels of mitigation are put in place.

Statement of going concern

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.

Ultra's net debt at 31 December 2018 was £157.4m (2017: £74.5m). The Group's committed banking facilities amount to £526.4m in total, together with a £5.0m and $10.0m overdraft. The Group's revolving credit facility of £300m is denominated in Sterling, US Dollars, Canadian Dollars, Australian Dollars or Euros. The facility is provided by a group of six international banks and has a committed maturity to November 2023, and may be extended to November 2024 subject to lender consent. The facility agreement permits an additional £150m "accordion" which is uncommitted and subject to lender consent and can be used in certain acquisition scenarios. The Group holds $165m of term loan which was established in May 2015; $40m is repayable on 31 March 2019, $40m on 30 June 2019 and the remainder on 1 August 2019. The Group also has loan notes in issue to Pricoa which totalled £50m (with an expiry date of October 2025) and $60m (with an expiry date of 25 January 2019) at 31 December 2018 (2017: $70m). Agreement was reached with Pricoa in September 2018 to issue new loan notes of $70m. These were issued on 25 January 2019. This debt will expire in January 2026 and January 2029.

As well as being used to fund acquisitions, the financing facilities are also used for other balance sheet and operational needs, including the funding of day-to-day working capital requirements. The US Dollar borrowings also represent natural hedges against assets denominated in that currency. Details of how Ultra manages its liquidity risk can be found in note 22 – Financial Instruments and Financial Risk Management.

Though global macro-economic conditions remain uncertain, and there continues to be uncertainty over the future UK landscape due to Brexit (detail on the potential risks to the Group associated with this are set out on pages 35 and 38), 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.

Long-term viability statement

Long-term viability statement

In accordance with provision C.2.2 of the 2016 UK Corporate Governance 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 2021, 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 divisional 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 2021. 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 plausible scenarios, the uncertainty arising over the future landscape due to Brexit, 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 following two severe but plausible scenarios were modelled: (i) no revenue or underlying profit growth and an average underlying operating cash conversion of 50% over the three-year period to December 2021 and (ii) a year-on-year revenue and underlying operating profit decline of 10% over the period to December 2021. Consideration was also given to the level of unexpected cash outflow or decline in profitability that would be required to result in a breach of financial covenants.

The Directors have determined that the three-year period to December 2021 is an appropriate period to provide its viability statement. In making their assessment, of the viability of the Company 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 actions of restricting dividend payments and reductions in non-essential expenditure and capital expenditure.

This conclusion is based on a review of the resources available to the Group, taking account of the Group's financial projections, the diversified nature of the key markets and programmes on which the Group operates, the long-term nature of many of these programmes, together with available cash and committed borrowings and the ability of the Group to raise new finance, the key financial covenants and material uncertainties, including the uncertainty arising due to Brexit. 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.

Board of Directors and Company Secretary

Tony Rice
Chair

Time in position:
since 28 Jan 19

Tony Rice was CEO of Cable & Wireless Communications plc, CEO of Tunstall plc and held a number of senior roles in BAE Systems plc. Tony has a BA in Business Studies from City of London College and an MBA from Cranfield School of Management.

Appointed to the Board:
18 December 2018

Committees
Nomination (Chair)

Other Key Appointments
- Chair of Dechra Pharmaceuticals plc
- Senior Independent Director of Halma plc
- Non-Executive Director of the Whittington Hospital Trust

Skills and Experience
Senior business management in the aeronautical and electronics engineering sectors.
Senior non-executive roles in UK listed companies.

Simon Pryce
Chief Executive Officer

Time in position:
6 mths

Prior to his appointment, Simon was Group Chief Executive of BBA Aviation plc for 10 years.

Simon qualified as a Chartered Accountant in the UK before working at the global investment banking firms of Lazards and JP Morgan, and then at GKN plc.

Simon is a Fellow of the Royal Aeronautical Society and a member of the Chartered Institute for Securities and Investment. He is also a member of the Council of the University of Reading.

Appointed to the Board:
18 June 2018

Committees
None

Other Key Appointments
- Non-Executive Director of Electrocomponents plc

Skills and Experience
International automotive and engineering sector.
Senior leadership and general management experience in multinational listed companies.

Amitabh Sharma
Group Finance Director

Time in position:
2 yrs 8 mths

Amitabh has held senior finance positions at listed and private companies with multi-sector experience.

Amitabh was previously Group Financial Controller at Ultra from 1999 to 2005 and at Senior plc in 2014. He was Group Finance Director at Gibbs and Dandy plc (now Gibbs and Dandy Ltd) and a Divisional Finance Director at Saint Gobain.

He qualified as a Chartered Accountant in 1993 and was subsequently an audit manager with KPMG in London.

Appointed to the Board:
4 May 2016

Committees
None

Other Key Appointments
None

Skills and Experience
Financial professional with extensive industry experience.
Business management in the electronics sector.

John Hirst
Independent Non-Executive Director

Time in position:
4 yrs

John was Chief Executive of the Met Office, a post he held from 2005 to 2014. Between 1998 and 2005 John was CEO of Premier Farnell plc, having previously spent 19 years with ICI plc, where he was Chief Executive of ICI Performance Chemicals and ICI Autocolour, as well as being 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.

Appointed to the Board:
1 January 2015

Committees
Audit (Chair), Nomination and Remuneration

Other Key Appointments
- Non-Executive Director of Marsh UK; Jelf plc; ORSUS Medical Ltd and White Square Chemical Inc.
- Senior Independent Director and Audit Committee Chair at Anglian Water
- Chair of Risk Committee of Jelf plc
- Chairman of the British Standards Institute and the National Oceanography Centre

Skills and Experience
Leadership in large global organisations.
Public and private sector experience.

Executive Director
Non-Executive Director
Audit Committee member
Remuneration Committee member
Nomination Committee member

Geeta Gopalan
Independent Non-Executive Director

Time in position:
1 yr 8 mths

Geeta has worked in commercial and retail banking as well as social investment and community development in the third sector.

Her executive roles included Chair Europe for Monitise plc, and Director of Payments Services at HBOS. Geeta also worked at Citigroup for 16 years, during which time she was a Managing Director for its UK retail bank and Business Development Head of EMEA.

She has experience coaching and mentoring as well as in-depth knowledge of the digital economy, mobile and internet spaces.

Appointed to the Board:
28 April 2017

Committees
Audit, Nomination and Remuneration

Other Key Appointments
- Non-Executive Director of CYBG plc
- Non-Executive Director of Funding Circle Holdings plc
- Non-Executive Director of Wizink Bank S.A.

Skills and Experience
Senior management in the financial services sector digital economy and the social sector.

Martin Broadhurst
Independent Non-Executive Director

Time in position:
6 yrs 5 mths

JMartin 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, served as Chief Executive between February 1996 and December 2010.

During his time as Chief Executive, he served on the Group Holdings Board and was Chair of a number of subsidiary companies.

Appointed to the Board:
2 July 2012

Committees
Audit, Nomination and Remuneration (Chair)

Other Key Appointments
- Non-Executive Director of the Centre for Engineering and Manufacturing Excellence
- Trustee of the Royal Aeronautical Society

Skills and Experience
Extensive experience in the defence and aerospace markets. International business leadership and growth. Large engineering organisation management experience.

Victoria Hull
Independent Non-Executive Director

Time in position:
1 yr 8 mths

Victoria is a former Executive Director and General Counsel of Invensys plc and Telewest Communications plc.

She has considerable international and domestic experience of legal, commercial and governance matters having worked in global and domestic companies operating at a Executive Committee or Board level.

Appointed to the Board:
28 April 2017

Committees
Audit, Nomination and Remuneration

Other Key Appointments
- Non-Executive Director of Rosenblatt Group plc

Skills and Experience
Experience across a diverse range of sectors. Legal and Board-level experience.

Sir Robert Walmsley
Senior Independent Non-Executive Director

Time in position:
9 yrs 11 mths

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.

Appointed to the Board:
22 January 2009

Committees
Audit, Nomination and Remuneration

Other Key Appointments
- Non-Executive Director of Cohort plc

Skills and Experience
Defence, security, transport and energy. Knowledge of Ultra's main geographic markets. Substantial experience of government procurement.

Louise Ruppel
General Counsel and Company Secretary

Time in position:
Since 28 Jan 2019

Louise Ruppel joined Ultra in January 2019. She trained as a solicitor at UK city firm Slaughter and May where she qualified into the corporate department. She subsequently worked as an in-house lawyer at Merrill Lynch & Co. Limited in London and worked for FirstGroup plc as Company Secretary and Group Legal Director until 2016, when she left to become General Counsel and Company Secretary at Manchester Airports Group.

Skills and Experience
Legal, compliance and Board-level experience.

Chair's Governance Statement

"A refreshed Board and Executive Team and a renewed focus on business strategy, culture and governance, will ensure that Ultra remains a resilient and sustainable business."

Dear Shareholder,

This is my first Governance Report as Chair of Ultra Electronics Holdings plc. First, I would like to thank Douglas Caster for his work as Chair and Executive Chair. The Board is particularly grateful to Douglas for having stepped into the Executive Chair role at a difficult time for Ultra and for his leadership and guidance during the ensuing period of significant change and transition. On behalf of the Board and all of Ultra's employees, I would like to thank Douglas for his long and dedicated service to the Group and wish him all the best for his retirement.

The key themes of Board composition, culture and governance reform that Douglas referred to in the 2017 Governance Statement remained pertinent throughout 2018. Whilst a number of governance objectives have been successfully achieved during the year, others have come to the fore and we remain vigilant and firm in our resolve to ensure that our governance supports and enhances the performance of our Group's businesses.

I am therefore pleased to present Ultra's 2018 Corporate Governance Report, which explains how the Board has applied itself to good governance and, in particular, applied the principles of the UK Corporate Governance Code (the Code) during the year.

Board changes and succession planning

A year ago the Board, and particularly the Nomination Committee, was in the process of recruiting a new Chief Executive Officer. That process was successfully completed during the year and we are already seeing the benefits of having our new Chief Executive Officer, Simon Pryce, in place. Simon's appointment also enabled Douglas to step back into the role of Non-Executive Chair.

In addition to recruiting Simon, the Board and the Nomination Committee, led by Sir Robert Walmsley as Senior Independent Non-Executive Director, undertook a search for a new Non-Executive Director and Chair Designate, resulting in my joining the Board in December 2018 and taking over as Chair on 28 January 2019. Details of the process by which I was appointed are set out in the Report from the Chair of the Nomination Committee set out on page 54.

As announced on 6 March 2019, due to his increasing non-Ultra commitments and his recent appointment as Chair of the British Standards Institution, John Hirst has indicated that he intends to step down as a Non-Executive Director and Chair of the Audit Committee later this year, once a suitable replacement has been found. John will step down from the Remuneration Committee after the 2019 Annual General Meeting. We thank him for his wise counsel over the years and wish him all the best for his future endeavours.

Sir Robert Walmsley's term as a Non-Executive Director was due to expire in April 2018. Given the changes to the Board, in November 2017, it was announced that the Board had asked Sir Robert to remain on the Board for a further year as Senior Independent Non-Executive Director to provide non-executive continuity and leadership. Despite the considerable progress in 2018 there are further changes needed and the Board has again requested Sir Robert to continue as Senior Independent Non-Executive Director until, at the latest, January 2020. This allows sufficient time to recruit a new Chair of Audit Committee and a replacement Senior Independent Non-Executive Director, whilst maintaining a degree of business continuity and industry knowledge, particularly in light of Sir Robert's extensive understanding of the UK and US defence sectors. The Board is mindful of the need to ensure that we maintain a broad and complementary range of experience, skills, personalities and competencies on the Board, and this will form part of its criteria for any new non-executive appointments.

Culture

In the 2017 Governance Statement, recognising the importance of culture as the foundation for resilient and sustainable businesses across the Group, Douglas commented on the Board's role in overseeing the culture of the Group and the importance it plays in creating accountability and responsibility. We welcomed the appointment of a new Chief Human Resources Officer during the year, who will assist the Board in its continuing work in this area.

As part of its role in overseeing the culture of the business, the programme of Non-Executive Director site visits continued during 2018 including visits to our facilities in the UK and the USA. The Board and Executive Team also have a number of visits planned for 2019, which will be important in assessing how Ultra's "Focus, Fix, Grow" journey is being supported across the Group.

Corporate governance reforms – looking ahead

The publication, in July 2018, of the new UK Corporate Governance Code, has prompted the Board to review how it engages with key stakeholders (and especially employees), promotes diversity across the workforce (including the Executive Team), and monitors and assesses Ultra's culture, so that behaviour throughout the Group is aligned with its values and strategic goals. A review of the Group's governance arrangements is under way, aimed at ensuring that the Group operates effectively within the new Code and statutory reporting requirements, and the outcome and compliance with the Code and those requirements will be reported in our 2019 Annual Report.

Notwithstanding the challenges it has faced in the past 18 months, I believe that a refreshed Board and Executive Team and a renewed focus on business strategy, culture and governance, will ensure that Ultra remains a resilient and sustainable business, focused on medium and long-term growth and value generation.

TONY RICE
Chair
6 March 2019

Corporate Governance Report

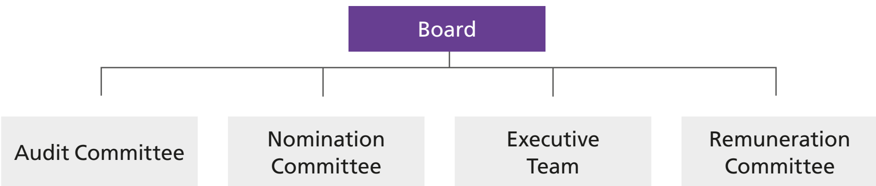
Compliance statement

Until the appointment of Simon Pryce as Chief Executive Officer on 18 June 2018, Douglas Caster carried out the role of Executive Chair, meaning that the Board did not comply with Code Provision A.2.1 of the Code, which requires the separation of the roles of Chair and Chief Executive Officer. Following the resignation of the previous Chief Executive in November 2017, Douglas' appointment as Executive Chair was always expected to be a temporary arrangement pending the appointment of a new Chief Executive Officer. That process concluded in March 2018 when it was announced that Simon Pryce would be appointed Chief Executive Officer from 18 June 2018, and Douglas would revert to being the Non-Executive Chair. Since 18 June 2018, the Board has been compliant with Code Provision A.2.1.

In late 2017, the Board asked Sir Robert Walmsley, whose term as a Non-Executive Director was due to expire in April 2018, to remain on the Board for a further year as Senior Independent Director. As outlined above, this step was taken to provide non-executive continuity on the Board during the period of transition in the executive leadership of the Company. Further, for the reasons set out above, Sir Robert's term has been further extended until January 2020. The Board has always considered Sir Robert to be independent in character and judgement, which is the primary consideration for the purposes of Provision B.1.1 of the Code, and he has continued to demonstrate that independence of character and judgement, and to constructively challenge Board and Management decisions through his participation in Board meetings and strategy reviews during the year. On that basis, the Board considers that Sir Robert should continue to be regarded as independent for the purposes of the Code. The Board is confident that he will continue to demonstrate these characteristics during the coming year, until he retires from the Board.

Throughout the financial year ended 31 December 2018, the Board considers that it, and the Company, has complied in all other respects with the other provisions set out in the Code. The Code is issued by the Financial Reporting Council and is publicly available on their website (www.frc.org.uk). In this Corporate Governance Report, we describe how the Board has applied the Main Principles of the Code.

Board and Committee Structure



The Board has delegated certain key responsibilities to the Nomination Committee (see page 54), to the Audit Committee (see page 57) and to the Remuneration Committee (see page 62). These Committees make recommendations to the Board for approval; however, ultimate responsibility lies with the Board.

Summarised below and explained in detail throughout this report, we have described how we have applied the main principles of the Code.

LEADERSHIP

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

Read more about the Board's LEADERSHIP on **Pg 48**

EFFECTIVENESS

Directors are appointed on merit, following a rigorous and transparent process. The Board has evaluated 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 **Pg 51**

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 **Pg 53**

RELATIONS WITH SHAREHOLDERS

We maintain strong relations with shareholders through events and consultations.

Read more about SHAREHOLDER RELATIONS on **Pg 53**

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 **Pgs 62–77**

Corporate Governance Report continued

Leadership

Summary of Board Activities during 2018

Key Activity	Timetable
Review of Health, Safety and Environmental Report	January Board Meeting
Receipt of Ethics Committee Report	April Board Meeting
Governance Workshop	April
Received Divisional Strategy Presentations	September, November and December
Appointment of CEO	June Board Meeting
Appointment of NED and Chair Designate	December Board Meeting

Board attendance during 2018 (9 scheduled and 6 unscheduled meetings held)	
Douglas Caster (Chair)	15/15
Simon Pryce	6/15
Amitabh Sharma	15/15
Martin Broadhurst	15/15
Geeta Gopalan	14/15
John Hirst	14/15
Victoria Hull	15/15
Sir Robert Walmsley	15/15
Tony Rice	1/15

Simon Pryce attended all Board meetings after his appointment in June 2018; Geeta Gopalan and John Hirst were unable to attend one unscheduled meeting; Tony Rice attended all Board meetings after his appointment as Non-Executive Director in December 2018.

Roles

The role of the Board

All the Directors are collectively responsible for providing effective leadership and direction in delivering the key corporate objective of generating shareholder value. In addition, the Non-Executive Directors are responsible for exercising independent and objective judgement and for scrutinising and challenging management. The Board is responsible for approving strategy and policies, for oversight of risk, controls and corporate governance, and for setting a culture which encourages the Group's businesses to behave ethically. The Board is accountable to shareholders for the proper conduct of the business and for Ultra's long-term success; it represents the interests of all stakeholders.

Members of the Board and their biographies are shown on pages 44 and 45.

Leadership

The Board is led by the Chair of the Board, whilst the Chief Executive Officer is ordinarily responsible for the running of the business. Between November 2017 and June 2018, Douglas Caster, as Executive Chair, undertook both roles on an interim basis pending the appointment of a new Chief Executive Officer. Since June 2018, the roles of Chair of the Board and Chief Executive Officer have been held by different individuals. A written statement of the responsibilities of the Chair of the Board, Senior Independent Director and Chief Executive Officer has been in place for several years and will be reviewed in 2019.

Executive Team

It is the function of the Group's management, through the Chief Executive Officer and his Executive Team, to run the operations of the Group. The Executive Directors set the Group strategy, which is subject to challenge by the Board before final agreement. The Executive Team considers major business issues and reviews those matters which are to be submitted to the Board for its consideration. The Chief Executive Officer is responsible for establishing the Executive Team and chairing the Executive Team meetings.

The Executive Team comprises: Chief Executive Officer; Group Finance Director; Corporate Marketing Director; EVP Commercial and Corporate Affairs; General Counsel and Company Secretary; Chief HR Officer; and Divisional Managing Directors/Presidents.

Ethics Overview Committee

Ultra is committed to ethical business conduct. In this regard, the Group has the benefit of an independent Ethics Overview Committee. Ultra's Policy Statement on Ethics and Business Conduct is available from the Corporate Responsibility section of the Group's website www.ultra-electronics.com. The Ethics Overview Committee, through its independently appointed members, underpins this policy, by checking and testing it in support of the Board. It does this through discussions with senior managers, receipt of reports, visits to Company sites, engagement with employees and managers at those sites and, where appropriate, requests to senior managers for various documents that assist the members in fulfilling this role.

Board meetings

There were nine scheduled Board meetings during 2018, plus a number of unscheduled Board meetings to consider and approve, amongst other things, the termination of Ultra's bid to acquire Sparton Corporation, the raising of long-term debt of up to US$200m, and the appointment of a new Chief Executive Officer and a new Non-Executive Director and Chair Designate.

Comprehensive briefing papers were circulated to the Directors in advance of each Board meeting. At each scheduled Board meeting, the Board received:

- An Executive Chair's (prior to June)/Chief Executive Officer's Report (from June onwards), which covered the Group's operational performance and particular performance issues in each division;
- A Group Finance Director's Report, which covered financial forecasts for the half-year and full-year and reviews of financial performance, banking covenants and analysts' views of the Group, major shareholdings and major share buyers and sellers; and
- An update on Major Projects and Mergers, Divestments and Acquisitions.

At certain scheduled Board meetings, presentations were made by Ultra's businesses detailing recent performance, key opportunities (including in respect of specific bids or programmes) and future forecasts. The Executive Directors provided appropriate explanations for matters having a significant impact on the Group's financial performance and drew the wider Board's attention to any significant trends or deviations from budget revealed by monthly forecasts of future performance. Acquisition and divestment opportunities were also presented to the Board.

As a result of responsibility for the preparation of papers for the Board passing to the new Chief Executive Officer, (having previously been the responsibility of the Executive Chair), the structure of the Board papers has developed during the year. In addition, the Board received regular privileged legal reports on the investigation by the Serious Fraud Office (the 'SFO'), announced on 19 April 2018, and also reports on the Sparton acquisition and Senior Management and Board recruitment. The Group also received compliance reports from the businesses across the Group.

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, forecasts for the half- and full-year, and a shareholder analysis summary report on Ultra.

During 2018, the Board visited three operating businesses in the UK: Command and Sonar Systems at Loudwater, PMES at Rugeley and PCS, Cheltenham. Martin Broadhurst also visited some of the Company's US businesses in October 2018. Such visits provide a useful cultural barometer and enable the Board to see the Group's capabilities first-hand and to engage with colleagues, both formally and informally. Members of the Ethics Overview Committee also visited Energy in Wimborne, 3eTI in Washington, USA and Energy and ATS in Austin, USA.

A summary of how the Board spent its time in 2018 is set out below. The full range of Board responsibilities are detailed in the document entitled "Terms of Reference for Main Board", which is available from the Group's website (www.ultra-electronics.com/about-us/corporate-governance/board-and-sub-committees-terms-of-reference). The principal duties of the Board during the year were discharged as follows:

Group strategy

- Review the Group's strategies for growth and the market segment strategies.
- Monitor the performance of the Group against these strategies.

- Half-day Board strategy sessions were held on 27 September, 29 November and 17 December, which focused on the divisional strategies. Presentations were given by the Executive Team and Divisional Leads and discussions were held on significant matters identified in respect of each of the divisions.
- Following his appointment to the Board, the new Chief Executive Officer has reported his initial thoughts on the strategic and operational development of the Group and has provided regular updates to the Board as his views on the Group's strategy crystallise.

Financial reporting and controls

- Agree the budget.
- Review the financial results and forecasts, reports on performance against budget.
- Shareholder engagement and analysis.
- Treasury and tax activities.
- Review dividend policy and set dividend.
- Review and approve the Annual Report and Accounts and interim report.

- 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 and also considered the implications of US Corporate Tax Reform for the Company.
- The Board approved the raising of long-term debt up to US$200m.

Market analysis and major bids

- Receive market reports.
- Review major bid wins and losses.
- Review significant current and future bids.

- At each scheduled Board meeting, the Board received a Marketing Report providing a brief on market developments, order intake and bids (including information in respect of missed bids). Further improvements were made to this report in the year to improve order pipeline visibility.

Corporate Governance Report continued

Group risk framework and management

- Set the Group's risk appetite and monitor the Group's significant risks.

- The Board supported by the Audit Committee conducted an annual refresh of the Group risk register (including risk appetite), and reviewed the Group's principal risks to determine the nature and extent of the risks it is willing to take and to review the management of those risks.
- The Board received a health, safety and environment report summarising the position across the Group and considered reports on externally reportable health and safety incidents and evaluated the adequacy of the correction and mitigation plans.
- The Board approved the Group's insurance programme.

People, Board effectiveness and succession planning

- Receive reports on changes in senior management.
- Review board succession planning.
- Undertake formal Board evaluation.

- At each scheduled Board meeting, the Board received an update on changes and recruitment in senior management.
- The Board took part in an annual Board evaluation (see page 52 for further information on this).

Significant transactions, matters and expenditure

- Consider, review and approve significant transactions.
- Review major capital projects and bids.
- Monitor significant litigation and disputes.

- At each scheduled Board meeting, the Board received project reports on major contracts and programmes (including the S3 and ERP programmes) and evaluated acquisition opportunities.
- Privileged legal reports were received on the regulatory processes in connection with the conclusion of the Sparton Corporation acquisition and the ongoing SFO investigation.

Corporate governance and legal & regulatory compliance

- Receive reports from the Board Committees.
- Receive reports on legal and regulatory developments.
- Review Group policies.

- Biannually, the Board reviews the Compliance Reports prepared by Divisional Managing Directors (DMDs) and Presidents which summarise the compliance matters in the Business Performance Reports submitted each month by the Business MDs and Presidents.
- The Board participated in a Corporate Governance Workshop.
- The Board considered and approved Group policies.
- The Board reviewed and approved its policy in relation to the use of Agents.
- The Board reviewed the annual corporate governance update prepared by the General Counsel and Company Secretary, and approved recommended associated actions.
- The Board considered, evaluated and approved actions in respect of material upcoming legal and regulatory updates, including the EU General Data Protection Regulation (GDPR), gender pay gap reporting and US tax reforms.
- The Board received a report on the UK Corporate Governance Code and considered the steps to be taken to ensure compliance.
- The Board reviewed reports on the Group's offset policy.

Board priorities for 2019

- Strategic development and implementation.
- Support further development of talent and succession planning across the Group with particular focus on the sales and marketing, project management and commercial functions.
- Ensure that the Board has the right mix of experience and competencies, particularly in the light of the ongoing changes to its composition.
- Governance and Compliance – continue to develop and maintain best practice standards in corporate governance and compliance – the Board will oversee the Group's compliance with GDPR, gender pay gap reporting, payment practices reporting, and any changes required as a result of the 2018 Code and new statutory reporting requirements.

Effectiveness

Board skills and experience

The Board has a balance of skills, understanding, perspectives and experience relevant to the Group's activities. Collectively, the Board members possess an understanding of the Group's core defence, security, transport and energy markets. This is complemented by members' experience and expertise in other industries and disciplines including procurement, accountancy, financial management and financial services, legal and growing international businesses. This range of skills and experience informs the Board's decision-making and enables it to provide effective leadership. The particular skills and experience that each Director brings to the Board are described in their biographies on pages 44–45 and summarised as follows:

	Sectors				Geographies			Experience				
	Defence & Aerospace	Security & Cyber	Transport markets	Energy markets	UK & Europe	North America	Rest of the World	Finance & legal	Capital markets & public companies	Public sector & procurement	Leadership in large organisations	Corporate Governance
Tony Rice	*				*	*	*	*	*	*	*	*
Douglas Caster	*	*	*	*	*	*	*	*	*	*	*	
Simon Pryce	*	*	*	*	*	*	*	*	*	*	*	*
Amitabh Sharma	*	*	*	*	*	*	*	*	*	*	*	
Martin Broadhurst	*	*	*		*	*	*			*	*	
Geeta Gopalan		*			*			*	*		*	
John Hirst	*	*	*		*	*	*	*	*	*	*	*
Victoria Hull					*	*	*	*	*		*	*
Sir Robert Walmsley	*	*	*		*	*	*			*	*	

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

Directors' induction and training

All new appointments to the Board receive an induction to the Group covering:

- the Group's strategy, governance framework policies, and procedures;
- the products and services of the Group's businesses;
- the key markets in which the businesses operate;
- the key risks which the Group faces (together with the actions and plans which are in place to mitigate these risks);
- the corporate and organisational structure;
- financing principles; and
- legal and regulatory matters.

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

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

Non-Executive Directors

The key role of the Non-Executive Directors is to provide an appropriate level of constructive challenge to the plans of the Executive Directors on behalf of stakeholders.

Martin Broadhurst, Geeta Gopalan, Victoria Hull, John Hirst and Sir Robert Walmsley are designated as independent Non-Executive Directors. The Board considers them all to be independent in character and judgement. In making this assessment, 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. Furthermore, with the exception of Sir Robert Walmsley for the reason set out on page 46 above, none of the circumstances set out in Code Provision B.1.1 applies to any of the Non-Executive Directors. The Chair of the Board 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 Chair of the Board and Non-Executive Directors serve to align their interests with those of its shareholders.

The Non-Executive Directors met without the Chair of the Board or Executive Directors being present during the year to discuss aspects relating to the Board and the Company and gave appropriate feedback.

Corporate Governance Report continued

Board evaluation

Historically, Board evaluations have been run on a two-year cycle with the effectiveness of the Board and its Committees evaluated in one year and, individual Directors' performance evaluated in the following year.

In November 2018, Jack Telfer of Auxesis Consulting Ltd facilitated a Board evaluation of the effectiveness of the Board and its Committees. All Directors completed a detailed questionnaire requiring them to give feedback on their perception of the effectiveness of the Board and its Committees. The objective of the process was to encourage the improved performance of the Board as a whole. A report of the results was given to the Chair and discussed with the Board in December 2018. The Chair has also met with Mr Telfer, and with each member of the Board separately, to discuss the findings of the report, and actions resulting from the evaluation will be formulated over the coming weeks and months.

Mr Telfer has considerable experience working at board level. He was the Group Human Resources Director of Ultra until June 2004 (when he left Ultra to set up his own consultancy) and so is able to facilitate the evaluation from a position of having a good understanding of the foundation of the Group's operations culture.

The report reflects a point in time following a period of significant change and a number of challenges faced by the Board. In this context it is acknowledged in the report that some disruption to the Board's usual disciplines was always likely, but the Board had worked well together in difficult circumstances to respond to a challenging set of events. The evaluation, report and subsequent Board discussions have resulted in certain key areas of focus for the Board in 2019, which are set out below:

- Ensuring Board oversight of risk and oversight processes and practices across the Group;
- Keeping management accountable for business performance;
- improving the rigour of decision-making processes for key investment opportunities;
- Ensuring effective processes are in place to develop senior management;
- Reviewing Board processes, administration and functionality.

The Board considered that prioritising these matters in 2019 would improve the performance of the Board as a whole. Further, the appointment of a new Chief Human Resources Officer in November 2018, a new Head of Investor Relations and a permanent General Counsel and Company Secretary in January 2019, and a permanent Chief Risk Officer during the course of 2019, would support the Board's renewed focus on these matters in 2019.

The Board intends to commission an external Board evaluation in 2020 but, given the ongoing changes to the composition of the Board, it considers it more appropriate to carry out an internal evaluation in 2019, facilitated by the General Counsel and Company Secretary, but using a recognised online Board evaluation platform.

The evaluation and subsequent discussions demonstrate the Board's commitment to continue to improve its effectiveness as a whole. Further, the Board considers that each Director contributes effectively and demonstrates commitment to the role. In addition, whilst the Nomination Committee's focus has turned to succession planning for the Board and its Committees, there is currently an appropriate balance of skills, experience, independence, diversity and knowledge of the Company to enable the Directors to discharge their respective duties and responsibilities effectively.

Commitment of time by all Directors to Board and Committee meetings and other duties is also considered sufficient for the effective discharge of their responsibilities.

Corporate Governance Workshop

In April 2018, the Board participated in a Governance Workshop facilitated by BP&E Global, the purpose of which was to review certain corporate governance processes and systems, and consider whether the Board perceived that any improvements to such processes and systems were required.

In preparation for the Workshop, a Senior Consultant at BP&E Global held telephone interviews with, or received email feedback from, each member of the Board in order to create a suitable framework for discussions at the Workshop.

A summary of the significant and common themes based on these telephone calls/email feedback were provided at the Workshop to facilitate Board discussions. A number of action points, focused on improving certain elements of Ultra's internal governance processes, were agreed as a result of this Workshop. A follow-up meeting of the Board in November 2018 reviewed progress in respect of each of these actions, and ongoing implementation will continue to be monitored by the Board during 2019.

Serious Fraud Office investigation

As previously announced, the SFO is continuing to investigate the conduct of business in Algeria by Ultra Electronics Holdings plc ('Ultra'), its subsidiaries, employees and associated persons. The investigation commenced in April 2018 following a voluntary self-report made by Ultra to the SFO. Ultra continues to cooperate with the SFO and will make a further statement once the investigation is complete.

Accountability

Risk management and internal control

The Board is responsible for the Group's risk management framework and internal control systems and for reviewing their effectiveness.

The Group has internal control systems across finance, operations, human resources and compliance and key controls have been identified. The Board, via the Audit Committee, monitors the internal control systems on an ongoing 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. In addition, the Company is in the process of recruiting a permanent Chief Risk Officer to bolster the monitoring and reporting of risk to the Board.

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.
- Except as described on page 52 no significant failings or weaknesses have been identified and the systems accord with the FRC guidance on risk management, internal control and related financial business reporting.

In light of developments during the year, the Board has reviewed risk management and internal control processes and, except as set out on page 52, consider that they continue to be effective. Further details on the internal control systems and processes can be found in the Audit Committee Report.

Relations with shareholders

Commitment to dialogue

The Board is committed to a high-quality dialogue with shareholders. The Executive Directors take the lead in engaging with shareholders and analysts on the performance of the business. The Chair of the Board, Senior Independent Director and other Non-Executive Directors are available to meet with shareholders on request if there are matters that they wish to discuss outside of the normal channels of communication. The Board conducted an independent perception audit of the Group during the year which included views from shareholders and analysts. As a result, a new Head of Investor Relations was appointed in January 2019. Her role is to strengthen relationships with shareholders and to create a more consistent communications strategy for the Group. She will keep the Board informed of views and changes in Ultra's shareholder base.

Annual programme

A full programme of engagement with shareholders, potential investors and analysts is undertaken each year by the Executive Directors. Focused events and/or site visits are arranged 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.

During 2018, two roadshows were held following the preliminary and interim results announcements, and analysts were invited to visit the Ultra stand at the Farnborough airshow.

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 Head of Investor Relations and the Company's stockbrokers on analysts' and major shareholders' views on the Company. The Board receives a report at each Board meeting on any changes to the holdings of the Company's main institutional shareholders.

Nomination Committee Report

"We continue to be mindful of the expectation of our shareholders and other stakeholders in relation to diversity, in all of its forms."

TONY RICE
Chair of the Nomination Committee

CONSTITUTION

- Written terms of reference of the Committee include all matters recommended by the Code.
- The terms of reference were reviewed during 2018.
- These terms of reference are available on the Group's website (www.ultra-electronics.com/investor-centre).

CHAIR'S INTRODUCTION

Dear Shareholder,

During 2018, our main priority was to undertake in a timely and thorough manner, the process of appointing a new Chief Executive and Chair. After objectives were successfully achieved in June and December respectively, our focus has turned to reviewing the tenure of our long-serving Non-Executive Directors, and succession planning to ensure a balance of skills, experience and knowledge is maintained on the Board and its Committees.

We also kept in view the succession planning and career progression of senior employees, and the recruitment and development of talent across the Group. We believe that the Board and its Committees have an appropriate mix of skills and experience to operate effectively, but recognise that changes to the composition of the Board will be needed to ensure that the balance of executive and independent non-executive oversight is maintained. As we carry on with this process, we continue to be mindful of the expectation of our shareholders and other stakeholders in relation to the diversity, in all of its forms, of our Board.

TONY RICE
Chair of the Nomination Committee

About the Committee

Committee membership	Attendance during 2018
Tony Rice (Chair) (appointed 28 January 2019)	0/5
Douglas Caster	4/5
Martin Broadhurst	5/5
Geeta Gopalan	5/5
John Hirst	5/5
Victoria Hull	5/5
Sir Robert Walmsley	5/5

Douglas Caster did not attend one meeting at which the agenda items dealt with his succession.

Activity during 2018

During 2018, there were five (two scheduled and three unscheduled) meetings of the Committee. The key activities of the Committee during the year are summarised as follows:

Board appointment

- Before any appointment is made by the Board, evaluate the balance of skills, knowledge, experience and diversity on the Board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.
- In identifying suitable candidates, the Committee shall: use open advertising or the services of external advisors to facilitate the search.
- Consider candidates from a wide range of backgrounds.
- Consider candidates on merit and against objective criteria and with due regard for the benefits of diversity on the Board, including gender.

The search for a new Chief Executive Officer was the primary task of the Committee in the first half of 2018. The executive search firm Korn Ferry was engaged to assist in this process. The Company does not have any other connection with Korn Ferry. The following process was adopted:

- the role specification and selection criteria were determined by the Nomination Committee;
- the curricula vitae of the candidates were considered by the Nomination Committee;
- a sub-committee of the Committee interviewed the shortlisted candidates (four of whom were external and two of whom were internal candidates);
- a number of shortlisted candidates were subsequently interviewed by each member of the Nomination Committee;
- the Nomination Committee met to agree the appointment of Simon Pryce as Chief Executive Officer; and
- a recommendation was put to the Board and approved.

The search for a new Chair was undertaken in the second half of the year. Korn Ferry was again engaged to assist in this process. Sir Robert Walmsley led the process and chaired all meetings in relation to this appointment:

- the role specification and selection criteria were determined by the Nomination Committee;
- the curricula vitae of the candidates were considered by the Nomination Committee;
- a sub-committee of the Committee interviewed the shortlisted candidates;
- a number of shortlisted candidates were subsequently interviewed by each member of the Nomination Committee;
- the Nomination Committee met to agree the appointment of Tony Rice as Non-Executive and Chair designate; and
- a recommendation was put to the Board and was subsequently approved by the Board.

Board composition and pipeline

- Regularly review the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board in line with the Code's requirements.
- 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 Committee considered the composition of the Board in view of Sir Robert Walmsley's tenure as Non-Executive Director having exceeded the nine-year term recommended by the UK Corporate Governance Code. As previously mentioned, the Committee's focus in the year was on the recruitment of the CEO and the Chair, and, in 2019, consideration will be given to finding appropriate replacements for John Hirst as Chair of the Audit Committee and Sir Robert Walmsley as Senior Independent Director.
- The Committee also reviewed the appointment of Martin Broadhurst, given that his period of service had exceeded six years. The Committee concluded that his contribution and role on the Board was invaluable at a time of changes on the Board and unanimously supported his continued appointment as an independent Non-Executive Director.

Nomination Committee Report continued

Succession planning

• Consider succession planning for Directors and senior executives below Board level.	• In consideration of Executive-level succession planning, the Committee received a report explaining the annual Organisation, Succession & Development Plan (OSDP) process, the output from which is reviewed quarterly 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. A review of the OSDP process will be undertaken in 2019. • Senior Executive Team recruitment processes were undertaken during the year in respect of the appointment of a Chief Human Resources Officer and a permanent General Counsel and Company Secretary.

Board evaluation

• Consider the results of the annual Board evaluation.	• The results of the Board performance evaluation process were considered and presented to the new Chair of the Board shortly after his appointment.

Board Diversity Policy

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

Statement

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

Objectives

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

Progress against the Board Diversity Policy

Following the appointment of Victoria Hull and Geeta Gopalan to the Board during 2017, the proportion of female members of the Board was 29% (2/7 Directors) at the beginning of the year. Simon Pryce was appointed to the Board as Chief Executive Officer following a rigorous appointment process, which was conducted in conformity with this Board Diversity Policy. Nevertheless, with the appointment of another male Board member, the proportion of female members of the Board is currently 25% (2/8 Directors).

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

Further information 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, is set out on page 25 of our Strategic Report. Details of our Gender Pay Gap is provided on our website at www.ultra-electronics.com.

The Committee's focus for 2019

In 2019, the focus of the Nomination Committee will be to:

- Appoint a replacement for Sir Robert Walmsley as a Senior Independent Director.
- Appoint a replacement for John Hirst as Chair of the Audit Committee.
- Review the performance of Executive Directors on the Board as part of the Committee's regular review of the Board's composition.
- Review the remit and constitution of the Committee in the light of the requirements of the 2018 UK Corporate Governance Code.
- In association with the Executive Team review the OSDP process.

Audit Committee Report

"Throughout the year, the Committee continued to focus on the integrity of financial reporting, internal controls and risk management processes."

JOHN HIRST
Chair of the Audit Committee

CONSTITUTION

- Written terms of reference of the Committee include all matters recommended by the Code.
- The terms of reference were reviewed during 2018.
- These terms of reference are available on the Group's website (www.ultra-electronics.com/investor-centre).
- The Board is kept fully informed of the Committee's work and the minutes of each Committee meeting are circulated to Board members.

CHAIR'S INTRODUCTION

Dear Shareholder,
Throughout the year, the Committee continued to focus on the integrity of financial reporting, internal controls and risk management processes.

The Board's report on the systems of internal control and their effectiveness can be found in the Corporate Governance Report on page 53.

An assessment of the Group's principal risks and uncertainties can be found on pages 34–42 and the going concern and long-term viability statements can be found on pages 42 and 43.

The Group's risk management framework has been a particular area of focus during 2018. With the position of Chief Risk Officer being vacant throughout 2018, the Audit Committee has monitored the compensating activities of the Executive Team and the work of the Risk Owners at Business Unit level to ensure that appropriate levels of focus and proactivity have been maintained. Evolving areas of risk have been reviewed with specific assessments being undertaken on Brexit and innovation risk. Regular reports from PwC who provide the Group's internal audit function on the testing of the Group's control activities have indicated that the business control environments continue to show improvements.

We continue to work to ensure that our financial reporting is accurate and complies with emerging regulatory requirements. We monitored the impacts of IFRS 9, IFRS 15 and IFRS 16 on our financial reporting as well as scrutinising the approach taken by management to the key areas of judgement in preparing the financial statements (see the section on Significant Judgements on page 59).

About the Committee

Committee membership	Attendance during 2018
John Hirst (Chair)	4/4
Martin Broadhurst	4/4
Geeta Gopalan	4/4
Victoria Hull	4/4
Sir Robert Walmsley	4/4

The Chair 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.

In addition to the members of the Committee, regular attendees included the Chair, Chief Executive Officer and the Group Finance Director. The General Counsel and Company Secretary is the Secretary to the Committee.

Deloitte is the Group's external auditor and is represented at all scheduled Committee meetings, and the partner from PwC attends those meetings at which key findings from Internal Audit reports were reviewed by the Committee. During 2018, the Chair 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.

JOHN HIRST
Chair of the Audit Committee

Audit Committee Report continued

Activity during 2018

Financial statements and accounting policies

- Review management's significant issues and judgements.
- Review 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 of the annual and interim financial statements and related results announcements.
- The Committee discussed the key accounting policies and practices adopted by the Group.
- It also reviewed the key accounting judgements and matters that required the exercise of significant management judgement (see section on Significant Judgements on page 59).
- The Committee reviewed the underlying assumptions and the rigour of the testing underpinning the going concern statement and long-term viability statement (which are set out on pages 42 and 43) prior to approving them.

Internal controls and financial control frameworks

- 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 discussed the Internal Controls Status Report which summarised the results from the six-monthly divisional internal control review meetings.
- The Committee reviewed the principal risks, the Group's risk appetite and risk metrics and considered their alignment to the achievement of Ultra's strategic objectives.
- An assessment was undertaken of the key controls in place and future planned management actions to address the risks.
- The Committee considered reports on known or suspected fraud.

Further details of the approach to risk management can be found on pages 34 and 35.

Internal audit

- Review the effectiveness of the Internal Audit function.
- Discuss control issues identified by Internal Audit.

- Following its review of the adequacy of the internal control framework for the Group, the Committee agreed the Internal Audit plan for the year.
- The Committee considered summary reports from the risk-based and rotational reviews and progress reports on the implementation of remedial actions, noting the progress made in the control environment within the Group's businesses. It also considered the controls around the ERP Programme rollout, and the results of a review across a number of the businesses assessing compliance against the contract management policies.

External audit, engagement and policy

- Review the scope and effectiveness of the external audit process.
- Negotiating the terms of the external auditor's appointment, the scope, fees and independence.
- Supervising any audit tender process.

- The Committee considered Deloitte's external audit planning report prior to the commencement of the 2018 audit.
- The Committee received reports from the external auditor on the outcomes of their audit process and the external audit plan for the year.
- The Committee discussed Deloitte's letter to management and management responses to that letter.
- The Committee reviewed the external auditor's engagement policy, independence and effectiveness, and audit and non-audit fees.

Significant judgements

The Audit Committee considered the areas of most significant accounting judgement and disclosure both prior to and during the course of the 2018 year-end external audit.

Judgement area	Committee assessment
Valuation and impairment testing of goodwill and intangible assets	The Committee reviewed the methodology and assumptions used to determine the balance sheet carrying values, including the discount rates and value in use determinations. The Committee considered the recoverability of the goodwill relating to the C2ISR CGU grouping, and sensitivity disclosures made, in light of the development contract cost overruns at Herley in the year. The Committee also considered the implications of the disposal of the Airport Systems business in relation to the Infrastructure CGU goodwill.
Accounting updates – IFRS 9 (Financial Instruments); IFRS 15 (Revenue from Contracts with Customers); IFRS 16 (Leases)	Updates on the implementation of the new IFRS requirements and their impact on the financial statements and disclosure were presented and considered by the Committee.
Long-term contract accounting	The Committee considered the judgements taken in the forecast cost to complete estimates for significant contracts.
Pension scheme obligations	The Committee considered the current funding level of the pension scheme and the liabilities of the Defined Benefit Pension Scheme, and the impact of the High Court ruling in October 2018 against Lloyds Banking Group that impacts many UK businesses with regards to Guaranteed Minimum Pensions (GMP) Equalisation.

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.

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 has delegated control ownership to each of the businesses and established a framework for reporting whether the controls are designed and operating effectively. Every six months, Divisional Internal Control Meeting (DICM) meetings are attended by the Group Finance Director, the Divisional Finance Director and by Internal Audit.

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

- Self-assessment against the Group Operating Manual.
- Outstanding Internal and External Audit recommendations.
- Review of segregation of duties.
- Review of reconciliations.

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

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

The Committee's focus for 2019

In addition to the annual routine matters for consideration, the main areas of focus for the Committee for 2019 will be:

- Focusing on the risks highlighted in the 2018 internal audit.
- Overseeing the transfer of GDPR processes from a change programme to business as usual.

Internal audit

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

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

Audit Committee Report continued

The lead Partner from PwC reports directly to the Chair 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 Chair of the Committee without management being present and views from senior management and the Group Finance Director.

External auditor

The performance, effectiveness and independence of the Company's external auditor, Deloitte, is reviewed annually by the Committee. The Committee received a briefing by Deloitte on the firm's policies on these matters and noted that such policies are subject to external monitoring by the Audit Quality Review Team, which is a part of the FRC's Conduct Division. The FRC's Audit Quality Review Team selected to review the audit of Ultra's 2017 Annual Report as part of the 2018 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 Chair of the Audit Committee received a full copy of the findings and discussed these with Deloitte. The Audit Committee confirms that there were no significant areas for improvement identified with 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.

The Committee believes that sufficient and appropriate information is obtained to form an overall judgement on the effectiveness of the external audit process. The Committee concluded that Deloitte had been sufficiently transparent and incisive and that the audits had been effective. In addition, the Committee concluded that Deloitte was both independent and objective and that the reappointment of Deloitte as external auditor should be recommended to the shareholders.

Accordingly, a resolution to reappoint Deloitte will be put to shareholders at the 2019 Annual General Meeting.

The senior audit partner employed by Deloitte on the Group's audit is subject to a strict policy of regular rotation such that there is a change in this role at least once every five years. This is in accordance with professional practice guidelines.

Deloitte was appointed in 2002. A new partner was appointed in 2016. The Committee considers that for an organisation of the size and complexity of Ultra, the tendering of external audit must be well planned to ensure that the Group complies with best practice corporate governance as well as ensuring the Group receives a high-quality, efficient and effective external audit service.

The Committee considers that it would be appropriate to conduct an External Audit tender by no later than 2023 at which point Deloitte would be precluded from being Ultra's external auditor. The Company is in compliance with the requirements of the Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 and the Corporate Governance 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.

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 Chair 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 Chair of the Committee, as appropriate, must ensure that the external auditor is satisfied that there is no issue regarding independence and objectivity and that other potential providers are adequately considered. In providing a non-audit service, the external auditor should not: audit their own work; make management decisions for the Company; create a mutuality of interest; or find themselves in the role of advocate for Ultra. The policy for engagement of the external auditor to undertake non-audit work will be reviewed during 2019.

Ultra has adopted a policy which restricts on non-audit fees arising from EU audit legislation. From 2020, the maximum non-audit fees that the statutory auditor can bill in any one year is set at 70% of the average of the audit fees billed over the preceding three years. All non-audit services provided by Deloitte in the year will be tracked relative to this cap.

The Committee considers that certain non-audit services should be provided by the external auditor, because its existing knowledge of the business makes it the most efficient and effective way for non-audit services to be carried out. In 2017 Deloitte provided non-audit services related to the Sparton acquisition. Being a Class 1 transaction, a significant amount of non-audit work was required and the scope and fees for the work was agreed by the Audit Committee prior to commencement. The fees paid to Deloitte in respect of audit and non-audit services are shown on page 99 of the Financial Statements.

Fraud

The Internal Audit process, carried out by PwC, described on page 59, 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 Chief Executive Officer review the performance of the businesses with the Divisional team monthly. Significant differences between forecast and reported financial results are highlighted and require explanation by the business unit concerned.

The internal control framework that is in place is supplemented by the External Audit process which represents a second independent review of controls and procedures, with selective transaction testing of higher risk areas. There is a fraud reporting process in place. All cases of fraud would be immediately investigated and the situation reported to the Committee and the Board.

Whistleblowing

An independently hosted Employee Hotline (EthicsPoint) is used to provide a process for reporting ethical concerns. Such concerns can be filed anonymously. Employees are informed of this process through posters (which are translated into local languages) and through the Group intranet. Employee concerns are forwarded to the Senior Independent Director or, in the case of issues covered by US security legislation, to the Chair of the Security Committee of either Ultra's Special Security Agreement Company or Ultra's Proxy Board Company, as appropriate. During 2018, two reports were filed via this system (one for an HR matter and one an unsolicited invitation to a conference). Each of these reports were reviewed as received, responses were provided promptly via the system, and the matters were subsequently closed.

Anti-bribery

Ultra has anti-bribery policies and procedures in place, which it continues to review on a regular basis, and update as required. All Directors and employees are required to sign Ultra's code of conduct on anti-bribery and commit to act in accordance with it. All new-starters at Ultra are also required to undertake anti-bribery training, and then subsequently on a regular basis. Additional anti-bribery training is given as appropriate; it is intended that focused anti-bribery training will be delivered across the Ultra Group during the year ahead. The Group intranet contains a statement regarding compliance with Ultra's anti-bribery policies.

Directors' Remuneration Report

"I am pleased to present the Remuneration Report, as prepared by the Remuneration Committee for the financial year ended 31 December 2018."

MARTIN BROADHURST
Chair of the Remuneration Committee

KEY ACTIVITIES OF THE COMMITTEE

- Considered Appointment Terms of Chief Executive Officer; Chair Designate and new Executive Team members.
- Reviewed salaries of the Group Finance Director and the Executive Team.

1. ANNUAL STATEMENT

Dear Shareholder,

As the Chair of the Remuneration Committee, I am pleased to present the Remuneration Report, as prepared by the Remuneration Committee and approved by the Board, for the financial year ended 31 December 2018. It has been prepared in accordance with Schedule 8 of The Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 as amended in August 2013 and has been divided into the following three sections:

1. This ANNUAL STATEMENT, which summarises the major decisions on, and any substantial changes to, Directors' remuneration;

2. The DIRECTORS' REMUNERATION POLICY, which sets out Ultra's policy on the remuneration of Executive and Non-Executive Directors; and

3. The ANNUAL REPORT ON REMUNERATION, which discloses how the Remuneration Policy was implemented in the financial year ended 31 December 2018 and how the Remuneration Policy will be implemented in the financial year ending 31 December 2019.

Board changes

During the year, the Committee considered the appointment terms of Simon Pryce as Chief Executive Officer, which are in line with the shareholder-approved Policy. The Chief Executive Officer was appointed on a base salary of £665,000. The maximum annual bonus potential is 125% of salary, which is pro-rated for service in 2018. Shortly after his arrival, a long-term incentive grant was made equal to 175% of salary which will vest three years from the date of grant, subject to performance conditions and in line with awards granted to the Group Finance Director and members of the Executive Team during the year. In line with the Policy, a two-year post-vesting holding period applies and the Chief Executive Officer is required to retain at least 50% of the post-tax shares received on the vesting of this award until he has met the share ownership guidelines. These requirements will also apply to any future Long-Term Incentive Plan (LTIP) awards. This award level is made under the exceptional limit of the policy and future awards will be limited to the normal annual limit. The Committee believes the total package reflects Simon's extensive skills, experience and track record that he brings to the Company.

Douglas Caster reverted to the role of Non-Executive Chair from 18 June 2018, the date of appointment of the Chief Executive Officer. His remuneration returned to the previous arrangements from that date.

Performance and reward during 2018

In 2018, revenue and underlying operating profit* were £766.7m (2017: £775.4m) and £112.7m (2017: £120.1m) respectively; underlying earnings per share* was 109.5p (2017: 116.7p); underlying operating cash flow was £89.3m (2017: £116.5m); and total shareholder return was -5% (2017: -2%).

Bonuses for 2018 were based on underlying operating profit (25% of the maximum bonus opportunity) and underlying operating cash flow (75% of the maximum bonus opportunity). Based on the business performance stated above and in accordance with the design of the bonus plans, a bonus payout of 70.6% of the maximum opportunity was therefore achieved.

As a result, bonuses of 88.25% of base salary versus a maximum opportunity of 125% of base salary were awarded to the Executive Directors. In line with the Policy, 20% of the bonus is deferred into shares for three years. As noted above, the Chief Executive Officer's bonus is pro-rated for time served.

The 2016 LTIP awards due to vest in 2019 will not vest as a result of TSR targets not being met over the three-year period to 31 December 2018.

Key activities of the Committee during 2018

In addition to the Board change-related activities outlined above, the Committee also reviewed the salaries of the Group Finance Director and the Executive Team, approved the offers for all new members of the Executive Team appointed in 2018 and reviewed and approved changes to the Bonus Plan design for the Executive Team for 2019. It also approved the targets for the 2019 bonus plans and the LTIP performance for awards that were due to vest in 2018. The Committee has continued to monitor developments in corporate governance and has considered changes to the UK Corporate Governance Code and UK secondary legislation to amend the annual report regulations under the Companies Act 2006. Requirements under both of these will apply from the 2019 financial year, and will be reflected in next year's Annual Report and Accounts.

* See footnote on page 145.

Implementation of the Policy for 2019

In the latter part of 2018 and moving into 2019, the Committee has been working, and will continue to work on changes to our reward strategy that better align with our overall business strategy and objectives.

As a result, for the 2019 Executive Directors' bonus plan, whilst the overall bonus opportunity remains at 125% of base salary, we have adjusted the relative weightings between cash and profit metrics to 45% and 40% of maximum, respectively (2018: 75% and 25%), which reflects the relative importance of profit delivery alongside cash. Further, the cash metric will be linked to average working capital turn improvement during the year rather than underlying operating cash flow at the mid-year and year-end in order to improve business practices and culture.

In addition, individual performance objectives will apply to the remaining 15% of maximum bonus. These are targeted against four categories: delivering business results; creating efficiencies and productivities; driving strategic growth; and improving the organisation's health and have also been introduced to focus Ultra's business leaders on objectives that will help meet our short-term goals and longer-term aspirations, whilst also improving the overall engagement and retention of existing staff across the business.

In 2019, the Committee will be reviewing our overall Group compensation strategy, philosophy, processes and governance. The Committee will also review the outputs of a project looking at introducing a consistent job-levelling architecture across the organisation. Additionally, we will be reviewing our Long-Term Incentive Plans, in order to make sure our senior business leaders are incentivised to focus on delivering long-term, sustainable value for the overall Group.

For the 2019 financial year, the Committee has determined to increase the Group Finance Director’s salary by 2% from £350,000 to £357,000. This increase takes into account the salary increase of 9.38% awarded in 2018 to position the Group Finance Director at an industry-competitive level and is in line with the overall salary budgets for the rest of the organisation and general industry market movements. The Committee also reviewed the salary of the Chief Executive Officer and decided not to increase the salary due to the salary being competitively positioned at the time of joining the Company in June 2018. The Committee intends to grant a Long-Term Incentive award of 150% to the Chief Executive Officer and 125% to the Group Finance Director, with metrics and weightings unchanged.

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
Chair of the Remuneration Committee

Directors' Remuneration Report continued

2. DIRECTORS' REMUNERATION POLICY

The Policy described in this section was approved by shareholders at the 2017 AGM on 28 April 2017. Minimal wording changes have been made to the Policy below to reflect the approval of the Long-Term Incentive Plan (LTIP) at the 2016 AGM, to remove the legacy pension arrangement for the former Chief Executive Officer and to update the scenario charts for the 2019 Executive Director remuneration levels. The full version of the Policy approved by shareholders can be found in the 2016 Annual Report available online at www.ultra-electronics.com.

Policy overview

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

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

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

Directors' Remuneration Report continued

2. DIRECTORS' REMUNERATION POLICY continued

How the remuneration element supports our strategy	Operation of the remuneration element	Maximum potential	Performance targets
SHARE OWNERSHIP GUIDELINES To provide alignment of interests between Executive Directors and shareholders	Executive Directors are required to build and maintain a shareholding equivalent to two years' base salary through the retention of at least 50% of the post-tax shares received on the vesting of LTIP awards and at least 50% of the post-tax shares received upon vesting of the deferred bonus	n/a	Aim to hold a shareholding equal to 200% of base salary for all Executive Directors
ALL-EMPLOYEE SHARE PLANS The Executive Directors are eligible to participate in the Company's UK tax-advantaged All-Employee Share Ownership Plan (AESOP) and the Savings Related Share Option Scheme on the same terms as other employees To encourage employee share ownership and increase alignment with shareholders	Under the AESOP, UK employees are offered the opportunity to buy shares at market value from pre-tax salary. Shares are normally held in trust until the maturity date or until employment with Ultra ends Under the Savings Related Share Option Scheme, employees are entitled to save from post-tax pay for the purchase of Ultra shares at a discount of up to 20%	Under the AESOP, up to the prevailing HMRC limits, or any lower limit set by Ultra, per annum from pre-tax salary Under the Savings Related Share Option Scheme, up to the prevailing HMRC limits, or any lower limit set by Ultra, per annum from post-tax salary	n/a
NON-EXECUTIVE DIRECTOR FEES Reflects time commitments and responsibilities of each role Reflects fees paid by similar-sized companies to ensure that the Company attracts Non-Executive Directors of the highest calibre and with the right skills, knowledge and experience to support our strategy The Chair'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 12-month contracts with no notice periods An additional fee is paid to the Chair 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 2019 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. Underlying operating cash conversion and profit are both Key Performance Indicators of the Group. The performance conditions applicable to the LTIP 2019 awards were selected by the Committee on the basis that:
- Total Shareholder Return (TSR), one of the Group's Key Performance Indicators, aligns the performance objectives of the Executive Directors more closely with the interests of the shareholders;
- Organic revenue growth provides an indication of the rate at which the Group's business activity is expanding;
- Organic operating profit growth demonstrates that the additional revenue is being gained without profit margins being compromised; and
- ROIC is felt to be an appropriate measure for the Company to focus on over the medium to long term and an appropriate measure of how well the Company is performing and being managed.

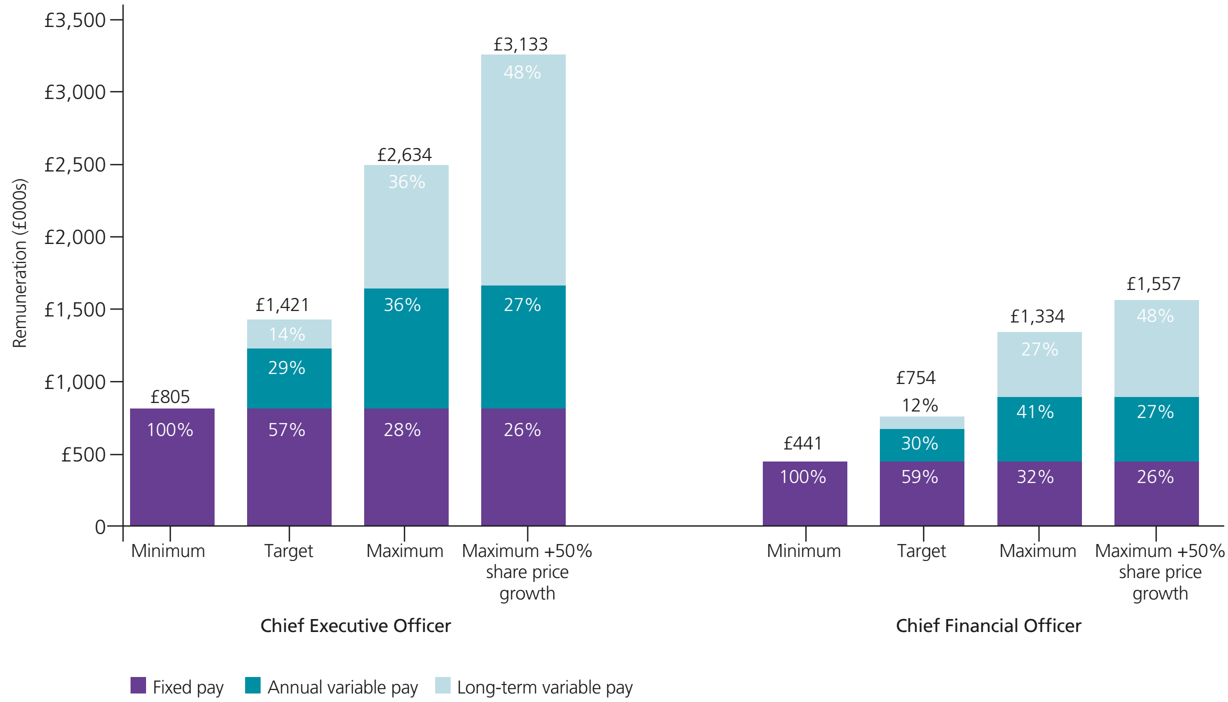
(4) None of the employee share plans operate performance conditions.

(5) As highlighted above, Ultra has a share ownership policy which requires the Executive Directors to build up and maintain a target holding equal to 200% of base salary. Details of the extent to which the Executive Directors had complied with the policy are set out on page 73.

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

Remuneration 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.



Notes to remuneration scenarios:
(1) Base salary levels are based on those applying from 1 April 2019.
(2) Benefit values for 2019 have been based on 2018 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 Officer and 125% of salary for the Group Finance Director which vests in full at maximum performance, while 20% is assumed to vest at target level of performance.
(5) For maximum plus 50% growth, LTIP awards vest at maximum performance, with an assumed share price increase of 50% over the performance period.

Directors' Remuneration Report continued

2. DIRECTORS' REMUNERATION POLICY continued

Director recruitment policy

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

Salary

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

Short-term incentives

Short-term incentives are offered in line with those paid to other Executive Directors. Maximum opportunities will be in line with current plan maximums for existing Executive Directors (i.e. 125% of salary p.a.). The Company may also apply different performance measures if it feels 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.

Buyouts

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 Directors' service contracts

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

Name	Effective date of contract	Notice Period
S Pryce	18 Jun 2018	12 months
A Sharma	2 May 2016	12 months

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

External appointments of Executive Directors

Executive Directors may accept no more than one external appointment as a Non-Executive Director (excluding Chair). 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.

3. ANNUAL REPORT ON REMUNERATION

Implementation of the Directors' Remuneration Policy in 2019

A summary of how the Directors' Remuneration Policy will be applied for the year ending 31 December 2019 is set out below.

Salaries

Salary increases are effective from 1 April 2019 and the increases for the Executive Directors are in line with those for the wider workforce. Current Executive Director salary levels, and increases effective in April 2019, are as follows:

	2019 Salary £'000	2018 Salary £'000	Increase awarded from 1 April 2019 %
S Pryce	665	665	0
A Sharma	357	350	2

S Pryce hired in June 2018 so less than 1 year service, salary will be reviewed in 2019.

Directors' pension entitlements

Simon Pryce and Amitabh Sharma receive an annual Company contribution of 18% of salary. Simon receives this as a cash allowance in lieu of pension contribution. Amitabh can elect to receive cash supplements in lieu of pension contributions to the Company defined contribution scheme on a cash-neutral basis where he has exceeded the annual allowance or the lifetime allowance.

Non-Executive Directors' fees

Non-Executive Directors' fees will increase by 5.6% from 1 April 2019 to re-align with market levels (the Chair's fees remains unchanged). The fee structure is as follows:

	Fees £'000
Chair	202
Non-Executive Director	56
Senior Independent Director	7.5
Committee Chair	7.5

Annual bonus for 2019

The maximum bonus for Executive Directors in 2019 will be 125% of base salary; 20% of the bonus paid will be deferred into Ultra shares for three years.

Up to 40% of maximum will be payable for the achievement of an agreed profit target, up to 45% payable for the achievement of an agreed improvement in average working capital turn and up to 15% payable for the achievement of individual objectives. 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 improvement in average working capital turn target, vesting occurs on a straight-line basis from threshold to maximum. For the individual measure 0% of the maximum is awarded for below expectations performance against aligned personal objectives with a maximum payable for exceeds expectations performance rating.

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

Long-term awards to be granted in 2019

Consistent with the Directors' Remuneration Policy, the Committee intends to grant an annual LTIP award in the form of shares worth 150% of salary for the Chief Executive Officer and 125% of salary for the Group Finance Director during 2019.

For 2019, 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 operating profit: 25%
- Annual growth in organic revenue: 25%

Directors' Remuneration Report continued

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

* See footnote on page 145.

Single total figure of remuneration – Audited

Directors' emoluments are detailed below:

	Basic salary/fees £'000	Benefits[6] £'000	Pension[7] £'000	Subtotal £'000	Annual performance bonus[8] £'000	LTIP[9] £'000	Subtotal £'000	Total £'000
2018								
Executive Directors								
S. Pryce[1, 2]	358	11	64	433	317	–	317	750
D. Caster[3,4]	275	9	–	284	–	–	–	284
A. Sharma	343	20	61	424	302	–	302	726
Non-Executive Directors								
D. Caster[5]	101	–	–	101	–	–	–	101
M. Broadhurst	58	–	–	58	–	–	–	58
G. Gopalan	53	–	–	53	–	–	–	53
J. Hirst	58	–	–	58	–	–	–	58
V. Hull	53	–	–	53	–	–	–	53
Sir Robert Walmsley	58	–	–	58	–	–	–	58
Total	**1,357**	**40**	**125**	**1,522**	**619**	**–**	**618**	**2,141**

1 Simon Pryce joined as a Director on 18 June 2018.
2 Simon Pryce is a Non-Executive Director of Electrocomponents. Simon received fees of £36,667 in relation to this role for the period 18 June 2018 to 31 December 2018.
3 Douglas Caster transferred from Executive Chair to Chair on 18 June 2018. Remuneration is shown in respect of his time as Executive Chair.
4 Douglas Caster was a Non-Executive Director of Morgan Advanced Materials (now Non-Executive Chair) and is Non-Executive Chair of Metalysis. During his appointment as Executive Chair, Douglas received fees of £68,450 in aggregate in relation to these roles.
5 Douglas Caster transferred from Executive Chair to Chair on 18 June 2018. Remuneration is shown in respect of his time as Chair.
6 Benefits are taxable car benefit, life assurance and private medical insurance (Douglas Caster did not receive private medical insurance whilst Executive Chair). No other benefits are payable.
7 Pensions: Simon Pryce received a cash supplement in lieu of pension contribution of 18% of salary. Amitabh Sharma received pension contributions of 18% of basic salary, part cash supplement part pension contribution.
8 20% of this bonus is deferred into shares for three years.
9 No current Executive Directors have LTIP awards vesting in the year.

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

1 Douglas Caster transferred from Chair to Executive Chair on 10 November 2017. Remuneration is shown in respect of his time as Executive Chair.
2 Douglas Caster was a Non-Executive Director of Morgan Advanced Materials (now Non-Executive Chair) and is Non-Executive Chairman of Metalysis. Since his appointment as Executive Chair, Douglas received fees of £23,976 in aggregate in relation to these roles.
3 Douglas Caster transferred from Chair to Executive Chair on 10 November 2017. Remuneration is shown in respect of his time as Chair.
4 Rakesh Sharma ceased to be a Director on 10 November 2017.
5 Rakesh Sharma is a Non-Executive Director of PayPoint. Rakesh received fees of £23,300 in relation to this role for the period 1 January 2017 to 10 November 2017.
6 Mark Anderson ceased to be a Director on 1 June 2017 and left the Group on 31 October 2017.
7 Geeta Gopalan and Victoria Hull joined the Board on 28 April 2017.
8 Benefits comprise: taxable car benefit, life assurance and private medical insurance (Douglas Caster did not receive private medical insurance during his time as Executive Chair).
9 Pensions: Rakesh Sharma received a cash supplement in lieu of pension contribution of 36.4% of salary. Amitabh Sharma, who is an eligible member (and Mark Anderson, who was an eligible member) of the defined contribution scheme, received pension contributions of 18% of basic salary. Amitabh Sharma can also elect to receive cash supplement given in lieu of pension contributions on a cash-neutral basis where he has exceeded the annual allowance or the lifetime allowance.
10 No current Executive Directors have LTIP awards vesting in the year.

Annual bonus for year under review – Audited

Annual bonuses in relation to 2018 were based upon the achievement of a sliding scale of underlying profit before tax and underlying operating cash flow targets. Targets were derived from the annual budgets approved by the Board and 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 pages 10 and 11 for details.

The bonus targets set by the Committee for 2018 were: a maximum of 31.25% of salary (subject to the achievement of £101.4m* underlying profit before tax); and a maximum of 93.75% of salary (subject to achieving an underlying operating cash flow of £100.8m* 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 Committee assessed the achievement of performance against each target as follows:

	Threshold[1] (0% payable) £'000	Maximum (100% payable) £'000	Actual achieved £'000	Bonus payable %
Underlying profit before tax	91,244	101,382	101,379	31.25%
Underlying operating cash flow*	70,560	100,800	89,253	57.00%

1 The underlying operating cash flow element is payable only if the profit element achieves threshold.

The Committee determined that bonuses of 88.25% of salary would be payable to the Executive Directors. The bonus for Simon Pryce was pro-rated to reflect time served in the year. In line with the policy, 20% of any bonus awarded is deferred into shares for three years. Accordingly bonuses for the Executive Directors were as follows:

	% of maximum	% of salary	Cash bonus £'000	Deferred bonus £'000	Total bonus £'000
S. Pryce	70.6	88.25	254	63	317
A. Sharma	70.6	88.25	242	60	302

LTIP vesting for year under review – Audited

No awards vested to Executive Directors in 2018.

* See footnote on page 145.

Directors' Remuneration Report continued

Share awards granted during the year – Audited

	Scheme	Date of grant	Basis of award	Face value[3] £'000	Number of shares	Vesting at threshold	Vesting at maximum	Performance period
S. Pryce[1, 2]	LTIP*	2 July 2018	175% of salary	1,164	71,978	20%	100%	3 years to 31 December 2020
A. Sharma[2]	LTIP*	20 March 2018	125% of salary	400	28,145	20%	100%	3 years to 31 December 2020

* Structured as nil cost options. The 2018 grant is subject to a two- year holding period.

1 In line with the policy, Simon Pryce received an LTIP grant equivalent to 175% of salary on appointment.
2 In addition, Simon Pryce purchased 30 Partnership shares and Amitabh Sharma purchased 120 Partnership shares and received six Dividend Shares under the AESOP during 2018.
3 Face value of the award calculated at time of grant using the average of the five previous days' mid-market price of 1616.8p for Simon Pryce and 1392p for Amitabh Sharma.

For the awards presented above, four performance metrics apply, which are equally weighted:

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

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

Change in Chief Executive Officer's remuneration

The following table illustrates the change (as a percentage) in elements of the Chief Executive Officer's remuneration from 2017 to 2018, and compares that to the average remuneration of employees of the Group in the UK, excluding the Chief Executive Officer, who were employed on 1 January 2017 and 1 January 2018. This group best reflects the remuneration environment of the Chief Executive Officer. The Chief Executive Officer combines the remuneration of Douglas Caster for his period as Executive Chair, with that of Simon Pryce from his appointment as Chief Executive Officer.

	Chief Executive Officer/Executive Chair % change	All UK employees % change
Salary	6.0	5.1
Taxable Benefits	-35.4	5.1
Bonus	†	31.6

† Increased from £nil to £317,000.

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:

	2018 £m	2017 £m	Change %
Staff costs[1]	**252.7**	259.0	-2.4
Dividends[2]	**37.0**	38.4	-3.6
Revenue[3]	**766.7**	775.4	-1.1
Statutory profit before tax[3]	**42.6**	60.6	-29.7

1 £1.1m (2017: £1.5m) 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.

Payments for loss of office and payments to past Directors – Audited

No payments were made to Directors for loss of office and no payments were made to past Directors, other than the arrangements for Rakesh Sharma disclosed in last year's report.

Statement of Directors' shareholdings – Audited

	Legally owned		LTIP awards[1]	AESOP		SAYE				
	2018	2017	Unvested	Restricted[2]	Unrestricted	Under option	Exercised	Total	% Share ownership guidelines	Share ownership met Y/N
Executive Directors										
S. Pryce	13,820	–	71,978	20	–	830	0	86,628	200%	N
A. Sharma	8,026	7,371	47,101	274	–	794	0	55,921	200%	N
Non-Executive Directors										
D. Caster	308,160	308,160	–	–	–	–	–	308,160	–	–
M. Broadhurst	1,600	1,600	–	–	–	–	–	1,600	–	–
G. Gopalan	–	–	–	–	–	–	–	–	–	–
J. Hirst	4,055	4,055	–	–	–	–	–	4,055	–	–
V. Hull	1,684	1,684	–	–	–	–	–	1,684	–	–
T. Rice	–	–	–	–	–	–	–	–	–	–
Sir Robert Walmsley	3,000	3,000	–	–	–	–	–	3,000	–	–

1 There were no vested LTIP share awards within the period.
2 The restricted shares under the AESOP are held in the Ultra Electronics Holdings plc Employee Benefit Trust.

Directors' Remuneration Report continued

Total shareholder return graph and single figure remuneration table

The graph below shows the TSR performance of Ultra in comparison with the FTSE 250 Index over the past ten years. The graph shows the value at the end of 2018 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.

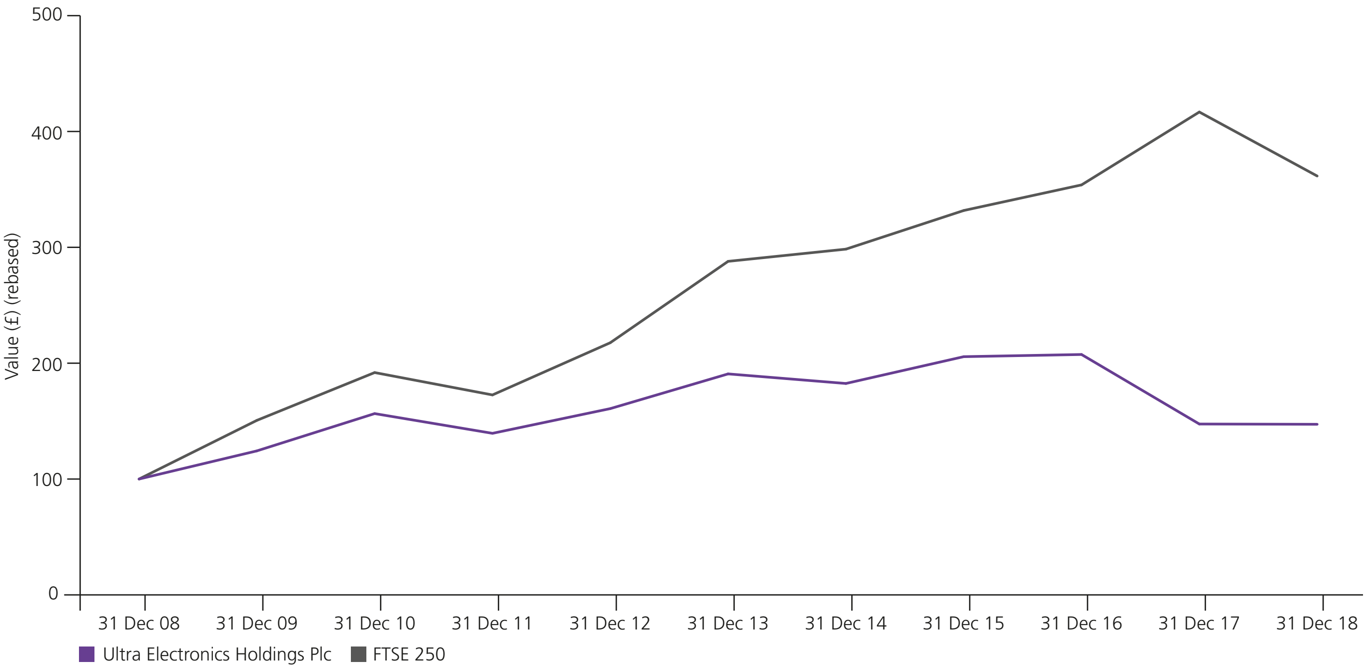
Total shareholder return – compared to FTSE 250 Index

	TSR (rebased to 100)	
Date	Ultra Electronics Holdings Plc	FTSE 250
31 December 2008	100.00	100.00
31 December 2009	124.29	150.64
31 December 2010	156.49	191.91
31 December 2011	139.46	172.60
31 December 2012	160.79	217.66
31 December 2013	190.75	287.90
31 December 2014	182.48	298.43
31 December 2015	205.62	331.78
31 December 2016	207.50	353.88
31 December 2017	147.49	416.80
31 December 2018	147.26	361.57

This graph shows the value, by 31 December 2018, of £100 invested in Ultra Electronics Holdings Plc on 31 December 2008, compared with the value of £100 invested in the FTSE 250 Index on the same date.

The other points plotted are the values at intervening financial year-ends.

Total shareholder return
Source: FactSet



Total shareholder return graph and single figure remuneration table

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

	Year ended	Total remuneration £'000	Annual bonus % max. payout	LTIP % max. payout
S. Pryce[1]	31 December 2018	750	71	–
D. Caster[2]	31 December 2018	284	–	–
D. Caster[3]	31 December 2017	81	–	–
R. Sharma[4]	31 December 2017	765	–	–
R. Sharma	31 December 2016	1,194	82	–
R. Sharma	31 December 2015	1,197	88	–
R. Sharma	31 December 2014	680	–	–
R. Sharma	31 December 2013	612	–	–
R. Sharma	31 December 2012	597	–	–
R. Sharma[5]	31 December 2011	722	76	–
D. Caster[6]	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 Officer from 18 June 2018.
2 Executive Chair to 18 June 2018.
3 Executive Chair from 10 November 2017.
4 Chief Executive Officer to 10 November 2017.
5 Chief Executive Officer from 21 April 2011.
6 Chief Executive Officer to 21 April 2011.

Statement of Shareholder Voting

At the 2018 Annual General Meeting, the 2017 Directors' Remuneration Report received the following votes from shareholders:

	Total number of votes	% of votes cast
Votes for	63,109,042	99.73
Votes against	172,420	0.27
Total votes cast (for and against)	63,281,462	100
Votes withheld	613,029	
Total votes cast (including withheld votes)	63,894,491	

At the 2017 Annual General Meeting, the 2016 Director's Remuneration Policy received the following votes from shareholders:

	Total number of votes	% of votes cast
Votes for	59,669,864	99.33
Votes against	402,746	0.67
Total votes cast (for and against)	60,072,610	100
Votes withheld	656,074	
Total votes cast (including withheld votes)	60,728,684	

Directors' Remuneration Report continued

Directors' interests under Long-Term Incentive Plans

Details of the Directors' interests in these arrangements are given below:

Interests under the Ultra Electronics Long-Term Incentive Plan 2007 and the Ultra Electronics Long-Term Incentive Plan 2017

	S. Pryce	A. Sharma	Market price of shares granted	Crystallising dates of outstanding awards
2017 award	–	18,956	£21.10	March 2020
Interests at 1 January 2018	–	18,956		
2018 award (March)	–	28,145	£13.92	March 2021
2018 award (July)	71,978	–	£16.17	July 2021
Awards lapsed during the year	–	–		
Interests at 31 December 2018	71,978	47,101		

Mr Sharma did not receive a 2015 or 2016 LTIP award.

Directors' interests under the All-Employee arrangements

	Interests as at 1 January 2018	Shares acquired during year	Interests as at 31 December 2018	Shares acquired from 1 January 2019 to 1 March 2019	Interests as at 1 March 2019
S. Pryce	–	20	20	35	55
A. Sharma	148	126	274	35	309

Other than those purchased under the AESOP no other shares were purchased by Executive Directors in 2019.

During the year, the Employee Benefit Trust, established and operated in connection with the AESOP, purchased 32,958 (2017: 27,018) Ultra Electronics Holdings plc shares, with a nominal value of £1,648 (2017: £1,351) for £495,377 (2017: £515,711).

Directors' interests under the Save As You Earn arrangements

	Interests as at 1 January 2018	Share Options acquired during year	Interests as at 31 December 2018	Share Options acquired from 1 January 2019 to 1 March 2019	Interests as at 1 March 2019
S. Pryce	–	830	830	–	830
A. Sharma	794	–	794	–	794

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, Chair of the Board and senior management reporting to the Executive Directors (the Executive Team).
- Ensure that the Executive Directors are fairly rewarded for their individual contributions to the Group's overall performance with due regard to the interests of shareholders and to the financial and commercial health of the Group.
- Ensure that contractual arrangements, including the termination of Executive Directors, are fair both to the individuals concerned and to the Group.

The Committee's terms of reference include all matters indicated by the Code and are approved and reviewed by the Board annually. The terms of reference are available from the Investors' section of the Group's website (www.ultra-electronics.com/investor-centre).

Composition

Martin Broadhurst was Chair of the Committee and Sir Robert Walmsley, John Hirst, Geeta Gopalan and Victoria Hull were members throughout the year. The General Counsel and Company Secretary is Secretary to the Committee. Although not Committee members, amongst others, the Chair and Chief Executive Officer 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 the Executive Compensation practice of Aon plc. Aon is a member of the Remuneration Consultants Group and is a signatory to its Code of Conduct. Aon was appointed by the Committee after a tender process. During the year, Aon provided the Group with advice on the operation of Ultra's LTIP and other share schemes, remuneration benchmarking services and an annual update on market and best practice. During 2018, insurance broking services were also provided to the Group by other subsidiaries of Aon plc which the Committee considers in no way prejudices Aon's position as the Committee's independent advisers. Fees charged by Aon for advice provided to the Committee for 2018 amounted to £57,350 (excluding VAT) on a time and materials basis. Pension advisory services were provided to the Committee and the Group by Willis Towers Watson. The Committee considers Willis Towers Watson to be objective and independent. Fees charged by Willis Towers Watson for advice provided to the Committee for 2018 amounted to £88,270 (excluding VAT) on a time and materials basis, no other services have been provided to the Company by Willis Towers Watson. In addition, the Committee consults the Chief Executive Officer 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 2019 Annual General Meeting

The Committee encourages shareholders to vote in favour of the Directors' Remuneration Report resolution at the 2019 AGM. The Directors' Remuneration Report was approved by the Board on 6 March 2019 and signed on its behalf by:

MARTIN BROADHURST
Chair of the Remuneration Committee

Directors' Report

FOR THE YEAR ENDED 31 DECEMBER 2018

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 2018.

Results and dividends

The Group results for the year-ended 31 December 2018 are set out on page 3 of the Strategic Report.

The final 2018 dividend of 37.0 pence per share (2017: 35.0 pence per share) is proposed to be paid on 9 May 2019 to shareholders on the register of members on 12 April 2019. The interim dividend of 14.6 pence per share (2017: 14.6 pence per share) was paid on 22 September 2018, making a total of 51.6 pence per share in the year (2017: 49.6 pence).

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 £145.8m (2017: £161.1m) was spent on engineering and business development of which £117.7m (2017: £131.2m) was funded by customers and £28.1m (2017: £29.9m) by the Group.

Political expenditure

Neither the Company nor any of its subsidiaries have made any political donations during the year (2017: £nil).

Directors

Details of the Directors serving during the year are set out on pages 44 of the Corporate Governance Report. Martin Broadhurst, Geeta Gopalan, John Hirst, Victoria Hull, Amitabh Sharma and Sir Robert Walmsley will stand for re-election at the Annual General Meeting on 3 May 2019. Simon Pryce and Tony Rice will stand for election.

Directors and their interests

The Directors who served throughout the year and to the date of signing of this Report (see biographies on pages 44–45), and their interests in the shares and share options of Ultra at the end of the year and at 6 March 2019 are shown in the Annual Report on Remuneration (see page 73).

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 2018.

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 6,288,127 (2017: nil) ordinary shares and nil (2017: nil) ordinary shares were distributed following vesting of awards under the Ultra Electronics Long-Term Incentive Plan. At 31 December 2018, the Group held 227,174 ordinary shares under the Ultra Electronics Long-Term Incentive Plan (representing 0.3% of the ordinary shares in issue as at 31 December 2018).

Substantial shareholdings

As at 1 March 2019, being the latest practicable date prior to the approval of this report, Ultra had been notified of the following voting rights as shareholders of Ultra:

	Percentage of ordinary share capital	Number of 5p ordinary shares
Fidelity Management & Research Company	10.00	7,083,423
Fidelity International Limited	9.49	6,721,162
Invesco Ltd	6.54	4,630,632
Heronbridge Investment Management	6.11	4,331,165
Baillie Gifford & Co Ltd	4.93	3,490,258
Mondrian Investment Partners Ltd	4.86	3,588,536
Legal & General Investment Mgmt Ltd	4.86	3,443,207
Aberforth Partners LLP	4.81	3,403,594
BlackRock Inc	4.22	2,988,535
Aberdeen Standard Investments	3.99	2,824,639
Wellington Management Company	3.85	2,729,425
The Vanguard Group Inc	3.41	2,418,219

Capital structure

Details of the authorised and issued share capital, together with details of the movements in Ultra's issued share capital during the year, are shown in note 26. Ultra has one class of ordinary shares which carry no right to fixed income and each share carries the right to one vote at general meetings of Ultra.

There are no specific restrictions either on the size of a holding or on the transfer of shares, which are both governed by the general provisions of the Company's Articles of Association and prevailing legislation.

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/investor-centre).

Annual General Meeting

The next Annual General Meeting of Ultra will be held at 10.00 a.m. on 3 May 2019 at 417 Bridport Road, Greenford, Middlesex UB6 8UA. A separate circular providing details of the Annual General Meeting will be sent to shareholders with the 2018 Annual Report and Accounts.

Additional disclosure requirements

The following information which is required to be included in the Strategic Report and forms part of this Report may be found elsewhere in the Annual Report as follows.

Information	Location
Business review	Strategic Report: pages 28–33
Future developments	Strategic Report: pages 4–9
Corporate responsibility	Strategic Report: pages 22–27
The environment and greenhouse gas emissions	Strategic Report: page 26–27
Principal risks and uncertainties facing the Group	Strategic Report: pages 36–41
Business ethics and employment practices	Strategic Report: pages 18–21
Details of long-term incentive plans	Governance Report: pages 62–77 and note 26 to the financial statements
Corporate Governance	Governance Report: pages 46–53
Non-Financial KPI's	Strategic Report page 11
Financial Risk Management	Finance Report: pages 28–33 and note 22 to the financial statements

A non-financial information statement summarising the nature and location of non-financial disclosures within the Strategic Report is provided on page 11, in compliance with sections 414CA and 414CB of the Companies Act 2006. There is no other information to be disclosed pursuant to the requirements of the Listing Rule 9.8.4R.

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.

This Directors' Report was approved by the Board on 6 March 2019 and signed on its behalf by:

LOUISE RUPPEL
General Counsel and Company Secretary
Registered Office: 417 Bridport Road, Greenford, Middlesex, UB6 8UA
Registered Number: 02830397

Directors' Responsibility 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 on pages 3–43 and this Directors' Responsibilities Statement) was approved by the Board on 6 March 2019 and signed on its behalf by:

LOUISE RUPPEL
General Counsel and Company Secretary

Independent Auditor's Report

TO THE MEMBERS OF ULTRA ELECTRONICS HOLDINGS PLC

Opinion

In our opinion:

- the financial statements of Ultra Electronics Holdings plc (the 'parent company') and its subsidiaries (the 'group') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2018 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 Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which 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 and parent company statements of changes in equity;
- the statement of accounting policies; and
- the related notes 1 to 48.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Revenue and profit recognition • Management override of controls • Valuation of goodwill and intangible assets • Defined benefit pensions liabilities valuation Within this report, any new key audit matters are identified with ⇧ and any key audit matters which are the same as the prior year identified with ⇨.
Materiality	The materiality that we used for the group financial statements was £5.0m which was determined on the basis of 5% of underlying profit before tax.
Scoping	We focused our group audit scope primarily on the audit work at 17 (2017: 20) locations, 12 (2017: 12) of these were subject to a full audit, whilst the remaining 5 (2017: 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 17 locations accounted for 88% (2017: 88%) of group revenue and 86% (2017: 94%) of underlying profit before tax.
Significant changes in our approach	The reduced number of audit locations reflects amalgamations made by management of certain business units. There are no other significant changes to our audit approach.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement on page 42 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 and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We considered as part of our risk assessment the nature of the group, its business model and related risks including where relevant the impact of Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the directors' assessment of the group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the directors' plans for future actions in relation to their going concern assessment.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the group's and the company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 36 to 42 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on pages 34 to 35 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on page 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 are also required to report whether the directors' statement relating to the prospects of the group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Independent Auditor's Report continued

TO THE MEMBERS OF ULTRA ELECTRONICS HOLDINGS PLC

Revenue and profit recognition ⇒

Key audit matter description	The group recognised revenue of £766.7m in 2018 (2017: £775.4m). IFRS 15 was adopted on 1 January 2018 and all revenues are now accounted for under this standard. £462.7m of the 2018 revenue was recognised on an over time basis, and £304.0m on a point in time basis. There is a risk arising from either error or fraud, that revenue and profit is recognised incorrectly based on judgements within the cost to complete estimate of significant contracts. We consider that those contracts with a design phase have a heightened risk of cost escalation due to extended or unforeseen effort necessary to achieve contract milestones. Further, given the bespoke nature and the length of time to develop and manufacture many of Ultra's products and solutions, the contracts between Ultra and its customers can contain complex terms or contract variations and therefore there is also a risk that revenue is not recognised in accordance with such terms. Refer to page 131 (key sources of estimation uncertainty – contract revenue and profit recognition); page 133 (accounting policies – revenue recognition); page 59 (Audit Committee report – significant judgements considered; and page 98 (note 3 of the Financial Statements).
How the scope of our audit responded to the key audit matter	We assessed the adequacy of the design and implementation of controls over long-term contract accounting. To assess whether revenue recognised to date is based on the current best estimate of the degree of work performed under the contract, for a sample of contracts we reviewed the evidence for the progress made against the contract, such as milestone completion. To verify the margin achieved on contracts recognised over time, we sought to confirm the costs to complete, by agreeing to evidence of committed spend, budgeted rates or actual costs incurred to date when compared to the remaining work to be performed under the contract. We reviewed the contract risk registers to provide evidence over the judgement taken when providing for the cost of mitigating technical risks and meeting future milestones. We understood and challenged management's judgements by referring to evidence including signed contract terms and latest project status reports, and discussed contract progress and future risks with contract engineers. We also assessed the reliability of management estimates through consideration of the historical accuracy of prior period management estimates. For our sample of contracts, we made enquiries as to any unusual contract terms or side agreements separate to the original contract, in addition to testing a sample of billings and costs incurred to date.
Key observations	We considered the costs to complete and therefore the revenue and margin recognised on the sampled contracts to be appropriate, based on the assessment of the risks remaining in the contracts and work performed to date.

Management override of controls ⇒

Key audit matter description	We consider that the risk of error or fraud as a result of management override of controls is heightened in light of the revised full-year profit expectation communicated in June 2018. We therefore consider this to be a key audit matter. There are a number of areas within the Group financial statements which contain accounting estimates made by management or have been determined as a result of management's judgements as set out on page 131 (critical accounting judgements and key sources of estimation uncertainty), in particular those areas of judgement and estimation uncertainty related to contract revenue and profit recognition, the valuation of goodwill and intangible asset, and the valuation of pension liabilities. In addition, management also exercised judgement in the presentation of the Group's income statement, and the classification of items excluded from underlying profit measures, in particular the S3 programme as set out in note 2 to the financial statements. Accordingly, there is a risk that the Group's results are influenced through management bias in determining such estimates and judgements. This risk can manifest itself through the posting of invalid journals, recorded to influence the financial statements, which circumvent the controls in place to stop the recording of inappropriate journals.

How the scope of our audit responded to the key audit matter	We assessed the design and implementation of controls which address the risk of management override at both a business unit and a group basis. We reviewed the areas of judgement and estimation uncertainty related to the areas noted above to determine whether any evidence existed of management bias. Further details of our audit response are included in the other key audit matters. We challenged the distinction between underlying and non-underlying items of income or expense by considering the nature of each item. We reviewed the disclosure in note 2 to the financial statements to assess whether it is consistent with our understanding. We profiled the full year's transactions listing to identify manual journals displaying characteristics of potential fraud. For the journals identified together with the Group consolidation journals, we have understood the business rationale and obtained appropriate audit evidence to support the journal.
Key observations	We did not identify any material matters or bias arising from management override of controls.

Valuation of goodwill and intangible assets ⇒

Key audit matter description	The group held £377.8m (2017: £394.5m) of goodwill arising on its acquisitions made and £93.2m (2017: £118.4m) of acquired intangibles as at 31 December 2018. 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 in use, being the recoverable amount of these assets. This could therefore result in an impairment being required. This is particularly relevant given the volatility and uncertainty in defence spending in both new and traditional markets. As a result of the poor financial performance in 2018, we have focused this key audit matter on the following goodwill and acquired intangible asset balances: • goodwill attributable to the C2ISR cash generating unit group; and • certain acquired intangible assets associated with the Herley business. Refer to page 132 (Critical accounting estimates and assumptions – impairment testing); page 132 (accounting policies – goodwill); page 59 (Audit Committee report – significant judgements considered); and pages 103 to 105 (note 14 and 15 of the Financial Statements).
How the scope of our audit responded to the key audit matter	We assessed the adequacy of the design and implementation of controls over monitoring the carrying value of goodwill and acquired intangibles. We challenged the discount rate and cash flow assumptions used by management in their impairment assessment. We used valuation specialists within the audit team to benchmark the discount rate against independently available data, together with performing peer group analysis. We obtained support for secured orders and used our understanding of these orders to underpin the group's cash flow forecasts, considered external data on forecast market growth as well as management's assessment of the impact of Brexit, and reviewed the historical performance of the businesses. Having challenged the assumptions, we checked that the impairment model had been prepared on the basis of management's assumptions and was arithmetically accurate. We challenged the appropriateness of management's sensitivities based on our work performed on the key assumptions, and recalculated these sensitised scenarios. With regards to the disclosures within the Annual Report, we assessed whether they appropriately reflect the facts and circumstances within management's assessment of impairment over goodwill and acquired intangibles and specifically on the disclosure relating to the C2ISR cash generating unit group under a sensitised scenario.
Key observations	We are satisfied that headroom exists over the carrying value of the C2ISR cash generating unit group, and the acquired intangible assets associated with the Herley business, and therefore no impairment has been recognised. We consider that the disclosure in note 14 of a goodwill impairment to the C2ISR cash generating unit group within a sensitised scenario is appropriate.

Independent Auditor's Report continued

TO THE MEMBERS OF ULTRA ELECTRONICS HOLDINGS PLC

Defined benefit pensions liabilities valuation ⇒

Key audit matter description	The group operates defined benefit pension schemes in the UK, Switzerland and Canada. At 31 December 2018 the defined benefit pension scheme obligation was £370.7m (2017: £389.0m) which resulted in a net IAS 19 'Employment Benefits' deficit of £73.0m (2017: £82.7m). The UK scheme accounted for 98% of this net deficit. There is a risk that the assumptions used in determining the defined benefit obligation for the UK scheme are not appropriate, resulting in an inappropriate pension valuation which would have a material impact on the financial statements. The most sensitive assumption is the discount rate, and we also considered the assumptions relating to the Guaranteed Minimum Pensions ("GMP") equalisation. Refer to page 131 (key sources of estimation uncertainty – retirement benefit plans); page 135 (accounting policies – pensions); and page 59 (Audit Committee report – significant issues considered), and pages 120 to 123 (note 30 of the Financial Statements).
How the scope of our audit responded to the key audit matter	We 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 comparison with the peer group. Along with our specialist, we also assessed the additional liability in respect of GMP equalisation. We reviewed the suitability of the methodology used to value the defined benefit pension scheme obligation.
Key observations	Our assessment concluded that Ultra's pension assumptions overall lie in the middle of our acceptable range.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Materiality	£5.0m (2017: £5.5m)	£2.0m (2017: £2.2m)
Basis for determining materiality	5% (2017: 5%) of underlying profit before tax Underlying profit before tax is reconciled to statutory profit before tax in note 2 of the financial statements.	Parent company materiality represents less than 1% of net assets, but capped at 40% (2017: 40%) of the Group materiality.
Rationale for the benchmark applied	Underlying profit before tax is a key performance measure for the group and it is therefore an appropriate basis on which to determine materiality.	The parent company is non-trading, and we therefore consider that a balance sheet based metric is most appropriate to determine materiality. The parent company is also a component of the consolidated group financial statements, and so the determined materiality has been capped by the level of materiality identified for the component audits.

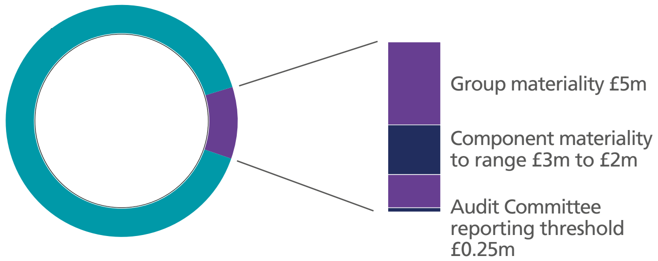
We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £250k (2017: £275k), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level. Based on that assessment, we focused our group audit scope primarily on the audit work at 17 (2017: 20) locations, 12 (2017: 12) of these were subject to a full audit, whilst the remaining 5 (2017: 8) were subject to either an audit of specified account balances or specified audit procedures where the extent of our testing was based on our assessment of the risks of material misstatement and of the materiality of the group's operations at those locations.

- Underlying PBT **101m**
- Group materiality

UNDERLYING PBT



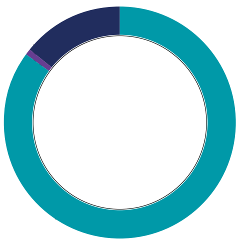
These 17 locations, which are largely located in the UK and USA, represent the principal business units and account for 88% (2017: 88%) of the group's revenue and 86% (2017: 94%) of the group's underlying profit before tax. They also provided an appropriate basis for undertaking audit work to address the risks of material misstatement identified above. Our audit work at the 17 units was executed at levels of materiality applicable to each individual entity, ranging from £2.0m to £3.0m (2017: £2.2m to £3.3m), which did not exceed 60% (2017: 60%) of group materiality.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

The group audit team follows a programme of planned visits that has been designed so that the Senior Statutory Auditor or another senior member of the group audit team visits each of the significant overseas component locations at least once every three years. Every year, regardless of whether we have visited or not, we include the component audit partner and other senior members of the component audit team in our team briefing, direct the scope of their work for the purposes of our group audit, discuss their risk assessment and review documentation of the findings from their work. In 2018, a senior member of the group audit team visited all of the UK components as well as the following overseas components: USSI, Herley, Ocean Systems, NSPI and ATS.

Full audit scope	**75%**
Specified audit procedures	**13%**
Review at group level	**12%**

REVENUE



Full audit scope	**85%**
Specified audit procedures	**1%**
Review at group level	**14%**

PROFIT BEFORE TAX

Independent Auditor's Report continued

TO THE MEMBERS OF ULTRA ELECTRONICS HOLDINGS PLC

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- *Fair, balanced and understandable* – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- *Audit committee reporting* – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- *Directors' statement of compliance with the UK Corporate Governance Code* – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management, internal audit and the audit committee, including obtaining and reviewing supporting documentation, concerning the group's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance. In particular, we considered the response in relation to the ongoing SFO investigation;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;
- discussing among the engagement team, including all component audit teams, and involving relevant internal specialists, including tax, valuations, pensions, and financial instruments, regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas:
  - manipulation of revenue and profit recognition to improve performance;
  - management bias within the critical accounting judgements and key sources of estimation uncertainty to improve performance;
- obtaining an understanding of the legal and regulatory framework that the group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the group. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules, pensions legislation and tax legislation.

Audit response to risks identified

As a result of performing the above, we identified key audit matters with respect to revenue and profit recognition, and management override of controls. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the audit committee and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with HMRC; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; challenging the presentation of the financial statements and the distinction between underlying and non-underlying items of income and expense, and; evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and all component audit teams, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

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

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Independent Auditor's Report continued

TO THE MEMBERS OF ULTRA ELECTRONICS HOLDINGS PLC

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records Under the Companies Act 2006 we are required to report to you if, in our opinion: • we have not received all the information and explanations we require for our audit; or • adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or • the parent company financial statements are not in agreement with the accounting records and returns.	**We have nothing to report in respect of these matters.**
Directors' remuneration Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the directors' remuneration report to be audited is not in agreement with the accounting records and returns.	**We have nothing to report in respect of these matters.**

Other matters

Auditor tenure

Following the recommendation of the audit committee, we were appointed by the board of directors on 17 April 2003 to audit the financial statements for the year ending 31 December 2003 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 15 years, covering the years ending 31 December 2003 to 31 December 2018.

Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Alexander Butterworth ACA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Reading, United Kingdom
6 March 2019

Group highlights

FOR THE YEAR ENDED 31 DECEMBER 2018

	2018 £'000	2017 £'000	Change %
Revenue	**766,745**	775,400	-1.1
Operating profit	**65,338**	61,484	+6.3
Underlying operating profit*	**112,726**	120,136	-6.2
Profit before tax	**42,555**	60,592	-29.8
Underlying profit before tax*	**101,379**	110,002	-7.8

	2018 pence	2017 pence	Change %
Basic earnings per share	**43.6**	66.2	-34.1
Underlying earnings per share*	**109.5**	116.7	-6.2
Dividend per share	**51.6**	49.6	+4.0

* Alternative Performance Measures

'Underlying' information is presented to provide readers and stakeholders with additional performance indicators that are prepared on a non-statutory basis. These non-statutory performance measures are consistent with how business performance is reported within the internal management reporting. See page 138 for further information. A reconciliation is set out in note 2 between operating profit and underlying operating profit, between profit before tax and underlying profit before tax and between cash generated by operations and underlying operating cash flow. The calculation for underlying earnings per share is set out in note 13.

Underlying operating profit is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, acquisition and disposal related costs net of contingent consideration adjustments, and significant legal charges and expenses.

Underlying profit before tax is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, fair value movements on derivatives and the loss on closing out a foreign currency derivative contract, defined benefit pension finance charges and GMP equalisation, acquisition and disposal related costs net of contingent consideration adjustments, loss on disposal, and significant legal charges and expenses.

Underlying earnings per share is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, fair value movements on derivatives and the loss on closing out a foreign currency derivative contract, defined benefit pension finance charges and GMP equalisation, acquisition and disposal related costs net of contingent consideration adjustments, loss on disposal, significant legal charges and expenses and before related taxation.

Consolidated income statement

FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 £'000	2017 £'000
Revenue	3	**766,745**	775,400
Cost of sales		**(544,649)**	(545,178)
Gross profit		**222,096**	230,222
Other operating income	4	**3,195**	249
Distribution costs		**(1,573)**	(1,066)
Administrative expenses		**(138,721)**	(134,857)
Other operating expenses	5	**(3,275)**	(15,648)
Impairment charges	2	**(7,589)**	(1,608)
S3 programme	2	**(6,503)**	(7,850)
Significant legal charges and expenses	7	**(2,292)**	(7,958)
Operating profit	6	**65,338**	61,484
Loss on disposal	31	**(729)**	–
Retirement benefit scheme GMP equalisation	30	**(3,150)**	–
Investment revenue	9	**6,193**	12,439
Finance costs	10	**(25,097)**	(13,331)
Profit before tax		**42,555**	60,592
Tax	11	**(10,205)**	(11,666)
Profit for the year		**32,350**	48,926
Attributable to:			
Owners of the Company		**32,381**	48,956
Non-controlling interests		**(31)**	(30)
Earnings per ordinary share (pence)			
Basic	13	**43.6**	66.2
Diluted	13	**43.6**	66.1

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 2018

	Note	2018 £'000	2017 £'000
Profit for the year		**32,350**	48,926
Items that will not be reclassified to profit or loss:			
Actuarial profit on defined benefit pension schemes	30	**4,588**	24,135
Tax relating to items that will not be reclassified	11	**(713)**	(4,113)
Total items that will not be reclassified to profit or loss		**3,875**	20,022
Items that may be reclassified to profit or loss:			
Exchange differences on translation of foreign operations		**21,100**	(44,089)
Transfer from profit and loss on cash flow hedge		**435**	27
(Loss)/profit on loans used in net investment hedges		**(11,521)**	20,567
(Loss)/profit on cash flow hedge		**(604)**	407
Tax relating to items that may be reclassified	11	**29**	(74)
Total items that may be reclassified to profit or loss		**9,439**	(23,162)
Other comprehensive income/(expense) for the year		**13,314**	(3,140)
Total comprehensive income for the year	27	**45,664**	45,786
Attributable to:			
Owners of the Company		**45,695**	45,816
Non-controlling interests		**(31)**	(30)

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

Consolidated balance sheet

31 DECEMBER 2018

	Note	2018 £'000	2017 £'000
Non-current assets			
Goodwill	14	**377,761**	394,529
Other intangible assets	15	**113,889**	136,889
Property, plant and equipment	16	**62,597**	59,150
Deferred tax assets	24	**18,692**	15,659
Derivative financial instruments	22	**113**	2,025
Trade and other receivables	19	**22,639**	32,225
		595,691	640,477
Current assets			
Inventories	17	**88,551**	76,627
Trade and other receivables	19	**205,184**	205,627
Tax assets		**8,108**	11,127
Cash and cash equivalents		**96,319**	149,522
Derivative financial instruments	22	**301**	437
Assets classified as held for sale	31	**30,575**	–
		429,038	443,340
Total assets		**1,024,729**	1,083,817
Current liabilities			
Trade and other payables	20	**(212,247)**	(215,080)
Tax liabilities		**(5,032)**	(2,255)
Derivative financial instruments	22	**(5,534)**	(11,203)
Borrowings	21	**(175,759)**	(51,752)
Liabilities classified as held for sale	31	**(8,575)**	–
Short-term provisions	25	**(13,326)**	(8,665)
		(420,473)	(288,955)
Non-current liabilities			
Retirement benefit obligations	30	**(72,970)**	(82,732)
Other payables	20	**(14,878)**	(8,114)
Deferred tax liabilities	24	**(10,454)**	(11,337)
Derivative financial instruments	22	**(1,000)**	(2,688)
Borrowings	21	**(77,964)**	(172,227)
Long-term provisions	25	**(6,200)**	(5,553)
		(183,466)	(282,651)
Total liabilities		**(603,939)**	(571,606)
Net assets		**420,790**	512,211
Equity			
Share capital	26	**3,574**	3,887
Share premium account	27	**201,033**	200,911
Capital redemption reserve	27	**314**	–
Own shares	27	**(2,581)**	(2,581)
Hedging reserve	27	**(59,720)**	(48,059)
Translation reserve	27	**116,503**	95,403
Retained earnings	27	**161,659**	262,611
Equity attributable to owners of the Company		**420,782**	512,172
Non-controlling interests	27	**8**	39
Total equity		**420,790**	512,211

The financial statements of Ultra Electronics Holdings plc, registered number 02830397, were approved by the Board of Directors and authorised for issue on 6 March 2019.

On behalf of the Board,

S. PRYCE, Chief Executive Officer
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 2018

	Note	2018 £'000	2017 £'000
Net cash flow from operating activities	28	**86,712**	77,565
Investing activities			
Interest received		**715**	455
Purchase of property, plant and equipment		**(12,953)**	(7,098)
Proceeds from disposal of property, plant and equipment		**134**	102
Expenditure on product development and other intangibles		**(7,029)**	(5,680)
Disposal of subsidiary undertakings	31	**225**	–
Net cash used in investing activities		**(18,908)**	(12,221)
Financing activities			
Issue of share capital		**123**	137,255
Share buy-back (including transaction costs)		**(91,902)**	–
Dividends paid		**(36,883)**	(34,959)
Loan syndication costs		**(657)**	(2,040)
Repayments of borrowings		**(181,297)**	(168,975)
Proceeds from borrowings		**198,961**	83,493
Cash out-flow on closing out foreign currency hedging contracts		**(11,104)**	–
Net cash (used in)/from financing activities		**(122,759)**	14,774
Net (decrease)/increase in cash and cash equivalents	28	**(54,955)**	80,118
Cash and cash equivalents at beginning of year		**149,522**	74,625
Effect of foreign exchange rate changes		**1,752**	(5,221)
Cash and cash equivalents at end of year		**96,319**	149,522

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 2018

Equity attributable to equity holders of the parent

	Share capital £'000	Share premium account £'000	Capital redemption reserve £'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 2017	**3,523**	**64,020**	**–**	**(2,581)**	**(68,986)**	**139,492**	**228,034**	**69**	**363,571**
Profit for the year	–	–	–	–	–	–	48,956	(30)	48,926
Other comprehensive income for the year	–	–	–	–	20,927	(44,089)	20,022	–	(3,140)
Total comprehensive income for the year	**–**	**–**	**–**	**–**	**20,927**	**(44,089)**	**68,978**	**(30)**	**45,786**
Issue of share capital	352	133,195	–	–	–	–	–	–	133,547
Equity-settled employee share schemes	12	3,696	–	–	–	–	682	–	4,390
Dividend to shareholders	–	–	–	–	–	–	(34,959)	–	(34,959)
Tax on share-based payment transactions	–	–	–	–	–	–	(124)	–	(124)
Balance at 31 December 2017	**3,887**	**200,911**	**–**	**(2,581)**	**(48,059)**	**95,403**	**262,611**	**39**	**512,211**
Adoption of IFRS 15	–	–	–	–	–	–	(12,156)	–	(12,156)
Tax adjustment on adoption of IFRS 15	–	–	–	–	–	–	2,240	–	2,240
Restated total equity at 1 January 2018	**3,887**	**200,911**	**–**	**(2,581)**	**(48,059)**	**95,403**	**252,695**	**39**	**502,295**
Profit for the year	–	–	–	–	–	–	32,381	(31)	32,350
Other comprehensive income for the year	–	–	–	–	(11,661)	21,100	3,875	–	13,314
Total comprehensive income for the year	**–**	**–**	**–**	**–**	**(11,661)**	**21,100**	**36,256**	**(31)**	**45,664**
Equity-settled employee share schemes	1	122	–	–	–	–	1,493	–	1,616
Shares purchased in buy-back	(314)	–	314	–	–	–	(91,902)	–	(91,902)
Dividend to shareholders	–	–	–	–	–	–	(36,883)	–	(36,883)
Balance at 31 December 2018	**3,574**	**201,033**	**314**	**(2,581)**	**(59,720)**	**116,503**	**161,659**	**8**	**420,790**

Notes to accounts – Group

FOR THE YEAR ENDED 31 DECEMBER 2018

1 Segment information

For management purposes, the Group is organised into three operating segments, which comprise the divisions Aerospace & Infrastructure, Communications & Security and Maritime & Land. These operating segments are consistent with the internal reporting as reviewed by the Chief Executive Officer. Each segment includes businesses with similar operating and market characteristics. See the Divisional reviews on pages 12–17 for further information.

	2018			2017		
	External revenue £'000	**Inter-segment £'000**	**Total £'000**	External revenue £'000	Inter-segment £'000	Total £'000
Revenue						
Aerospace & Infrastructure	**196,213**	**7,938**	**204,151**	203,174	10,219	213,393
Communications & Security	**252,575**	**8,972**	**261,547**	242,708	7,000	249,708
Maritime & Land	**317,957**	**12,960**	**330,917**	329,518	14,920	344,438
Eliminations	**–**	**(29,870)**	**(29,870)**	–	(32,139)	(32,139)
Consolidated revenue	**766,745**	**–**	**766,745**	775,400	–	775,400

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

	2018				
	Aerospace & Infrastructure £'000	**Communications & Security £'000**	**Maritime & Land £'000**	**Unallocated £'000**	**Total £'000**
Underlying operating profit	**29,966**	**29,953**	**52,807**	**–**	**112,726**
Amortisation of intangibles arising on acquisition	**(1,357)**	**(14,437)**	**(12,466)**	**–**	**(28,260)**
Impairment charge	**(6,550)**	**–**	**(1,039)**	**–**	**(7,589)**
Significant legal charges and expenses	**–**	**–**	**–**	**(2,292)**	**(2,292)**
Acquisition and disposal related costs net of adjustments to contingent consideration	**(560)**	**(465)**	**(1,719)**	**–**	**(2,744)**
S3 programme	**(457)**	**(1,484)**	**(4,562)**	**–**	**(6,503)**
Operating profit/(loss)	**21,042**	**13,567**	**33,021**	**(2,292)**	**65,338**
Loss on disposal					**(729)**
Retirement benefit scheme GMP equalisation					**(3,150)**
Investment revenue					**6,193**
Finance costs					**(25,097)**
Profit before tax					**42,555**
Tax					**(10,205)**
Profit after tax					**32,350**

Significant legal charges and expenses include £2,292,000 incurred in relation to the ongoing anti-bribery and corruption investigation. £7,958,000 was incurred in the prior period on legal charges relating to the Ithra contract. Unallocated items are specific corporate level costs that cannot be allocated to a specific division. The S3 programme is the Group's Standardisation & Shared Services programme.

	2017			
	Aerospace & Infrastructure £'000	Communications & Security £'000	Maritime & Land £'000	Total £'000
Underlying operating profit	32,638	28,235	59,263	120,136
Amortisation of intangibles arising on acquisition	(1,136)	(20,070)	(7,242)	(28,448)
Impairment charge	–	(1,608)	–	(1,608)
Significant legal charges and expenses	(7,958)	–	–	(7,958)
Acquisition and disposal related costs net of adjustments to contingent consideration	1,163	(366)	(13,585)	(12,788)
S3 programme	(1,085)	(3,446)	(3,319)	(7,850)
Operating profit	23,622	2,745	35,117	61,484
Investment revenue				12,439
Finance costs				(13,331)
Profit before tax				60,592
Tax				(11,666)
Profit after tax				48,926

The acquisition and disposal-related costs of £12,788,000 in 2017 included those associated with the proposed Sparton Corporation acquisition and 3Phoenix staff retention payments (see note 31) which were put in place at the time of the acquisition of that business.

Notes to accounts – Group continued
FOR THE YEAR ENDED 31 DECEMBER 2018

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	
	2018 £'000	2017 £'000	**2018 £'000**	2017 £'000
Aerospace & Infrastructure	**4,172**	3,546	**4,807**	4,783
Communications & Security	**9,268**	4,840	**19,471**	25,516
Maritime & Land	**6,542**	4,392	**17,021**	11,862
Total	**19,982**	12,778	**41,299**	42,161

The 2018 depreciation and amortisation expense includes £32,366,000 of amortisation charges (2017: £31,995,000) and £8,933,000 of property, plant and equipment depreciation charges (2017: £10,166,000).

Total assets by segment

	2018 £'000	2017 £'000
Aerospace & Infrastructure	**224,523**	227,932
Communications & Security	**429,451**	428,884
Maritime & Land	**247,222**	248,231
	901,196	905,047
Unallocated	**123,533**	178,770
Consolidated total assets	**1,024,729**	1,083,817

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

Total liabilities by segment

	2018 £'000	2017 £'000
Aerospace & Infrastructure	**51,573**	61,376
Communications & Security	**87,479**	81,443
Maritime & Land	**104,848**	102,085
	243,900	244,904
Unallocated	**360,039**	326,702
Consolidated total liabilities	**603,939**	571,606

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:

	2018 £'000	2017 £'000
United Kingdom	**171,511**	161,293
Continental Europe	**62,870**	78,199
Canada	**22,825**	22,844
USA	**416,495**	384,330
Rest of World	**93,044**	128,734
	766,745	775,400

During the year, there was one direct customer (2017: one) that individually accounted for greater than 10% of the Group's total turnover. Sales to this customer in 2018 were £127.2m (2017: £146.6m) across all segments.

1 Segment information continued

Other information (by geographic location)

	Non-current assets		Total assets		Additions to property, plant and equipment and intangible assets (excluding acquisitions)	
	2018 £'000	2017 £'000	**2018 £'000**	2017 £'000	**2018 £'000**	2017 £'000
United Kingdom	**163,060**	206,433	**328,296**	342,792	**7,781**	4,742
USA	**322,611**	317,613	**439,749**	426,826	**7,531**	6,069
Canada	**82,549**	91,057	**118,209**	123,646	**4,278**	1,341
Rest of World	**8,666**	7,689	**14,943**	11,784	**392**	626
	576,886	622,792	**901,197**	905,048	**19,982**	12,778
Unallocated	**18,805**	17,685	**123,532**	178,769	**–**	–
	595,691	640,477	**1,024,729**	1,083,817	**19,982**	12,778

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:

	2018 £'000	2017 £'000
Operating profit	**65,338**	61,484
Amortisation of intangibles arising on acquisition (see note 15)	**28,260**	28,448
Impairment charges (see notes 14 and 15)	**7,589**	1,608
Significant legal charges and expenses (see note 7)	**2,292**	7,958
Acquisition and disposal related costs net of adjustments to contingent consideration (see note 1)	**2,744**	12,788
S3 programme	**6,503**	7,850
Underlying operating profit	**112,726**	120,136
Profit before tax	**42,555**	60,592
Amortisation of intangibles arising on acquisition (see note 15)	**28,260**	28,448
Impairment charges (see notes 14 and 15)	**7,589**	1,608
Acquisition and disposal related costs net of adjustments to contingent consideration (see note 1)	**2,744**	12,788
Loss on closing out foreign currency derivative contract*	**11,104**	–
(Profit) on fair value movements of derivatives (see note 22)	**(5,476)**	(11,983)
Net interest charge on defined benefit pensions (see note 10)	**1,929**	2,741
S3 programme	**6,503**	7,850
Loss on disposal (see note 31)	**729**	–
Significant legal charges and expenses (see note 7)	**2,292**	7,958
Retirement benefit scheme GMP equalisation (see note 30)	**3,150**	–
Underlying profit before tax	**101,379**	110,002
Cash generated by operations (see note 28)	**102,446**	97,432
Purchase of property, plant and equipment	**(12,953)**	(7,098)
Proceeds on disposal of property, plant and equipment	**134**	102
Expenditure on product development and other intangibles	**(7,029)**	(5,680)
Significant legal charges and expenses	**1,532**	9,836
S3 programme	**2,600**	8,949
Acquisition and disposal related payments	**2,523**	12,966
Underlying operating cash flow	**89,253**	116,507

The above analysis of the Group's operating results 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 138 for further details.

* In March 2018, the USD 250m foreign exchange forward, put in place in July 2017 with respect to the proposed Sparton acquisition, was closed out when the acquisition was terminated. This resulted in a £11.1m non-underlying cash outflow and a net debit to the 2018 income statement of £3.9m when the impact to the fair value movements on derivatives is also taken into consideration. In 2017, the fair value movements on derivatives included £7.2m of loss incurred with respect to the mark-to-market revaluation of this derivative as at 31 December 2017.

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

3 Revenue

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

2018 under IFRS 15

	Aerospace & Infrastructure 2018 £'000	Communications & Security 2018 £'000	Maritime & Land 2018 £'000	Total 2018 £'000
Point in time	**105,411**	**114,620**	**84,000**	**304,031**
Over time	**90,802**	**137,955**	**233,957**	**462,714**
	196,213	**252,575**	**317,957**	**766,745**

2017 under IAS 11 and IAS 18

	2017 £'000
Sale of goods	308,416
Revenue from long-term contracts	466,984
	775,400

The recognition of over time revenue and profit is a critical accounting estimate as set out on page 131.

The table below notes the revenue expected to be recognised in the future that is related to performance obligations that are unsatisfied (or partially unsatisfied) at the reporting date.

	2019 £'000	2020 £'000	2021 and beyond £'000	Total £'000
Over time revenue	**289,174**	**157,958**	**171,253**	**618,385**
Point in time revenue	**244,588**	**91,664**	**29,224**	**365,476**

4 Other operating income

Amounts included in other operating income were as follows:

	2018 £'000	2017 £'000
Foreign exchange gains	**3,195**	249
	3,195	249

Foreign exchange gains and losses are impacted by gains or losses on foreign exchange transactions and revaluation of currency assets and liabilities.

5 Other operating expenses

Amounts included in other operating expenses were as follows:

	2018 £'000	2017 £'000
Amortisation of internally generated development costs (see note 15)	**1,502**	1,197
Foreign exchange losses	**1,773**	14,451
	3,275	15,648

6 Operating profit

Operating profit is stated after charging/(crediting):

	2018 £'000	2017 £'000
Raw materials and other bought in inventories expensed in the year	**238,380**	224,215
Staff costs (see note 8)	**252,691**	258,981
Depreciation of property, plant and equipment	**8,933**	10,166
Amortisation of internally generated intangible assets	**1,502**	1,197
Amortisation of acquired intangible assets	**30,864**	30,798
Impairment of intangible assets (see notes 14 and 15)	**7,589**	1,608
Contingent consideration release	**–**	(1,194)
Government grant income (see note 23)	**(233)**	(2,029)
Net foreign exchange (gain)/loss	**(7,228)**	7,007
Loss on disposal of property, plant and equipment	**53**	565
Operating lease rentals		
– plant and machinery	**898**	1,352
– other	**14,565**	12,474
Research and development costs	**26,441**	28,314
Auditor's remuneration for statutory audit work (including expenses)	**1,212**	1,199

6 Operating profit continued

Analysis of auditor's remuneration

	2018 £'000	2017 £'000
Fees payable for the audit of the annual accounts	**330**	348
Fees payable for the audit of subsidiaries	**882**	851
Total for statutory Group audit services	**1,212**	1,199
Analysis of non-audit services:		
Audit related services	**11**	–
Tax compliance	**3**	5
Corporate finance services – due diligence and reporting accountant work	**–**	1,498
Other advisory	**13**	8
Total for non-audit services	**27**	1,511

During the prior year, the auditor provided due diligence and reporting accountant work principally relating to the Circular Announcement in relation to the proposed Sparton acquisition.

The Company-only audit fee included in the Group audit fee shown above was £20,000 (2017: £20,000).

7 Significant legal charges and expenses

Significant legal charges and expenses are the charges arising from investigations and settlement of litigation that are not in the normal course of business. £2,292,000 was expensed in the current year relating to anti-bribery and corruption investigation costs. In the prior year, £7,958,000 of legal charges associated with the Oman Airport IT contract termination were expensed to the income statement.

8 Staff costs

Particulars of employees (including Executive Directors) are shown below.

Employee costs during the year amounted to:

	2018 £'000	2017 £'000
Wages and salaries	**219,694**	228,270
Social security costs	**22,982**	20,616
Pension costs	**10,015**	10,095
	252,691	258,981

The wages and salaries figure for 2017 includes £6.5m in relation to 3Phoenix staff retention arrangements which were put in place at the time of the acquisition of that business.

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

	2018 Number	2017 Number
Production	**1,788**	1,729
Engineering	**1,381**	1,457
Selling	**217**	227
Support services	**733**	759
	4,119	4,172

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.

Notes to accounts – Group continued

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9 Investment revenue

	2018 £'000	2017 £'000
Bank interest	**717**	456
Fair value movement on derivatives	**5,476**	11,983
	6,193	12,439

10 Finance costs

	2018 £'000	2017 £'000
Amortisation of finance costs of debt	**825**	1,281
Interest payable on bank loans, overdrafts and other loans	**11,239**	9,309
Total borrowing costs	**12,064**	10,590
Retirement benefit scheme finance cost	**1,929**	2,741
Loss on closing out foreign currency derivative contract (see note 2)	**11,104**	–
	25,097	13,331

11 Tax

	2018 £'000	2017 £'000
UK taxes		
Corporation tax	**2,435**	2,441
Adjustment in respect of prior years	**2,683**	(122)
	5,118	2,319
Overseas taxes		
Current taxation	**7,494**	5,400
Adjustment in respect of prior years	**(375)**	(1,690)
	7,119	3,710
Total current tax	**12,237**	6,029
Deferred tax		
Origination and reversal of temporary differences	**(1,635)**	7,676
Recognition of deferred tax assets	**(397)**	(2,077)
US tax rate change	**–**	38
Total deferred tax (credit)/charge	**(2,032)**	5,637
Total tax charge	**10,205**	11,666

Corporation tax in the UK is calculated at 19.00% (2017: 19.25%) 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. US deferred tax balances at 31 December 2018 have been calculated at 24% (2017: 24%). 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:

	2018 £'000	2017 £'000
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Actuarial gain on defined benefit pension schemes	**(713)**	(4,113)
Revaluation of interest rate hedge	**29**	(74)
Total income tax charge recognised directly in other comprehensive income	**(684)**	(4,187)

11 Tax continued

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:

	2018 £'000	2017 £'000
Deferred tax		
IFRS 15 adjustment	**2,240**	–
Change in estimated excess tax deductions related to share-based payments	**–**	(124)
Total income tax recognised directly in equity	**2,240**	(124)

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:

	2018 £'000	2017 £'000
Group profit before tax	**42,555**	60,592
Tax on Group profit at standard UK corporation tax rate of 19.00% (2017: 19.25%)	**8,085**	11,664
Tax effects of:		
Income/(expenses) that are not taxable/allowable in determining taxable profits	**1,367**	5,113
Effect of change in US tax rate	**–**	38
(Recognition)/derecognition of deferred tax assets	**(374)**	(2,077)
Expenses for which no deferred tax asset recognised	**2,909**	1,000
Different tax rates of subsidiaries operating in other jurisdictions	**1,720**	1,238
CFC exemption	**(4,269)**	(4,401)
Deferred tax differences on temporary differences	**315**	–
Patent Box	**(342)**	(623)
Adjustments in respect of prior years	**794**	(286)
Tax expense for the year	**10,205**	11,666

Included within the tax reconciliation are a number of non-recurring items, principally non-tax deductible one-off costs which fluctuate from year to year and, in 2017, the recognition of Canadian deferred tax assets, which were not recognised in 2016. In addition, a deferred tax asset was not recognised for certain expenses in our US business in both 2018 and 2017 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 (the level of profits in overseas jurisdictions and changes to the UK and overseas tax rates will affect the size of this difference in the future).

The benefit of the CFC exemption is subject to an ongoing EU State Aid investigation into the UK's Controlled Foreign Company regime. In October 2017 the European Commission issued a preliminary finding that the Group financing partial exemption is illegal State Aid. In common with other UK-based international companies whose arrangements are in line with current UK CFC legislation we may be affected by the eventual outcome of the investigation and are monitoring developments. There have been no further announcements by the EU Commission since October 2017, no provision for this potential liability continues to be made in these financial statements as it is not clear what, if any, the eventual financial result will be.

12 Dividends

Amounts recognised as distributions to equity holders in the year:

	2018 £'000	2017 £'000
Final dividend for the year ended 31 December 2017 of 35.0p (2016: 33.6p) per share	**26,269**	23,647
Interim dividend for the year ended 31 December 2018 of 14.6p (2017: 14.6p) per share	**10,614**	11,312
	36,883	34,959
Proposed final dividend for the year ended 31 December 2018 of 37.0p (2017: 35.0p) per share	**26,360**	27,124

The 2018 proposed final dividend of 37.0p per share is proposed to be paid on 9 May 2019 to shareholders on the register at 12 April 2019. It was approved by the Board after 31 December 2018 and has not been included as a liability as at 31 December 2018.

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

13 Earnings per share

	2018 pence	2017 pence
Basic underlying (see below)	**109.5**	116.7
Diluted underlying (see below)	**109.5**	116.5
Basic	**43.6**	66.2
Diluted	**43.6**	66.1

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

	2018 £'000	2017 £'000
Earnings		
Earnings for the purposes of basic earnings per share being profit for the year	**32,381**	48,956
Underlying earnings		
Profit for the year	**32,381**	48,956
Amortisation of intangibles arising on acquisition (net of tax)	**21,968**	20,005
Impairment charges (net of tax)	**7,342**	997
Acquisition and disposal related costs net of adjustments to contingent consideration (net of tax)	**2,744**	10,394
Loss on closing out foreign currency derivative contract (net of tax)	**11,104**	–
(Profit) on fair value movements on derivatives (net of tax)	**(6,433)**	(9,411)
Net interest charge on defined benefit pensions (net of tax)	**1,929**	2,275
S3 programme (net of tax)	**5,059**	5,983
Loss on disposal (net of tax)	**729**	–
Significant legal charges and expenses (net of tax)	**2,292**	7,097
Retirement benefit scheme GMP equalisation (net of tax)	**2,300**	–
Earnings for the purposes of underlying earnings per share	**81,415**	86,296

The adjustments to profit are explained in note 2.

The weighted average number of shares is given below:

	2018 Number of shares	2017 Number of shares
Number of shares used for basic earnings per share	**74,350,521**	73,959,565
Effect of dilutive potential ordinary shares – share options	**831**	86,340
Number of shares used for fully diluted earnings per share	**74,351,352**	74,045,905

	2018 £'000	2017 £'000
Underlying profit before tax (see note 2)	**101,379**	110,002
Tax rate applied for the purposes of underlying earnings per share	**19.7%**	21.6%

On 7 July 2017, a total of 7,047,168 ordinary shares of 5 pence were placed, representing 9.9% of Ultra's issued ordinary share capital prior to the placing. During 2018, the Company purchased and cancelled 6,288,127 shares. See note 26.

14 Goodwill

	2018 £'000	2017 £'000
Cost		
At 1 January	**451,807**	478,565
Exchange differences	**15,001**	(26,758)
Reclassified as held for sale (see note 31)	**(28,311)**	–
At 31 December	**438,497**	451,807
Accumulated impairment losses		
At 1 January	**(57,278)**	(62,972)
Impairment of goodwill (see note 31)	**(6,550)**	–
Reclassified as held for sale (see note 31)	**6,550**	–
Exchange differences	**(3,458)**	5,694
Carrying amount at 31 December	**377,761**	394,529

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:

	2018 Pre-tax Discount rate %	2017 Pre-tax Discount rate %	2018 £'000	2017 £'000
Aerospace	**9.7**	10.1	**32,686**	32,531
Infrastructure	**9.7**	10.1	**–**	28,276
Nuclear	**9.7 – 11.4**	10.1	**18,869**	18,030
Aerospace & Infrastructure			**51,555**	78,837
Communications	**9.7 – 11.4**	10.1	**92,279**	90,894
C2ISR	**10.7 – 11.4**	10.1	**120,020**	115,135
Communications & Security			**212,299**	206,029
Maritime	**9.7 – 11.4**	10.1	**35,118**	33,716
Underwater Warfare	**9.7 – 11.4**	10.1	**78,789**	75,947
Maritime & Land			**113,907**	109,663
Total – Ultra Electronics			**377,761**	394,529

Goodwill is initially allocated, in the year a business is acquired, to the CGU group expected to benefit from the acquisition. Subsequent adjustments are made to this allocation to the extent that operations, to which goodwill relates, are transferred between CGU groups. The size of a CGU group varies but is never larger than a reportable operating segment. There have been no changes in the year.

The recoverable amounts of CGUs are determined from value-in-use calculations. In determining the value-in-use for each CGU, the Group prepares cash flows derived from the most recent financial budgets and strategic plans, representing the best estimate of future performance. These plans, which have been approved by the Board, include detailed financial forecasts and market analysis covering the expected development of each CGU over the next five years. The cash flows for the following ten years are also included and assume a growth rate of 2.5% (2017: 2.5%) per annum. Cash flows beyond that period are not included in the value-in-use calculation.

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14 Goodwill continued

The key assumptions used in the value-in-use calculations are those regarding the discount rate, future revenues, growth rates, forecast gross margins, underlying operating profit* and underlying operating cash conversion*. Management estimates the discount rate using pre-tax rates that reflect current market assessments of the time value of money and risks specific to the Group, being the Weighted Average Cost of Capital (WACC). The WACC is then risk-adjusted to reflect risks specific to each business. The pre-tax discount rate used during 2018 was 9.7% for UK and Australia, 10.7% for Canada and 11.4% for USA (2017: 10.1% for all regions). 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 historical 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, which included consideration of the potential impacts of Brexit, has been performed on the value-in-use calculations to:
(i) reduce the post-2023 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.

Certain of these sensitivity scenarios give rise to a potential impairment in C2ISR, the CGU grouping which includes Herley, ATS and Forensic Technology. Profitability in Herley in 2017 and 2018 has missed expectations due to difficulties encountered with certain development contracts, however an improvement in profitability is envisaged in future years as contracts enter the production phase. Despite these profitability challenges at Herley, headroom in C2ISR which represents the value derived from the key growth assumptions in the value-in-use calculations, is £46.5m (2017: £79.4m). Sensitivity (ii) results in a £2.3m impairment to the goodwill allocated to the C2ISR CGU group. This CGU grouping is also sensitive to the ability of the operations to retain existing customers, win new business and profitably execute contracts over the medium term, particularly given the recent profitability challenges at Herley.

On 2 November 2018 Ultra announced the sale of its Airport Systems business for a total consideration of £22m. The Infrastructure CGU is comprised entirely of the Airport Systems business. The disposal proceeds are below the carrying value of the net assets being sold and consequently a goodwill impairment charge of £6.6m has been recorded in the year. Following the impairment charge, the carrying value of the goodwill for the Infrastructure CGU was £21.8m, which has been reclassified as held for sale. As set out in note 2, the £6.6m impairment charge has been included as part of the non-underlying operating results of the Group. Airport Systems is within the Aerospace & Infrastructure operating segment. The disposal completed on 1 February 2019.

For all other CGUs, the value-in-use calculations exceed the CGU carrying values after applying sensitivity analysis.

* See footnote on page 145.

15 Other intangible assets

	Acquired intangibles				Internally generated capitalised development costs	Software, patents and trademarks	Total
	Customer relationships £'000	Intellectual property £'000	Profit in order book £'000	Other acquired £'000	£'000	£'000	£'000
Cost							
At 1 January 2017	222,459	117,588	34,957	8,765	26,989	30,022	440,780
Foreign exchange differences	(12,574)	(7,114)	(1,882)	(388)	(1,264)	(1,621)	(24,843)
Additions	–	–	–	–	1,582	4,098	5,680
Reclassification from tangible fixed assets	–	–	–	–	–	418	418
Disposals	–	–	–	–	–	(1,595)	(1,595)
At 1 January 2018	**209,885**	**110,474**	**33,075**	**8,377**	**27,307**	**31,322**	**420,440**
Foreign exchange differences	6,581	3,909	1,014	148	755	1,005	13,412
Additions	–	–	–	–	1,651	5,378	7,029
Reclassified as held for sale (see note 31)	(1,377)	–	(381)	–	–	(323)	(2,081)
Disposals	–	(10,846)	(518)	(862)	–	(974)	(13,200)
At 31 December 2018	**215,089**	**103,537**	**33,190**	**7,663**	**29,713**	**36,408**	**425,600**
Accumulated amortisation							
At 1 January 2017	(125,692)	(65,389)	(33,422)	(4,024)	(14,988)	(23,628)	(267,143)
Foreign exchange differences	7,373	4,223	1,789	217	783	1,222	15,607
Impairment charges	–	–	–	–	(1,608)	–	(1,608)
Disposals	–	–	–	–	–	1,588	1,588
Charge	(18,193)	(8,359)	(954)	(942)	(1,197)	(2,350)	(31,995)
At 1 January 2018	**(136,512)**	**(69,525)**	**(32,587)**	**(4,749)**	**(17,010)**	**(23,168)**	**(283,551)**
Foreign exchange differences	(4,560)	(2,945)	(1,008)	(148)	(578)	(781)	(10,020)
Reclassified as held for sale (see note 31)	1,376	–	381	–	–	312	2,069
Impairment charges	–	–	–	–	(1,039)	–	(1,039)
Disposals	–	10,846	518	862	–	970	13,196
Charge	(15,556)	(11,401)	(494)	(809)	(1,502)	(2,604)	(32,366)
At 31 December 2018	**(155,252)**	**(73,025)**	**(33,190)**	**(4,844)**	**(20,129)**	**(25,271)**	**(311,711)**
Carrying amount							
At 31 December 2018	**59,837**	**30,512**	**–**	**2,819**	**9,584**	**11,137**	**113,889**
At 31 December 2017	73,373	40,949	488	3,628	10,297	8,154	136,889

Of the £11,137,000 (2017: £8,154,000) net book value within the software, patents and trademarks category, £241,000 (2017: £291,000) related to patents and trademarks. The amortisation of intangible assets charge is included within administrative expenses. Intangible assets, other than goodwill, are amortised over their estimated useful lives, typically as follows:

Customer relationships	5 to 21 years
Intellectual property	5 to 10 years
Profit in acquired order book	1 to 3 years
Other acquired	1 to 5 years
Development costs	2 to 10 years
Other intangibles:	
Software	3 to 5 years
Patents and trademarks	10 to 20 years

Notes to accounts – Group continued

31 DECEMBER 2018

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 2017	41,561	25,909	114,840	182,310
Foreign exchange differences	(1,640)	(1,076)	(5,073)	(7,789)
Additions	1,697	230	5,171	7,098
Disposals	(11)	(2,911)	(19,786)	(22,708)
Reclassified to software (see note 15)	–	–	(418)	(418)
At 1 January 2018	**41,607**	**22,152**	**94,734**	**158,493**
Foreign exchange differences	753	573	2,590	3,916
Additions	837	409	11,707	12,953
Disposals	(11)	(603)	(11,666)	(12,280)
Reclassified to held for sale	–	–	(4,057)	(4,057)
At 31 December 2018	**43,186**	**22,531**	**93,308**	**159,025**
Accumulated depreciation				
At 1 January 2017	(8,389)	(16,010)	(91,716)	(116,115)
Foreign exchange differences	359	794	3,744	4,897
Charge	(1,148)	(2,040)	(6,978)	(10,166)
Disposals	8	2,899	19,134	22,041
At 1 January 2018	**(9,170)**	**(14,357)**	**(75,816)**	**(99,343)**
Foreign exchange differences	(111)	(460)	(1,837)	(2,408)
Charge	(1,018)	(1,819)	(6,096)	(8,933)
Disposals	11	603	11,099	11,713
Reclassification	771	(438)	(333)	–
Reclassified to held for sale	–	–	2,543	2,543
At 31 December 2018	**(9,517)**	**(16,471)**	**(70,440)**	**(96,428)**
Carrying amount				
At 31 December 2018	**33,669**	**6,060**	**22,868**	**62,597**
At 31 December 2017	32,437	7,795	18,918	59,150

Freehold land amounting to £6,944,000 (2017: £6,748,000) has not been depreciated. Included within Land and Buildings is £nil (2017: £nil) of assets in the course of construction.

17 Inventories

	2018 £'000	2017 £'000
Raw materials and consumables	**56,090**	48,965
Work in progress	**23,682**	18,787
Finished goods and goods for resale	**8,779**	8,875
	88,551	76,627

The amount of any write-down of inventory recognised as an expense in the year was £2,342,000 (2017: £1,666,000).

18 Over time contract balances

Amounts receivable from over time contract customers relates to work performed and revenue recognised on agreed contracts prior to the customer being invoiced.

The movement in the year of amounts receivable from over time contract customers was as follows:

	2018 £'000
As at 1 January 2018	116,732
Adoption of IFRS 15 (see note 37)	(10,497)
Foreign exchange differences	1,776
Revenue earned net of billings	956
Impairment	(1,209)
Reclassified to held for sale	(4,093)
As at 31 December 2018	**103,665**

The impairment recognised in 2018 relates to a non-core product line that was closed in the Maritime & Land division in the year.

Amounts payable to over time contract customers relates to payments received from customers in relation to the contract prior to the work being completed and the revenue recognised.

The movement in the year of amounts payable to over time contract customers was as follows:

	2018 £'000
As at 1 January 2018	(58,707)
Adoption of IFRS 15 (see note 37)	(2,801)
Foreign exchange differences	(608)
Cash advances net of revenue recognised	(4,463)
Other	(3,044)
Reclassified to held for sale	6,120
As at 31 December 2018	**(63,503)**

Within the opening 2018 balance of £58.7m, £55.2m was utilised during the period.

19 Trade and other receivables

	2018 £'000	2017 £'000
Non-current		
Amounts receivable from over time contract customers (see note 18)	22,639	32,225
	22,639	32,225

	2018 £'000	2017 £'000
Current		
Trade receivables	109,176	102,934
Provisions against receivables	(3,910)	(1,505)
Net trade receivables	105,266	101,429
Amounts receivable from over time contract customers (see note 18)	81,026	84,507
Other receivables	6,517	12,897
Prepayments	9,180	6,794
Accrued income	3,195	–
	205,184	205,627

Trade receivables do not carry interest. The average credit period on sale of goods is 36 days (2017: 32 days).

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

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

19 Trade and other receivables continued

The ageing profile of unprovided overdue trade receivables was as follows:

	2018 £'000	**Related provision £'000**	**Total £'000**	2017 £'000	Related provision £'000	Total £'000
1 to 3 months	**18,038**	**(218)**	**17,820**	16,361	(112)	16,249
4 to 6 months	**1,382**	**(7)**	**1,375**	4,374	(480)	3,894
7 to 9 months	**808**	**(73)**	**735**	871	(71)	800
Over 9 months	**4,839**	**(3,612)**	**1,227**	1,214	(842)	372
Total overdue	**25,067**	**(3,910)**	**21,157**	22,820	(1,505)	21,315

The Group makes provisions against its trade receivables based on expected credit losses where there are serious doubts as to future recoverability based on prior experience, on assessment of the current economic climate and on the length of time that the receivable has been overdue. All trade receivables that have been overdue for more than a year are provided for in full.

Movement in the provision for trade receivables was as follows:

	2018 £'000	2017 £'000
Current		
Balance at beginning of year	**1,505**	1,307
Foreign exchange differences	**(1)**	(23)
Increase in provision for trade receivables regarded as potentially uncollectable	**2,611**	617
Decrease in provision for trade receivables recovered during the year	**(139)**	(396)
Reclassified to held for sale	**(66)**	–
Balance at end of year	**3,910**	1,505

Credit risk

Credit risk is defined as the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group mitigates this risk of financial loss by only dealing with creditworthy counterparties.

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies.

Whilst the Group has elements of concentration of credit risk, with exposure to a number of large counterparties and customers, the customers are mainly government agencies or multi-national organisations with whom the Group has long-term business relationships. The Group has a small number of customers with individually significant amounts outstanding. These customers are considered to have low credit risk.

Ongoing credit evaluation is performed on the financial condition of accounts receivable and, when appropriate, action is taken to minimise the Group's credit risk.

The carrying amount of financial assets recorded in the financial statements (see note 22), net of any allowances for losses, represents the Group's maximum exposure to credit risk.

20 Trade and other payables

	2018 £'000	2017 £'000
Amounts included in current liabilities:		
Trade payables	**78,742**	89,205
Amounts due to over time contract customers (note 18)	**52,442**	55,166
Other payables	**20,608**	21,007
Accruals	**42,158**	41,263
Deferred income	**18,297**	8,439
	212,247	215,080
Amounts included in non-current liabilities:		
Amounts due to over time contract customers (note 18)	**11,061**	3,541
Other payables	**7**	12
Accruals	**224**	3,333
Deferred income	**3,586**	1,228
	14,878	8,114

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

21 Borrowings

	2018 £'000	2017 £'000
Amounts due in less than one year:		
Bank loans	**128,722**	44,359
Unsecured loan notes	**47,037**	7,393
	175,759	51,752
Amounts due after more than one year:		
Bank loans	**17,582**	120,375
Unsecured loan notes	**50,000**	44,359
Loans from government (see note 23)	**10,382**	7,493
	77,964	172,227
Total borrowings:		
Amount due for settlement within 12 months	**175,759**	51,752
Amount due for settlement after 12 months	**77,964**	172,227
	253,723	223,979

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

22 Financial instruments and financial risk management

Derivative financial instruments

Exposure to currency and interest rate risks arises in the normal course of the Group's business. Derivative financial instruments are used to hedge exposure to all significant fluctuations in foreign exchange rates and interest rates.

Fair value measurements recognised in the balance sheet

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted (unadjusted) active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

All of Ultra's financial instruments have been assessed as Level 2 or Level 3. Further details on the SADI loan, which is classified as Level 3, are set out in note 23.

Fair value measurements recognised in the balance sheet

	Level 3 £'000	Level 2 £'000	2018 Total £'000
Financial assets at fair value			
Foreign exchange derivative financial instruments (through profit and loss)	**–**	**149**	**149**
Interest rate swap	**–**	**265**	**265**
Total	**–**	**414**	**414**
Financial liabilities at fair value			
SADI loan (see note 23)	**10,382**	**–**	**10,382**
Foreign exchange derivative financial instruments (through profit and loss)	**–**	**6,534**	**6,534**
Total	**10,382**	**6,534**	**16,916**

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

22 Financial instruments and financial risk management continued

Fair value measurements recognised in the balance sheet continued

	Level 3 £'000	Level 2 £'000	2017 Total £'000
Financial assets at fair value			
Foreign exchange derivative financial instruments (through profit and loss)	–	2,028	2,028
Interest rate swap	–	434	434
Total	–	2,462	2,462
Financial liabilities at fair value			
SADI loan (see note 23)	7,493	–	7,493
Foreign exchange derivative financial instruments (through profit and loss)	–	13,891	13,891
Total	7,493	13,891	21,384

	Current assets/(liabilities)		Non-current assets/(liabilities)	
	2018 £'000	2017 £'000	**2018 £'000**	2017 £'000
Financial assets/(liabilities) carried at fair value through profit or loss				
Foreign exchange currency liabilities	**(5,534)**	(11,203)	**(1,000)**	(2,688)
Foreign exchange currency assets	**36**	437	**113**	2,025

Financial assets

The financial assets of the Group were as follows:

	2018 £'000	2017 £'000
Cash and cash equivalents	**96,319**	149,522
Currency derivatives used for hedging and interest rate swap	**414**	2,462
Amounts receivable from over time contract customers	**103,665**	116,732
Other receivables	**6,517**	12,897
Trade receivables	**105,266**	101,429
Prepayments	**9,180**	6,794
Accrued income	**3,195**	–

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:

	2018 £'000	2017 £'000
Currency derivatives used for hedging	**6,534**	13,891
Bank loans and overdrafts	**146,304**	164,734
Loan notes	**97,037**	51,752
Government loans	**10,382**	7,493
Trade payables	**78,742**	89,205
Amounts due to over time contract customers	**63,503**	58,707
Deferred consideration	**2,441**	2,302
Accruals	**42,382**	44,596
Other payables	**20,615**	21,019

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

22 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. On 7 November 2017, the Group obtained a £300 million facility of revolving credit with a current expiry date of November 2023. The facility has the option to be extended, subject to lender consent, to November 2024. The facility also incorporates an uncommitted £150 million accordion. The facility is denominated in Sterling, US Dollars, Canadian Dollars, Australian Dollars and Euros and is used for balance sheet and operational needs. The Group holds $165m of term loan, which was established in May 2015; $40m is repayable on 31 March 2019, $40m on 30 June 2019 and the remainder on 1 August 2019.

All bank loans are unsecured. Interest was predominantly charged at 0.96% (2017: 1.20%) over base or contracted rate. At 31 December 2018, the Group had available £280 million (2017: £300 million) of undrawn, committed revolving credit facilities.

At 31 December 2018 the Group also has unsecured loan notes in issue to Prudential Investment Management Inc ("Pricoa") of £50m with an expiry date of October 2025, and US$60m with an expiry date of 25 January 2019 (2017: $70m). Agreement was reached with Pricoa in September 2018 for new loan notes of US$70m which were issued on 25 January 2019, this debt will expire in January 2026 and January 2029.

The Group is strongly cash-generative and the funds generated by operating companies are managed regionally to fund short-term local working capital requirements. Where additional funding is required, this is provided centrally through the Group's committed banking facilities.

The Group, through its Canadian subsidiary Ultra Electronics Tactical Communication Systems (TCS), participates in two Canadian programmes that provide government support in relation to the development of certain of its products. Further disclosure is provided in note 23.

A £5 million overdraft and US$10 million overdraft are available for short-term working capital funding.

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
2018					
Bank loans and overdrafts	**130,640**	**306**	**17,861**	**–**	**148,807**
Loan notes	**48,583**	**1,435**	**4,305**	**51,077**	**105,400**
Government loans	**–**	**–**	**–**	**10,382**	**10,382**
Trade payables	**78,742**	**–**	**–**	**–**	**78,742**
Currency derivatives used for hedging and interest rate swap	**5,534**	**641**	**359**	**–**	**6,534**
Deferred consideration	**59**	**–**	**2,382**	**–**	**2,441**
Accruals	**42,158**	**224**	**–**	**–**	**42,382**
Other payables	**20,608**	**7**	**–**	**–**	**20,615**
2017					
Bank loans and overdrafts	48,640	122,253	–	–	170,893
Loan notes	9,115	44,462	–	–	53,577
Government loans	–	–	–	7,493	7,493
Trade payables	89,205	–	–	–	89,205
Currency derivatives used for hedging	11,203	2,285	384	19	13,891
Deferred consideration	55	–	2,247	–	2,302
Accruals	41,263	2,736	597	–	44,596
Other payables	21,007	12	–	–	21,019

Capital risk management

The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The capital structure of the Group consists of debt, which includes the borrowings disclosed in note 21, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in the Group Statement of Changes in Equity.

The Group is not subject to externally imposed capital requirements.

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

22 Financial instruments and financial risk management continued

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 2018, the net fair value of the Group's currency derivatives is estimated to be a liability of approximately £6,387,000 (2017: liability £11,863,000), comprising £147,000 assets (2017: £2,462,000) and £6,534,000 liabilities (2017: £13,891,000). The gain on derivative financial instruments included in the Group's consolidated income statement for the period was £5,476,000 (2017: gain £11,983,000).

The net notional or net contracted amounts of foreign currency related forward sales contracts, classified by year of maturity are shown below.

	Not exceeding 1 year £'000	Between 1 year and 5 years £'000	Over 5 years £'000	Total £'000
2018				
US Dollars/Sterling	**66,758**	**24,347**	**–**	**91,105**
Euro/other currencies	**7,035**	**(8,435)**	**–**	**(1,400)**
Total	**73,793**	**15,912**	**–**	**89,705**
2017				
US Dollars/Sterling	(139,103)	57,182	–	(81,921)
Euro/other currencies	1,407	(9,806)	(589)	(8,988)
Total	(137,696)	47,376	(589)	(90,909)

In July 2017, the Group's foreign exchange derivatives included forward contracts to sell £191.9m and receive USD$250.0m in March 2018 in connection with the proposed Sparton Corporation acquisition. The 2017 table above includes these forwards.

Net investment hedges

At the year end, the Group had net investments in US companies where the associated foreign currency translation risk was hedged by external borrowings in US Dollars. The value of the borrowings does not exceed the net investments and meets the conditions required to qualify as effective hedges. The value of the net investment hedge was US$84m (2017: US$265m).

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 1.23%. The floating rates are US Dollar LIBOR. At the year end, the nominal amounts of the interest rate swaps were US$45m (2017: US$60m). The hedging contracts fix US$45m of borrowings to 31 December 2018 reducing to nil 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 2018, the net fair value of interest rate swaps was £265,000 (2017: £434,000). The amount recycled from the income statement during the year was £435,000 and has been credited to interest cost in the year (2017: £27,000 charged).

The fair value will be realised in the income statement on a quarterly basis over the next 0.5 years. The Group also has US$60m of fixed rate debt with Pricoa at an interest rate of 3.60%, which is due for repayment in January 2019, and £50m of fixed rate debt with Pricoa at an interest rate of 2.87%, which is due for repayment in October 2025. 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
2018						
Cash and cash equivalents	**0.57%**	**96,319**	**96,319**	**–**	**–**	**–**
Loan notes	**3.11%**	**97,037**	**47,037**	**–**	**–**	**50,000**
Unsecured bank loans	**2.46%**	**146,304**	**128,722**	**17,582**	**–**	**–**
Government loans	**4.43%**	**10,382**	**–**	**–**	**–**	**10,382**
2017						
Cash and cash equivalents	0.55%	149,522	149,522	–	–	–
Loan notes	3.60%	51,752	7,393	44,359	–	–
Unsecured bank loans	2.56%	164,734	44,359	120,375	–	–
Government loans	4.43%	7,493	–	–	–	7,493

22 Financial instruments and financial risk management continued

Market risk sensitivity analysis

Interest rate risk

During 2018 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 2018. There is no significant difference between the amount recharged to the income statement and equity in the year.

	Profit before tax £'000
2018	**1% change**
Interest rate sensitivity	**(1,977)**
2017	
Interest rate sensitivity	(1,700)

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
2018								
Transaction	**5,479**	**5,479**	**(5,479)**	**(5,479)**	**16,437**	**16,437**	**(16,437)**	**(16,437)**
P&L translation	**4,601**	**4,094**	**(4,601)**	**(4,094)**	**11,504**	**12,282**	**(11,504)**	**(12,282)**
Foreign exchange derivatives	**(13,776)**	**(13,776)**	**792**	**792**	**(28,713)**	**(28,713)**	**9,040**	**9,040**
Total foreign exchange	**(3,696)**	**(4,203)**	**(9,288)**	**(8,781)**	**(772)**	**6**	**(18,901)**	**(19,679)**
2017								
Transaction	6,689	6,689	(6,689)	(6,689)	20,067	20,067	(20,067)	(20,067)
P&L translation	5,177	4,686	(5,177)	(4,685)	12,942	11,713	(12,942)	(11,713)
Foreign exchange derivatives	10,885	10,885	(9,294)	(9,294)	32,948	32,948	(20,245)	(20,245)
Total foreign exchange	22,751	22,260	(21,160)	(20,668)	65,957	64,728	(53,254)	(52,025)

In 2017, the Group's foreign exchange derivatives include forward contracts to sell £191.9m and receive USD$250.0m in March 2018 in connection with the proposed Sparton Corporation acquisition. The 2017 table above includes these forwards.

23 Government grants and loans

The Group, through its Canadian subsidiaries Ultra Electronics Tactical Communication Systems (TCS) and Ultra Electronics Maritime Systems (UEMS), participates in three Canadian programmes that provide government support in relation to the development of certain of its products.

Under the Strategic Aerospace and Defence Initiative (SADI), the Canadian Federal Government provides a long-term funding arrangement in respect of certain eligible research and development project costs. Under this arrangement, C$31.8m was provided to TCS and will be reimbursed at favourable rates of interest over the period to 2032. Up to C$8m will be provided to UEMS and reimbursed at favourable rates of interest over the period 2020 to 2033. The benefit of the below-market rate of interest has been calculated as the difference between the proceeds received and the fair value of the loans and has been credited to profit in the year.

The fair value of the loans has been calculated using a market interest rate for a similar instrument. The valuation used the discounted cash flow method and considered the value of expected payments using a risk-adjusted discount rate; the discount rate used was 18% for TCS and 15% for UEMS. For TCS, the amount repayable depends on future revenue growth of the TCS business to 2032 and will be between zero and x1.5 of the amounts received up to a maximum of C$47.7m. For UEMS, the amount repayable depends on future revenue growth of the UEMS business from 2020 to 2033 and will be between x1.0 and x1.5 of the amounts received up until the end of the funding period in 2019. As at 31 December 2018 C$2.8m had been received by UEMS.

The significant unobservable inputs for this Level 3 financial instrument are (i) whether, and by how much, TCS/UEMS revenues will grow during the periods to 2032/2033, and (ii) the specific years in which revenue will grow. There are significant inherent uncertainties in management's ability to forecast revenue over the following 15 years, particularly in later years. For TCS, if the compound annual revenue growth rate over the period from 2018 to 2032 was 2.5% higher than assumed in the valuation model, then the net present value of the liability as at 31 December 2018 would increase by C$2.3m (£1.3m). If the forecast revenue growth occurs in earlier years than envisaged, then the net present value of the liability will increase; if the revenue growth increases were to occur one year earlier than assumed in the valuation model, then the net present value of the liability as at 31 December 2018 would increase by C$0.6m (£0.4m).

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

23 Government grants and loans continued

TCS has also benefited from an Investissement Quebec (IQ) research and development programme, whereby IQ shared in the cost of research and development of certain specified new products. Under this arrangement, from 2010 to 2014 IQ financed C$8.8M of eligible costs associated with these specified projects. The funding is repayable under a royalty arrangement over the period of 2014 to 2021, based on sales of specified products. As there is no minimum repayment, funding received in respect of the IQ programme has been included in the income statement. Royalties repaid have also been included as costs in the income statement in the period where they have been incurred.

Amounts recognised in the financial statements in respect of these programmes were as follows:

	2018 £'000	2017 £'000
Fair value of SADI loan brought forward	**7,493**	6,308
Contributions	**1,630**	214
Interest charged to finance costs	**1,444**	1,133
Foreign exchange differences	**(185)**	(162)
Fair value of SADI loan carried forward	**10,382**	7,493

Government grants credited to profit in the year

	2018 £'000	2017 £'000
SADI	**233**	2,010
Other†	**–**	19
	233	2,029

† In 2017, Ultra Electronics Limited received a £13,000 grant from the UK Government and a £6,000 grant from the Technology Strategy Board.

24 Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period.

	Accelerated* tax depreciation £'000	Employee share options costs £'000	Derivatives £'000	Retirement benefit obligations £'000	Goodwill £'000	Other £'000	Total £'000
At 1 January 2017	(3,596)	589	4,054	19,517	(12,629)	6,887	14,822
Credit/(charge) to income	1,087	(470)	(4,291)	(1,271)	(3,926)	3,272	(5,599)
Charge to other comprehensive income	–	–	–	(4,113)	–	(74)	(4,187)
Charge direct to equity	–	(124)	–	–	–	–	(124)
Exchange differences	462	5	–	–	(315)	(704)	(552)
Effect of change in US tax rate	(2,285)	–	–	–	5,268	(3,021)	(38)
Reclassification	346	–	–	–	–	(346)	–
At 1 January 2018	**(3,986)**	**–**	**(237)**	**14,133**	**(11,602)**	**6,014**	**4,322**
Credit/(charge) to income	(392)	–	1,252	(840)	(2)	2,014	2,032
Credit/(charge) to other comprehensive income	–	–	29	(713)	–	–	(684)
Credit direct to equity	–	–	–	–	–	2,240	2,240
Exchange differences	(154)	–	–	–	(42)	524	328
Effect of change in US tax rate	–	–	–	–	–	–	–
Reclassification	–	–	–	–	–	–	–
At 31 December 2018	**(4,532)**	**–**	**1,044**	**12,580**	**(11,646)**	**10,792**	**8,238**

	2018 £'000	2017 £'000
Non-current assets	**18,692**	15,659
Non-current liabilities	**(10,454)**	(11,337)
	8,238	4,322

* 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.

24 Deferred tax continued

Unrecognised deferred tax assets

Deferred tax assets, in excess of offsetting tax liabilities, are recognised for loss carry forwards and deductible temporary differences to the extent that the utilisation against future taxable profits is probable. UK deferred tax assets of £1.2m (2017: £1.2m) and a US deferred tax asset of £3.1m (2017: £0.7m) have not been recognised as their recovery is uncertain.

25 Provisions

	Warranties £'000	Contract related provisions £'000	Other £'000	Total £'000
At 1 January 2018	4,666	3,131	6,421	14,218
Created	3,081	5,959	1,900	10,940
Reversed	(189)	(1,365)	(207)	(1,761)
Utilised	(1,414)	(1,308)	(1,437)	(4,159)
Exchange differences	123	105	60	288
At 31 December 2018	**6,267**	**6,522**	**6,737**	**19,526**
Included in current liabilities	3,114	5,992	4,220	13,326
Included in non-current liabilities	3,153	530	2,517	6,200
	6,267	**6,522**	**6,737**	**19,526**

Warranty provisions are based on an assessment of future claims with reference to past experience. Such costs are generally incurred within two years after delivery. Contract related provisions, for example including provisions for agent fees, are utilised over the period as stated in the contract to which the specific provision relates. Other provisions include re-organisation costs, deferred consideration and dilapidation costs. Dilapidations will be payable at the end of the contracted life, which is up to fifteen years. Contingent consideration is payable when earnings targets are met.

26 Share capital and share options

	2018		2017	
	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	**71,470,065**	**3,574**	77,731,224	3,887

During 2018, the Company purchased and cancelled 6,288,127 shares. The shares were acquired at an average price of £14.52 per share, with prices ranging from £12.87 to £16.90. The total cost of £91,904,241, including fees and stamp duty of £606,011, has been transferred to retained earnings. The total reduction in paid up capital was £314,000.

23,968 ordinary shares having a nominal value of £1,198 were allotted during the year under the terms of the Group's various share option schemes. The aggregate consideration received was £123,000.

Share options

During the year to 31 December 2018, 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 average of the daily average market price on the day 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 average of the daily average market price on the day before the grant less 10%. The vesting periods are three and five years. If the options remain unexercised after a period of six months from the date of maturity, the options expire. Options are forfeited if the employee leaves the Group before the options vest.

Notes to accounts – Group continued

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26 Share capital and share options continued

At 31 December 2018, share options outstanding under the Savings-Related Share Option Schemes were as follows:

Options granted	Number of shares 2018	2017	Option price (£)	Exercise dates
2016 – US scheme	**36,392**	45,528	15.98	September 2018 – December 2018
2017 – US scheme	**43,945**	46,381	15.89	September 2019 – December 2019
2018 – US scheme	**44,497**	–	14.60	September 2020 – December 2020
2014 – Canadian scheme	**–**	6,526	16.13	October 2017 – April 2018
2015 – Canadian scheme	**9,391**	9,971	16.12	December 2018 – June 2019
2016 – Canadian scheme	**6,590**	6,905	15.98	December 2019 – June 2020
2017 – Canadian scheme	**7,800**	8,659	16.55	December 2020 – June 2021
2018 – Canadian scheme	**12,577**	–	14.45	December 2021 – June 2022
2012 – UK 5 year scheme	**–**	20,826	13.85	December 2017 – June 2018
2013 – UK 5 year scheme	**10,925**	11,323	16.80	December 2018 – June 2019
2014 – UK 3 year scheme	**–**	10,515	16.13	December 2017 – June 2018
2014 – UK 5 year scheme	**5,831**	5,924	16.13	December 2019 – June 2020
2015 – UK 3 year scheme	**9,725**	11,879	16.12	December 2018 – June 2019
2015 – UK 5 year scheme	**5,817**	6,189	16.12	December 2020 – June 2021
2016 – UK 3 year scheme	**46,617**	55,431	15.10	December 2019 – June 2020
2016 – UK 5 year scheme	**32,660**	34,764	15.10	December 2021 – June 2022
2017 – UK 3 year scheme	**26,829**	31,273	16.55	December 2020 – June 2021
2017 – UK 5 year scheme	**13,233**	14,682	16.55	December 2022 – June 2023
2018 – UK 3 year scheme	**35,219**	–	14.45	December 2021 – June 2022
2018 – UK 5 year scheme	**17,126**	–	14.45	December 2023 – June 2024

2. Company Share Option Plan

The Company Share Option Plan provides share options for nominated employees in the UK. The purchase price is set at a mid-market price on the date of the grant. This is an approved scheme and vesting is unconditional. Options vest after three years and lapse after ten years from the date of the grant.

At 31 December 2018, share options outstanding under the Company Share Option Plan were as follows:

Options granted	Number of shares 2018	2017	Option price (£)	Exercise dates
2010	**2,661**	3,054	14.83	March 2013 – March 2020
2011	**3,673**	3,673	16.97	March 2014 – March 2021
2012	**4,022**	4,022	17.10	March 2015 – March 2022
2013	**9,309**	10,715	17.18	March 2016 – March 2023
2014	**10,748**	13,108	18.29	March 2017 – March 2024
2015	**6,436**	10,758	17.31	March 2018 – March 2025
2016	**24,081**	27,206	17.90	March 2019 – March 2026
2017	**16,374**	18,674	21.91	March 2020 – March 2027
2018	**28,691**	–	14.65	March 2021 – March 2028

26 Share capital and share options continued

3. Executive Share Option Scheme

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

At 31 December 2018, share options outstanding under the Executive Share Option Scheme were as follows:

Options granted	Number of shares 2018	Number of shares 2017	Option price (£)	Exercise dates
2011	**–**	16,276	16.97	March 2014 – March 2018
2012	**20,296**	22,549	17.10	March 2015 – March 2019
2013	**40,266**	41,186	17.18	March 2016 – March 2020
2014	**53,901**	61,942	18.29	March 2017 – March 2021
2015	**91,284**	101,014	17.31	March 2018 – March 2022
2016	**105,623**	111,662	17.90	March 2019 – March 2023
2017	**102,255**	109,420	21.91	March 2020 – March 2024
2018	**161,865**	–	14.65	March 2021 – March 2025

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 62–77. In April 2018, LTIPs were awarded to nominated employees. The awards will vest in March 2021 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 (£) 2018	Number of options 2018	Weighted average exercise price (£) 2017	Number of options 2017
Beginning of year	**10.65**	**1,453,170**	11.64	1,450,545
Granted during the year	**7.34**	**614,785**	10.40	468,851
Forfeited during the year	**15.78**	**(31,762)**	15.91	(83,566)
Expired during the year	**6.28**	**(283,609)**	7.79	(176,792)
Exercised during the year	**4.68**	**(22,919)**	17.39	(205,868)
Outstanding at the end of the year	**10.17**	**1,729,665**	10.65	1,453,170
Exercisable at the end of the year	**17.20**	**309,029**	17.10	214,392

The Group recognised total expenses of £1,493,000 (2017: £682,000) 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 £15.00. The fair value of options granted during the year that are expected to vest was £4,402,058 (2017: £4,283,912).

The Group's equity-settled share-based payments are measured at fair value at the date of the grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. The fair value for all schemes other than the 2013, 2014, 2015 and 2016 March LTIP schemes are measured by use of the Black-Scholes option pricing model using the following assumptions:

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

26 Share capital and share options continued

	Share save*	CSOP*	ESOS*	LTIP*†
2018				
Weighted average share price (£)	**17.30**	**17.37**	**17.14**	**17.18**
Weighted average exercise price (£)	**15.53**	**17.42**	**17.13**	**n/a**
Expected volatility %	**22.8**	**23.5**	**24.4**	**5.2**
Expected option life (years)	**3.6**	**6.0**	**5.0**	**3.0**
Risk-free interest rate %	**0.7**	**1.4**	**1.5**	**0.2**
Expected dividends %	**2.7**	**2.5**	**2.4**	**0.0**
	Share save*	**CSOP***	**ESOS***	**LTIP***
2017				
Weighted average share price (£)	17.49	17.61	17.47	18.86
Weighted average exercise price (£)	15.71	17.66	17.46	n/a
Expected volatility %	20.4	23.2	23.9	19.0
Expected option life (years)	3.8	6.0	5.0	3.0
Risk-free interest rate %	0.6	1.4	1.5	0.5
Expected dividends %	2.6	2.4	2.3	0.0

* Figures in the above table show an average across the invested schemes at year end.
† April 2018 LTIP.

For the 2013, 2014, 2015 and 2016 March LTIP awards, the stochastic model has been used to calculate the fair value of the awards at the grant date as this is the most accurate way of modelling the TSR performance condition. The fair value of these schemes has been calculated using the following assumptions:

	2018	2017
Exercise price (£)	**n/a**	n/a
Share price at grant (£)	**17.96**	19.05
Expected option life (years)	**3.0**	3.0
Expected volatility %	**10.3**	19.2
Risk-free interest rate %	**0.3**	0.4

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

The weighted average fair value of options granted during the year was £8.32 (2017: £11.88).

The weighted average remaining contractual life of share options was 3.3 years (2017: 4.2 years).

27 Equity

	Share capital £'000	Share premium account £'000	Capital redemption reserve £'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 2017	3,523	64,020	–	(2,581)	(68,986)	139,492	228,034	69	363,571
Total comprehensive income for the year	–	–	–	–	20,927	(44,089)	68,978	(30)	45,786
Issue of share capital	352	133,195	–	–	–	–	–	–	133,547
Equity-settled employee share scheme	12	3,696	–	–	–	–	682	–	4,390
Tax on share based payments	–	–	–	–	–	–	(124)	–	(124)
Dividends to shareholders	–	–	–	–	–	–	(34,959)	–	(34,959)
Balance at 1 January 2018	**3,887**	**200,911**	**–**	**(2,581)**	**(48,059)**	**95,403**	**262,611**	**39**	**512,211**
Adoption of IFRS 15 (net of tax)	–	–	–	–	–	–	(9,916)	–	(9,916)
Total comprehensive income for the year	–	–	–	–	(11,661)	21,100	36,256	(31)	45,664
Equity-settled employee share scheme	1	122	–	–	–	–	1,493	–	1,616
Shares purchased in buy-back	(314)	–	314	–	–	–	(91,902)	–	(91,902)
Dividends to shareholders	–	–	–	–	–	–	(36,883)	–	(36,883)
Balance at 31 December 2018	**3,574**	**201,033**	**314**	**(2,581)**	**(59,720)**	**116,503**	**161,659**	**8**	**420,790**

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

The "own shares reserve" represents the cost of shares in Ultra Electronics Holdings plc purchased in the market and held by the Ultra Electronics Employee Trust to satisfy options under the Group's Long-Term Incentive Plan ("LTIP") share schemes. At 31 December 2018, the number of own shares held was 235,247 (2017: 235,245).

28 Notes to the cash flow statement

	2018 £'000	2017 £'000
Operating profit	**65,338**	61,484
Adjustments for:		
Depreciation of property, plant and equipment	**8,933**	10,166
Amortisation of intangible assets	**32,366**	31,995
Impairment charge	**7,589**	1,608
Cost of equity-settled employee share schemes	**1,493**	682
Adjustment for pension funding	**(10,301)**	(8,964)
Loss on disposal of property, plant and equipment	**53**	565
Increase/(decrease) in provisions	**4,948**	(7,086)
Operating cash flow before movements in working capital	**110,419**	90,450
Increase in inventories	**(10,198)**	(2,093)
Increase in receivables	**(1,808)**	(15,367)
Increase in payables	**4,033**	24,442
Cash generated by operations	**102,446**	97,432
Income taxes paid	**(4,640)**	(10,324)
Interest paid	**(11,094)**	(9,543)
Net cash from operating activities	**86,712**	77,565

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

	2018 £'000	2017 £'000
Net increase in cash and cash equivalents	**(54,955)**	80,118
Cash inflow from movement in debt and finance leasing	**(17,664)**	85,482
Change in net debt arising from cash flows	**(72,619)**	165,600
Loan syndication costs	**657**	2,040
Amortisation of finance costs of debt	**(761)**	(1,281)
Translation differences	**(10,224)**	15,884
Movement in net debt in the year	**(82,947)**	182,243
Net debt at start of year	**(74,457)**	(256,700)
Net debt at end of year	**(157,404)**	(74,457)

Net debt comprised the following:

	2018 £'000	2017 £'000
Cash and cash equivalents	**96,319**	149,522
Borrowings	**(253,723)**	(223,979)
	(157,404)	(74,457)

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

Reconciliation of changes in financing liabilities:

	2018 £'000	2017 £'000
Borrowings at start of year	**(223,979)**	(331,325)
Repayments of borrowings	**181,297**	168,975
Proceeds from borrowings	**(198,961)**	(83,493)
Loan syndication costs	**657**	2,040
Amortisation of finance costs of debt	**(761)**	(1,281)
Translation differences	**(11,976)**	21,105
Borrowings at end of year	**(253,723)**	(223,979)

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

29 Other financial commitments

a) Capital commitments

At the end of the year capital commitments were:

	2018 £'000	2017 £'000
Contracted but not provided	**1,009**	696

b) Lease commitments

At 31 December 2018, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2018 £'000	2017 £'000
Within one year	**10,390**	11,557
Between one and five years	**22,611**	24,402
After five years	**3,908**	5,961
	36,909	41,920

30 Retirement benefit schemes

Some UK employees of the Group are members of the Ultra Electronics Limited defined benefit scheme which was established on 1 March 1994. The scheme was closed to new members in 2003. The scheme is a final salary scheme with the majority of members accruing 1/60th of their final pensionable earnings for each year of pensionable service, however the scheme was closed to future benefit accrual from 5 April 2016. A defined contribution plan was introduced for other employees and new joiners in the UK. The latest full actuarial valuation of the defined benefit scheme was carried out as at 6 April 2016. The Group also operates two defined contribution schemes for overseas employees. In addition to these schemes, the Group's Tactical Communication Systems business based in Montreal, Canada, has three defined benefit schemes and the Swiss business of the Forensic Technology group has a defined benefit scheme.

Defined contribution schemes

The total cost charged to income in respect of the defined contribution schemes was £9,749,000 (2017: £9,848,000).

Defined benefit schemes

All the defined benefit schemes were actuarially assessed at 31 December 2018 using the "projected unit" method.

In the UK, Ultra Electronics Limited sponsors the Ultra Electronics Pension Scheme, a funded defined benefit pension scheme. The scheme is administered within a trust which is legally separate from the Company. Trustees are appointed by both the Company and the scheme's membership and act in the interests of the scheme and all relevant stakeholders, including the members and the Company. The Trustees are also responsible for the investment of the scheme's assets.

This scheme provides pensions and lump sums to members on retirement and to their dependants on death.

The Trustees are required to use prudent assumptions to value the liabilities and costs of the scheme whereas the accounting assumptions must be best estimates.

Responsibility for making good any deficit within the scheme lies with the Company and this introduces a number of risks for the Company. The major risks are: interest rate risk, inflation risk, investment risk and longevity risk. The Company and Trustees are aware of these risks and manage them through appropriate investment and funding strategies. The Trustees manage governance and operational risks through a number of internal controls policies, including a risk register.

Investment Strategy

The investment strategy is set by the Trustee of the Scheme. The current strategy is broadly split into growth and matching portfolios. The growth portfolio is primarily invested in equities, property, diversified growth funds, private equity and private credit. The matching portfolio is invested primarily in bonds, through the "absolute return bonds" holding, and liability driven investment ("LDI") funds. Part of the investment objective of the Scheme is to minimise fluctuations in the Scheme's funding levels due to changes in the value of the liabilities. This is primarily achieved through the use of the LDI funds that aim to hedge movements in the liabilities due to changes in interest rate and inflation expectations. Currently, the Scheme targets hedging of around 65% on the technical provisions funding measure to both interest rate and inflation expectation changes. LDI primarily involves the use of government bonds and derivatives such as interest rate and inflation swaps. The main risk is that the investments held move differently to the liability exposures; this risk is managed by the Trustee, its advisers and the Scheme's LDI manager, who regularly assess the position.

The assets held are also well diversified, across asset classes and investment managers. This reduces the risk of drops in the value of individual asset classes, or a particular manager underperforming its investment objectives, having a negative impact on the funding position of the Scheme. The investment performance and liability experience are regularly reviewed by the Trustee, and the Trustee will consult with the Company over any changes to the investment strategy.

30 Retirement benefit schemes continued

Rather than holding the underlying assets directly, the Scheme invests in pooled investment vehicles managed by professional external investment managers, whom the Trustee has appointed with the help of its investment advisors. The equity and diversified growth fund valuations are based on quoted market prices, while the property, private equity, private credit, absolute return bonds and LDI are primarily unquoted. All valuations are provided by the respective investment manager.

GMP Equalisation

Following a High Court judgment on 26 October 2018, it has become apparent across the UK pension industry that equalisation is required with respect to Guaranteed Minimum Pensions ("GMPs"). Scheme benefits earned in the period 17 May 1990 to 5 April 1997 may be affected by the requirement to equalise GMPs. It will take a considerable time for trustees and employers to decide on the approach for GMP equalisation, gather data, calculate the new benefits and cost, and ultimately make payments to members. The initial estimate for the Ultra Electronics Limited defined benefit scheme is that the impact is £3.2m; this has been recorded as a debit to the income statement in 2018 with a corresponding increase in scheme liabilities.

Valuation

The scheme is subject to regular actuarial valuations, which are usually carried out every three years. The last actuarial valuation of the scheme was on 6 April 2016. The next actuarial valuation is due to be carried out with an effective date of 6 April 2019. These actuarial valuations are carried out in accordance with the requirements of the Pensions Act 2004 and so include deliberate margins for prudence. This contrasts with these accounting disclosures, which are determined using best estimate assumptions.

The results of the 6 April 2016 valuation have been projected to 31 December 2018 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 2018	Canada 2018	Switzerland 2018	UK 2017	Canada 2017	Switzerland 2017
Discount rate	**2.80%**	**3.75%**	**0.90%**	2.50%	3.50%	0.65%
Inflation rate – RPI	**3.20%**	**3.20%**	**1.10%**	3.20%	3.20%	1.00%
Inflation rate – CPI	**2.20%**	**2.20%**	**1.10%**	2.20%	2.20%	1.00%
Expected rate of salary increases	**n/a**	**3.45%**	**1.00%**	n/a	3.45%	1.00%
Future pension increases (pre 6/4/08)	**2.95%**	**n/a**	**n/a**	2.95%	n/a	n/a
Future pension increases (post 6/4/08)	**1.95%**	**n/a**	**n/a**	1.95%	n/a	n/a

For each of these assumptions there is a range of possible values. Relatively small changes in some of these variables can have a significant impact on the level of the total obligation. For the UK scheme, a 0.5% increase in the inflation assumption to 3.70% and a 0.5% decrease in the discount rate to 2.30% would increase the scheme's liabilities by 6.5% and 9.6% respectively. If the members' life expectancy were to increase by 1 year, the scheme liabilities would increase by 4.2%. The average duration of the scheme liabilities is 18 years (2017: 19 years).

The assumptions used are provided by Willis Towers Watson as Company advisors, and also by reference to the Bank of England Gilt curve at a duration appropriate to the scheme's liabilities of 18 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 2017 1.25% imps from 2007 (UK only)
Future pensioners	100% SAPS S2PMA_L/84% SAPS S2PFA_L c2007 CMI 2017 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:

	2018	2017
Current pensioners (at 65) – males	**23 years**	23 years
Current pensioners (at 65) – females	**26 years**	26 years
Future pensioners (at 65) – males	**24 years**	25 years
Future pensioners (at 65) – females	**27 years**	27 years

Notes to accounts – Group continued

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30 Retirement benefit schemes continued

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

	UK 2018 £m	Canada 2018 £m	Switzerland 2018 £m	Total 2018 £m	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m
Current service cost	–	0.1	0.3	0.4	–	0.1	0.3	0.4
Administration expenses	–	0.1	–	0.1	0.9	0.1	–	1.0
Interest on pension scheme liabilities	9.1	0.4	–	9.5	9.6	0.3	0.1	10.0
GMP equalisation	3.2	–	–	3.2	–	–	–	–
Expected return on pension scheme assets	(7.2)	(0.4)	–	(7.6)	(7.0)	(0.3)	–	(7.3)
Charge/(credit)	5.1	0.2	0.3	5.6	3.5	0.2	0.4	4.1

Of the current service cost for the year, £0.1 million (2017: £nil) has been included in cost of sales, and £0.3 million (2017: £0.4 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 2018 £m	Canada 2018 £m	Switzerland 2018 £m	Total 2018 £m	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m
Fair value of scheme assets	281.7	9.6	6.4	297.7	289.8	10.6	5.9	306.3
Present value of scheme liabilities	(353.1)	(10.1)	(7.5)	(370.7)	(371.3)	(10.7)	(7.0)	(389.0)
Scheme deficit	(71.4)	(0.5)	(1.1)	(73.0)	(81.5)	(0.1)	(1.1)	(82.7)
Related deferred tax asset	12.3	0.1	0.2	12.6	13.9	–	0.2	14.1
Net pension liability	(59.1)	(0.4)	(0.9)	(60.4)	(67.6)	(0.1)	(0.9)	(68.6)

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

	UK 2018 £m	Canada 2018 £m	Switzerland 2018 £m	Total 2018 £m	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m
Present value of obligation at 1 January	(371.3)	(10.7)	(7.0)	(389.0)	(382.4)	(11.1)	(7.0)	(400.5)
Current service cost	–	(0.1)	(0.3)	(0.4)	–	(0.1)	(0.3)	(0.4)
Interest cost	(9.1)	(0.4)	–	(9.5)	(9.6)	(0.3)	(0.1)	(10.0)
Actuarial gains and losses	16.4	0.2	0.1	16.7	9.0	(0.2)	–	8.8
Exchange difference	–	0.3	(0.4)	(0.1)	–	0.3	0.3	0.6
Insured pensioner adjustment	–	(0.1)	–	(0.1)	–	–	–	–
GMP equalisation	(3.2)	–	–	(3.2)	–	–	–	–
Benefits paid	14.1	0.7	0.1	14.9	11.7	0.7	0.1	12.5
Present value of obligation at 31 December	(353.1)	(10.1)	(7.5)	(370.7)	(371.3)	(10.7)	(7.0)	(389.0)

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

	UK 2018 £m	Canada 2018 £m	Switzerland 2018 £m	Total 2018 £m	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m
Fair value at 1 January	289.8	10.6	5.9	306.3	271.2	10.4	5.7	287.3
Expected return on scheme assets	7.2	0.4	–	7.6	7.0	0.3	–	7.3
Actuarial gains and losses	(11.2)	(0.9)	–	(12.1)	14.7	0.4	0.2	15.3
Exchange differences	–	(0.3)	0.3	–	0.1	(0.3)	(0.3)	(0.5)
Employer contributions	10.0	0.5	0.3	10.8	9.4	0.6	0.4	10.4
Insured pensioner adjustment	–	0.1	–	0.1	–	–	–	–
Administration expenses	–	(0.1)	–	(0.1)	(0.9)	(0.1)	–	(1.0)
Benefits paid	(14.1)	(0.7)	(0.1)	(14.9)	(11.7)	(0.7)	(0.1)	(12.5)
Fair value at 31 December	281.7	9.6	6.4	297.7	289.8	10.6	5.9	306.3

30 Retirement benefit schemes continued

Scheme assets were as follows:

	UK 2018 £m	**Canada 2018 £m**	**Switzerland 2018 £m**	**Total 2018 £m**	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m
Fair value:								
Equities	**73.9**	**2.3**	**2.1**	**78.3**	95.1	3.5	2.1	100.7
Bonds	**–**	**4.6**	**1.7**	**6.3**	–	6.5	1.7	8.2
Property	**25.2**	**–**	**1.0**	**26.2**	16.6	–	0.8	17.4
Other assets	**0.6**	**2.7**	**1.3**	**4.6**	1.5	0.6	1.0	3.1
Other investment funds:								
Absolute return	**83.6**	**–**	**0.3**	**83.9**	78.4	–	0.3	78.7
LDI	**82.8**	**–**	**–**	**82.8**	75.5	–	–	75.5
Multi-asset credit	**15.6**	**–**	**–**	**15.6**	22.7	–	–	22.7
	281.7	**9.6**	**6.4**	**297.7**	289.8	10.6	5.9	306.3

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

	UK 2018 £m	**Canada 2018 £m**	**Switzerland 2018 £m**	**Total 2018 £m**	UK 2017 £m	Canada 2017 £m	Switzerland 2017 £m	Total 2017 £m
Actual return less expected return on pension scheme assets	**(11.2)**	**(0.9)**	**–**	**(12.1)**	14.7	0.4	0.2	15.3
Experience gains arising on scheme liabilities	**(3.7)**	**–**	**(0.1)**	**(3.8)**	(0.3)	(0.2)	(0.3)	(0.8)
Changes in assumptions underlying the present value of the scheme liabilities	**20.1**	**0.2**	**0.2**	**20.5**	9.3	–	0.3	9.6
	5.2	**(0.7)**	**0.1**	**4.6**	23.7	0.2	0.2	24.1

Cumulative actuarial losses, net of deferred tax, recognised in the consolidated statement of comprehensive income at 31 December 2018 were £68.9 million (2017: £73.5 million).

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

	2018 £m	2017 £m	2016 £m	2015 £m	2014 £m
Present value of defined benefit obligations	**(370.7)**	(389.0)	(400.5)	(322.4)	(321.7)
Fair value of scheme assets	**297.7**	306.3	287.3	237.6	234.4
Scheme deficit	**(73.0)**	(82.7)	(113.2)	(84.8)	(87.3)
Experience adjustments on scheme liabilities	**(3.8)**	(0.8)	4.0	–	(2.5)
Percentage of scheme liabilities	**(1.0%)**	(0.2%)	1.0%	–	0.8%
Experience adjustment on scheme assets	**(12.1)**	15.3	40.7	(7.9)	21.8
Percentage of scheme assets	**(4.1%)**	5.0%	14.2%	(3.3%)	9.3%

The amount of contributions expected to be paid to defined benefit schemes during the 2019 financial year is £10.5m. For the UK scheme this includes an additional deficit payment of £10m agreed with the Trustee. This will be followed by £11.0m per annum for the following five years.

31 Acquisitions and disposals

On 7 July 2017, Ultra announced that it had entered into a conditional agreement to acquire Sparton Corporation ("Sparton"), its 50/50 partner in the long-standing ERAPSCO joint venture, which supplies sonobuoys to the US Navy. The transaction was subject to the approval of the United States Department of Justice ("DOJ") under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR"). Following discussions with the DOJ, and competition concerns raised by it, Ultra and Sparton mutually decided to terminate the merger agreement in March 2018.

Acquisitions

In aggregate, cash consideration of £6.5m was paid in respect of retention payments in the prior period for the 3Phoenix acquisition. No such payments have been made in the current year.

Disposals

Fuel Cell business

The Maritime & Land division disposed of its small Fuel Cell business in December 2018. Cash proceeds of the sale totalled £0.6m, of which £0.2m was received in the year with an additional £0.4m to be received in 2019. The net loss on disposal was £0.7m.

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

31 Acquisitions and disposals continued

	2018 £'000
Property, plant and equipment	**402**
Inventories	**1,032**
Payables	**(80)**
Total	**1,354**
Proceeds (cash in 2018 and 2019)	**(625)**
Loss on disposal	**729**

Airport Systems

On 2 November 2018, the Group announced the agreed disposal of the Airport Systems business to ADB SAFEGATE for £22m, of which £2m will be deferred until the novation of certain contracts has completed. The Airport Systems business was in the Aerospace & Infrastructure division. The disposal was completed on 1 February 2019. As at 31 December 2018, the assets and liabilities have been classified as held for sale. As set out in note 14, a £6.6m goodwill impairment charge has been recorded in 2018.

	2018 £'000
Goodwill	**21,761**
Intangible fixed assets	**12**
Property, plant and equipment	**1,514**
Inventories	**615**
Trade and other receivables	**6,673**
Total assets classified as held for sale	**30,575**
Trade and other payables	**(8,575)**
Total liabilities classified as held for sale	**(8,575)**
Net assets of disposal group	**22,000**

32 Related party transactions

Remuneration of key management personnel

The remuneration of key management personnel, which includes the Directors of the Group, is set out below in aggregate for each of the categories specified in IAS 24: Related Party Disclosures. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report on pages 62–77.

	2018 £'000	2017 £'000
Short-term employee benefits	**3,301**	3,428
Post-employment benefits	**277**	425
Share-based payments	**3,761**	2,592
	7,339	6,445

33 Non-controlling interests

There is a 5% non-controlling interest in the Group's Corvid Holdings Limited subsidiary. Before any intra-Group eliminations, the consolidated revenue of the subsidiary in the year was £4,255,000 (2017: £4,211,000), the loss was £595,000 (2017: £578,000 loss) and the net assets were £2,321,000 (2017: £2,892,000). Sales to Group companies were £2,411,000 (2017: £2,418,000).

34 Contingent liabilities

The Group has entered into a number of guarantee and performance bond arrangements in the normal course of business totalling £50.6m (2017: £42.8m).

The nature of much of the contracting work performed by the Group means that there are occasional contractual issues, variations and renegotiations that arise. In addition, the Group is, from time to time, party to legal proceedings and claims which arise in the ordinary course of business. In particular, the Oman Airport IT contract between the Sultanate of Oman, Ministry of Transport & Communications and 'Ithra' ("Ultra Electronics in collaboration with Oman Investment Corporation LLC", the legal entity established with the sole purpose of delivering that contract and which was placed into voluntary liquidation in March 2015) was terminated in February 2015 and there are various proceedings in relation to that contract and its termination. There remains significant uncertainty regarding the likely outcome of these proceedings and it is not possible to reliably estimate the financial effect that may result from the ultimate outcome. Further, as previously announced, the SFO is continuing to investigate the conduct of business in Algeria by Ultra Electronics Holdings plc, its subsidiaries, employees and associated persons. The investigation commenced in April 2018 following a voluntary self-report made by Ultra to the SFO. Ultra continues to cooperate with the SFO and will make a further statement once the investigation is complete. It is not yet possible to estimate the timescale in which the investigation might be resolved, or to reliably predict its outcome.

35 Additional information as required by Listing Rules Requirement 9.8.4

- Long-term incentive schemes – see Directors' Remuneration Report
- Allocation of equity securities for cash – see note 26
- Election of independent Directors – see Corporate Governance Report on page 51
- Contractual arrangements – see Directors' Report on page 78
- Details of independent Directors – see Corporate Governance Report on page 44–45
- Substantial shareholders – see Directors' Report on page 78

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 are considered to be a Controlling Shareholder (as defined in Listing Rules 6.1.2A).

36 Related undertakings

The Company owns either directly or indirectly the ordinary share capital of the following undertakings:

Company name	Country incorporated	% owned	Direct/Indirect (Group interest)
3 Phoenix Inc.	United States	100%	Indirect (Group interest)
3e Technologies International Inc.	United States	100%	Indirect (Group interest)
AEP Networks Asia Pacific SDN BHD	Malaysia	100%	Indirect (Group interest)
AEP Networks Australia Pty Limited	Australia	100%	Indirect (Group interest)
AEP Networks Inc.	United States	100%	Indirect (Group interest)
AEP Networks Limited	Ireland	100%	Direct
AEP Networks Limited	United Kingdom	100%	Indirect (Group interest)
CORVID Holdings Limited	Guernsey	95%	Direct
CORVID Paygate Limited	Guernsey	95%	Indirect (Group interest)
CORVID Protect Holdings Limited	Guernsey	95%	Indirect (Group interest)
Dascam Consulting Limited	Cyprus	100%	Direct
DF Group Limited	United Kingdom	100%	Direct
EMS Development Corporation	United States	100%	Indirect (Group interest)
ERAPSCO	United States	50%	Indirect (Group interest)
EW Simulation Technology Limited	United Kingdom	100%	Indirect (Group interest)
Flightline Electronics Inc.	United States	100%	Indirect (Group interest)
Forensic Technology (Europe) Limited	Ireland	100%	Direct
Forensic Technology AEC Thailand Limited	Thailand	100%	Direct
Forensic Technology Inc.	United States	100%	Direct
Forensic Technology Mexico S. de RL. de C.V	Mexico	100%	Indirect (Group interest)
Forensic Technology-Tecnologia Forense Ltda	Brazil	100%	Indirect (Group interest)
Furnace Parts LLC	United States	100%	Indirect (Group interest)
Giga Communications Limited	United Kingdom	100%	Direct
GIGASAT, INC.	United States	100%	Direct
Gigasat. Asia Pacific Pty Limited	Australia	100%	Indirect (Group interest)
Herley Industries Inc.	United States	100%	Indirect (Group interest)
Herley-CTI Inc.	United States	100%	Indirect (Group interest)
Projectina AG	Switzerland	100%	Direct
Prologic Inc.	United States	100%	Indirect (Group interest)
Special Operations Technology Inc. (SOTECH)	United States	100%	Indirect (Group interest)
Ultra Electronics (USA) Group Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Advanced Tactical Systems Inc.	United States	100%	Indirect (Group interest)

Notes to accounts – Group continued

FOR THE YEAR ENDED 31 DECEMBER 2018

36 Related undertakings continued

Company name	Country incorporated	% owned	Direct/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 Finance Limited	Jersey	100%	Indirect (Group interest)
Ultra Electronics Finance Switzerland A.G.	Switzerland	100%	Indirect (Group interest)
Ultra Electronics Forensic Technology Inc./Les Technologies Ultra Electronics Forensic Inc.	Canada	100%	Direct
Ultra Electronics Hong Kong Holdings Limited	Hong Kong	100%	Direct
Ultra Electronics ICE, Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics in collaboration with Oman Investment Corporation LLC (in liquidation)	Oman	70%	Direct
Ultra Electronics Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Investments (USA) LLC	United States	100%	Indirect (Group interest)
Ultra Electronics Limited	United Kingdom	100%	Direct
Ultra Electronics Maritime Systems Inc.	Canada	100%	Indirect (Group interest)
Ultra Electronics Measurement Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics (Netherlands) Limited	United Kingdom	100%	Indirect (Group interest)
Ultra Electronics Ocean Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Pension Trustee Company Limited	United Kingdom	100%	Indirect (Group interest)
Ultra Electronics Precision Air and Land Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Secure Intelligence Systems Inc.	United States	100%	Indirect (Group interest)
Ultra Electronics Swiss Holdings Company Limited	United Kingdom	100%	Indirect (Group interest)
Ultra Electronics TCS Inc.	Canada	100%	Indirect (Group interest)
Ultra Electronics Technology (Beijing) Co Limited	China	100%	Direct
Ultra Electronics Tisys	France	100%	Direct
Ultra Electronics TopScientific Aerospace Limited	Hong Kong	50%	Direct
UnderSea Sensor Systems Inc.	United States	100%	Indirect (Group interest)
Vados Systems Limited	United Kingdom	100%	Indirect (Group interest)
Weed Instrument Company Inc.	United States	100%	Indirect (Group interest)

The principal activity of the trading subsidiary undertakings is the design, development and manufacture of electronic systems for the international defence and aerospace markets.

Registered Office: Ultra Electronics Holdings plc, 417 Bridport Road, Greenford, Middlesex UB6 8UA, England.

37 IFRS 15 – Revenue from contracts with customers

IFRS 15 Revenue from contracts with customers became effective from 1 January 2018. The standard has been adopted using the modified retrospective method such that the cumulative impact of IFRS 15 was posted through retained earnings on 1 January 2018, as shown on the Statement of Changes in Equity. Comparative statutory numbers are not restated. The table below sets out the impact to the 1 January 2018 opening balance sheet of the application of IFRS 15.

		Adjustment				
	Year ended 31 December 2017 as presented £m	Over time becoming point in time £m	Separation of performance obligations £m	Other £m	Total adjustment £m	Year ended 31 December 2017 if presented under IFRS 15 £m
Balance Sheet impact						
Inventories	76.6	1.5	–	(0.3)	1.2	77.8
Amounts receivable from over time contract customers	116.7	(1.6)	(10.3)	1.4	(10.5)	106.2
Amounts due to over time contract customers	(58.7)	(2.9)	–	0.1	(2.8)	(61.5)
Tax liabilities	(13.6)	–	–	2.2	2.2	(11.4)
Net assets	512.2	(3.0)	(10.3)	3.4	(9.9)	502.3
Adjustment to retained earnings	**262.6**	**(3.0)**	**(10.3)**	**3.4**	**(9.9)**	**252.7**

Although Ultra has adopted the modified retrospective approach, with the cumulative impact of IFRS 15 posted through retained earnings at 1 January 2018, to provide further information to readers of the financial statements, the table below sets out the impact to the 2017 full year income statement as if IFRS 15 had been applied during 2017.

		Adjustment				
	Year ended 31 December 2017 as presented £m	Over time becoming point in time £m	Separation of performance obligations £m	Other £m	Total adjustment £m	Year ended 31 December 2017 if presented under IFRS 15 £m
Income Statement impact						
Revenue	**775.4**	**(5.6)**	**(0.6)**	**(0.9)**	**(7.1)**	**768.3**
Cost of sales	(545.2)	4.2	–	0.5	4.7	(540.5)
Gross profit	230.2	(1.4)	(0.6)	(0.4)	(2.4)	227.8
Underlying operating profit	**120.1**	**(1.4)**	**(0.6)**	**(0.4)**	**(2.4)**	**117.7**
Statutory operating profit	61.5	(1.4)	(0.6)	(0.4)	(2.4)	59.1
Statutory profit before tax	60.6	(1.4)	(0.6)	(0.4)	(2.4)	58.2
Tax	(11.7)	–	–	0.7	0.7	(11.0)
Statutory profit after tax	**48.9**	**(1.4)**	**(0.6)**	**0.3**	**(1.7)**	**47.2**

The most significant changes relative to previous accounting treatments arise in the following areas:

Over time revenue becoming point in time

A small number of contracts no longer qualify to be contract-accounted and revenue is now recorded at the point at which control of the goods transfers to the customer as opposed to revenue being recognised over the life of the contract. If IFRS 15 had been applied in 2017 then £1.4m of profit would have been delayed from 2017 to 2018, when the control was transferred to the customer.

Separation of performance obligations

The revenue for the substantial majority of contracts that were previously recognised using contract accounting continues to be accounted for over the life of the contract, however the method by which performance obligations are determined has changed on certain contracts. Details on how the Group determines performance obligations is included in accounting policies on page 133.

For a performance obligation to be recognised over time, the Group recognises revenue using an input method. As such, revenue and related margin are calculated based on reliable estimates of transaction price and total expected costs, with revenue recognised as costs are incurred. The Group has determined that this method reflects the Group's performance in transferring control of the goods and services to the customer.

When applying IFRS 15 there was a separation of performance obligations on a number of contracts, primarily between development and production phases, which led to lower margins being recognised in the initial contract performance obligations. As such, £0.6m of profit recognised in 2017 under prior revenue recognition accounting standards is recognised in 2018 under IFRS 15. Additionally, revenue and profit recognised in prior periods would have been lower due to the lower margin on the initial performance obligations of these contracts. The separation of performance obligations led to an adjustment of £10.3m to reduce opening reserves and amounts receivable from over time contract

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FOR THE YEAR ENDED 31 DECEMBER 2018

37 IFRS 15 – Revenue from contracts with customers continued

customers; this was predominantly from two UK contracts within the Aerospace & Infrastructure division on electronics development and production programmes. These contracts have been running for a number of years and the majority of the impact to the income statement would have impacted the years prior to 2017, if IFRS 15 had been adopted in those earlier periods.

Other

Items included within the 'other' category in the tables on the prior page predominantly relate to certain licences that are deemed to provide separately identifiable benefits to customers and to certain material rights in licensing arrangements.

The timing of revenue recognised on the substantial majority of sale-of-goods contracts was not significantly affected with revenue continuing to be recognised as control of goods is passed to the customer, which is normally when legal title has passed to the customer.

2018 impact

The tables below set out the impact to the 2018 income statement and balance sheet if IFRS 15 had not been applied during the year:

	2018 as presented £m	Adjustment: Over time becoming point in time £m	Adjustment: Separation of performance obligations £m	Adjustment: Other £m	Adjustment: Total adjustment £m	2018 if not presented under IFRS 15 £m
Income Statement impact						
Revenue	**766.7**	**(2.7)**	**(0.1)**	**0.3**	**(2.5)**	**764.2**
Cost of sales	(544.6)	0.7	–	0.1	0.8	(543.8)
Gross profit	222.1	(2.0)	(0.1)	0.4	(1.7)	220.4
Underlying operating profit	**112.7**	**(2.0)**	**(0.1)**	**0.4**	**(1.7)**	**111.0**
Statutory operating profit	65.3	(2.0)	(0.1)	0.4	(1.7)	63.6
Statutory profit before tax	42.6	(2.0)	(0.1)	0.4	(1.7)	40.9
Tax	(10.2)	–	–	0.7	0.7	(9.5)
Statutory profit after tax	**32.4**	**(2.0)**	**(0.1)**	**1.1**	**(1.0)**	**31.4**

	2018 as presented £m	Adjustment: Over time becoming point in time £m	Adjustment: Separation of performance obligations £m	Adjustment: Other £m	Adjustment: Total adjustment £m	2018 if not presented under IFRS 15 £m
Balance Sheet impact						
Inventories	88.6	(0.7)	–	0.5	(0.2)	88.4
Amounts receivable from over time contract customers	103.7	1.2	10.3	(1.5)	10.0	113.7
Amounts due to over time contract customers	(63.5)	0.7	–	–	0.7	(62.8)
Tax liabilities	(15.5)	–	–	(1.5)	(1.5)	(17.0)
Net assets	420.8	1.2	10.3	(2.5)	9.0	429.8
Adjustment to retained earnings	**161.7**	**1.2**	**10.3**	**(2.5)**	**9.0**	**170.7**

38 IFRS 16 – Leases

IFRS 16 Leases is effective from 1 January 2019. A project has been undertaken to determine the impact of IFRS 16. The project has assessed lease contracts (excluding short-term and immaterial leases) from across all the Group's business units. The Group has adopted the modified retrospective approach and will recognise the cumulative effect of applying IFRS 16 at the 1 January 2019 transitional date; the prior period will not be restated. The table below sets out the current estimated impact to the 1 January 2019 balance sheet:

	31 December 2018 £m	Property leases adjustment £m	Non-property leases adjustment £m	1 January 2019 £m
Leased assets – Right of use asset	–	31.1	1.5	32.6
Lease liability	–	(34.9)	(1.5)	(36.4)
Lease accruals	(0.2)	0.2	–	–
Onerous lease provisions	(0.9)	0.9	–	–
Expected net assets adjustment	**420.8**	**(2.7)**	**–**	**418.1**
Expected adjustment to retained earnings	**161.7**	**(2.7)**	**–**	**159.0**

Further work will be undertaken in early 2019 to finalise this opening balance sheet determination.

38 IFRS 16 – Leases continued

Under IFRS 16, operating leases that are longer than 12 months must be recognised on the balance sheet and amortised over the life of the lease. The impact of IFRS 16 on the accounts will be as follows:

(i) Balance sheet – recognise right-of-use assets and lease liabilities in the consolidated balance sheet for all leases >1yr or where the asset value is >£3.5k. Leases that do not meet this criteria will be expensed on a straight-line basis. The asset and liability are initially measured at the present value of all future lease payments.
(ii) Income statement – previous lease charges (recognised in gross profit or indirect costs) are replaced with depreciation on the right-of-use asset and interest on the lease liability in the consolidated income statement.
(iii) Cash flow statement – the cash impact of the lease is split between the principal and interest, with net cash flow remaining unchanged to pre-IFRS 16 cash flow.

Onerous lease provisions are offset against the right-of-use asset and will be replaced by an annual assessment of impairment on the right-of-use assets in accordance with IAS 36. Additionally, under IFRS 16, lease incentives (e.g. rent free periods) will be recognised as part of the measurement of the right-of-use asset and lease liability rather than recognised as a separate liability as under IAS 17.

The Group will make use of the practical expedient available on transition to IFRS 16 not to reassess whether a contract is or contains a lease. Therefore, the definition of a lease in accordance with IAS 17 and IFRIC 4 will continue to apply to those leases entered or modified before 1 January 2019. For leases entered into or modified on or after 1 January 2019, a contract will be determined as a lease if the Group has control of the leased asset, as defined by IFRS 16. The following practical expedients, permitted by IFRS 16, have also been utilised:

- The application of a single discount rate to a portfolio of similar characteristic leases;
- Reliance on prior IAS 37 assessments of onerous leases as an alternative to performing an impairment review on transition;
- The use of hindsight: for property leases with historic extension option exercise dates, hindsight was applied such that the initial lease period also includes the extension period. Similarly, if the exercise date for a termination option had already passed by the transition date, it was assumed that the termination option was not exercised.

Statement of accounting policies

IN RESPECT OF THE GROUP'S CONSOLIDATED FINANCIAL STATEMENTS

A summary of the Group's principal accounting policies, all of which have been applied consistently across the Group throughout the current and preceding year, is set out below:

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"). The financial statements have also been prepared in accordance with IFRSs adopted by the European Union and therefore comply with Article 4 of the EU IAS regulations.

The consolidated financial information has been prepared on the historical cost basis except for certain assets and liabilities which are measured at fair value, see note 23.

Adoption of new and revised standards

The following IFRIC interpretations, amendments to existing standards and new standards have been adopted in the current year but have not impacted the reported results or the financial position:

- None.

The following standards were also adopted in the current year and have had the impact as set out below:

- IFRS 9 Financial Instruments.
- IFRS 15 Revenue from contracts with customers.

The impact of IFRS 15 on the accounts has been set out in note 37. The adoption of IFRS 9 has not had a financial impact. Further detail is provided on page 136.

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:

- 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 16 Leases – The new standard requires all leases to be recognised on the balance sheet with the exception of short-term and immaterial leases. IFRS 16 is effective from 1 January 2019. A project has been undertaken to determine the impact of IFRS 16. The key findings and determination of the impact are set out in note 38. The Group will recognise the cumulative effect of applying IFRS 16 at the 1 January 2019 transitional date. The prior period will not be restated.

Beyond the information above, it is not practicable to provide a reasonable estimate of the effect of these standards until a detailed review has been completed.

Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Group has adequate resources to continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Strategic Report on page 42.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved when the Company:

- has the power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statements of profit or loss and other comprehensive income from the date the Company gains control until the date when the Company ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income are attributed to the owners of the Company and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

All intra-Group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Company.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill) and liabilities of the subsidiary and any non-controlling interests. Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred directly to retained earnings) in the same manner as would be required if the relevant assets or liabilities were disposed of. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting or, when applicable, the cost on initial recognition of an investment in an associate or jointly controlled entity.

Critical accounting judgements and key sources of estimation uncertainty

In the application of the Group's accounting policies, the Directors are required to make judgements (other than those involving estimations) that have a significant impact on the amounts recognised and to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis and, in 2018, included consideration of the potential impacts of Brexit. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgements in applying the Group's accounting policies

The following are the critical judgements, apart from those involving estimations (which are dealt with separately below), that the Directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in financial statements.

Oman Airport IT contract

The Oman Airport IT contract was terminated in February 2015. On 4 March 2015, 'Ithra' ("Ultra Electronics in collaboration with Oman Investment Corporation LLC"), the legal entity established with the sole purpose of delivering the Oman Airport IT contract, was placed into voluntary liquidation. There are various proceedings in relation to that contract and its termination. There remains significant uncertainty regarding the likely outcome of these proceedings. Material items have been disclosed separately within the financial statements. In accordance with IAS 37, it is management's judgement that no provision is required at the balance sheet date.

Critical accounting estimates and assumptions

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting period, that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Contract revenue and profit recognition

A significant proportion of the Group's activities are conducted under long-term contract arrangements and are accounted for in accordance with IFRS 15 Revenue from contracts with customers. This revenue is derived from a large number of individual contracts across the Group.

Revenue and profit on such contracts are recognised in relation to estimates of the stage of completion of the contract performance obligation activity at the balance sheet date. Refer to our accounting policies on page 133 for more details on determining performance obligations. Revenue and profit are calculated by reference to reliable estimates of transaction price and total expected costs. The transaction price is allocated to each performance obligation based on relative standalone selling prices of all items in the contract. Refer to our accounting policies on page 133 for more details on allocating the transaction price. The revenue and costs of the contract are then applied to each individual performance obligation, which requires judgement by the Group. 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 and the allocation of costs and revenue to each performance obligation are carried out using the experience of the Group's engineers, project managers and finance and commercial professionals. Cost estimates are reviewed and updated on a regular basis using the Group's established project management processes. Some of the factors that will impact upon cost estimates include the availability of suitably qualified labour, the nature and complexity of the work to be performed, the availability of materials, the impact of change orders and the performance of sub-contractors.

The transaction price is typically allocated to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service (performance obligations) promised in the contract. If a stand-alone selling price is not observable then an estimate is calculated, which may use market data, a cost plus margin approach or other reliable data available. Discounts are generally allocated to all performance obligations based on the transaction price applied to the performance obligation. Variable consideration (for example discounts dependent on sales levels, returns, refunds, rebates and other incentives) is analysed to determine if it should be applied against one or more of the performance obligations based on the terms of the consideration and the contract. The variable consideration amount is estimated using an expected value method or applying the most likely amount. The estimated amount of variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in revenue will take place. Therefore this method is used to ensure the transaction price is constrained to the amount that is highly probable to be received.

A warranty may represent a separate performance obligation if it is distinct from the other elements of the contract (i.e. it can be sold separately and provides additional goods and services beyond the agreed-upon specifications), otherwise it is treated as a provision. If it is a separate performance obligation then the revenue is recognised when the control of the additional good or service under the warranty is passed to the customer.

Retirement benefit plans

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

The main assumptions used in determining the defined benefit post-retirement obligation include the discount rate used in discounting scheme liabilities, the inflation rate, the expected rate of future pension increases, expected returns on scheme assets and future mortality assumptions. For each of these assumptions, there is a range of possible values. Relatively small changes in some of these variables can have a significant impact on the level of the total obligation.

The valuation of pension scheme assets and liabilities at a specific point in time rather than over a period of time can lead to significant annual movements in the pension scheme deficit as calculated under IAS 19, but it has no impact on short-term cash contributions since these are based upon separate independent actuarial valuations.

In 2018, judgement has been applied with respect to determining how to estimate the impact of GMP Equalisation as set out in note 30.

Details of the pension scheme estimates, assumptions and obligations at 31 December 2018 are provided in note 30.

Statement of accounting policies continued

IN RESPECT OF THE GROUP'S CONSOLIDATED FINANCIAL STATEMENTS

Impairment testing
Each year, the Group carries out impairment tests of its goodwill balances which requires estimates to be made of the value-in-use of its cash generating units (CGUs). These value-in-use calculations are dependent on estimates of future cash flows and long-term growth rates of the CGUs. Further details on these estimates are provided in note 14.

Proxy Board

Certain Group companies in the US undertake work of importance to US national security; consequently activities are conducted under foreign ownership regulations, which require operation under a Proxy Agreement. The regulations are intended to insulate these activities from undue foreign influence as a result of foreign ownership. The entity that is operated under the management of a Proxy Board is Ultra Electronics Advanced Tactical Systems Inc. ("ATS").

The Directors consider that the Group has control over the operating and financial policies and results of this entity 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 IFRS 9, 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 are remeasured to their acquisition date fair value and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

Goodwill

Goodwill is initially recognised and measured as set out above. Goodwill is not amortised but is reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units or groups of cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

Goodwill arising on acquisitions before the date of transition to IFRSs has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and will not be included in determining any subsequent profit or loss on disposal.

Revenue recognition

IFRS 15 Revenue from contracts with customers was adopted on 1 January 2018. The Group has recognised the cumulative effect of applying IFRS 15 at the 1 January 2018 transitional date. The prior period has not been restated; the adjustment to opening retained earnings of £(9.9)m at 1 January 2018 is reflected in the Consolidated Statement of Changes in Equity. Refer to note 37 for details on the adjustment to opening retained earnings. The revenue recognition policy adopted from 1 January 2018 is as follows:

The Group recognises revenue from the sales of goods and from long-term contracts. Revenue is measured based on the consideration specified in a contract. Revenue is recognised either when the performance obligation in the contract has been performed, i.e. "point in time" recognition, or, "over time", as control of the performance obligation is transferred to the customer. Under a book-and-hold agreement with a customer, the Group may have physical possession of an asset that the customer controls, therefore the revenue is recognised when the customer has control of the asset. The Group follows the "five step" model as set out in IFRS 15 to ensure revenue is recognised at the appropriate point whether over time or at a point in time; the five steps are:

1. Identify the contract(s) with a customer.
2. Identify the performance obligations.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations.
5. Recognise revenue as performance obligations are satisfied.

For each performance obligation, the Group determines if revenue will be recognised over time or at a point in time.

Over time

Revenue that is recognised over time is determined by reference to the stage of completion of the performance obligation. For each performance obligation to be recognised over time, revenue and attributable margin are calculated by reference to reliable estimates of transaction price and total expected costs, after making suitable allowances for technical and other risks, except in limited scenarios where the proportion of costs incurred would not be representative of the stage of completion. Revenue and associated margin are recognised progressively as costs are incurred and as risks have been mitigated or retired.

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. For contracts with multiple activities or deliverables, management applies judgement to consider whether those promised goods and services are: (i) distinct – to be accounted for as separate performance obligations; (ii) not distinct – to be combined with other promised goods or services until a bundle is identified that is distinct; or (iii) part of a series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer.

The transaction price is allocated to each performance obligation based on relative standalone selling prices of all items in the contract, this could be based on list prices, external market evidence or where individual tailored products are concerned, based on the estimated expected costs to produce the item or deliver the services, plus a reasonable margin to reflect the risk of delivering the product or service. On complex contracts, judgement will be required to select appropriate inputs and estimates when determining the standalone selling price for each performance obligation.

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.

Point in time

If performance obligations do not meet the criteria to recognise revenue over time, then revenue from the sale of goods or services is recognised at a point in time. This is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods or services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Revenue is normally recognised when control of the goods or services have transferred to the customer. This may be:

- at the point of physical delivery of goods and acceptance by the customer;
- when the customer has legal title to the asset;
- when the customer has the significant risks and rewards of ownership of the asset; or
- when customer specific acceptance criteria have been met e.g. when product testing has been completed.

Contract assets and liabilities

Amounts payable to over time contract customers relates to payments received from customers in relation to the contract prior to the work being completed and the revenue recognised. Amounts receivable from over time contract customers relates to work performed and revenue recognised on agreed contracts prior to the customer being invoiced.

For contracts where revenue is recognised at a point in time, deferred income recorded on the balance sheet represents payments received from customers prior to the work being completed and the revenue recognised, and accrued income recorded on the balance sheet represents any revenue recognised on agreed contracts prior to the customer being invoiced.

When a good or service provided is returned or to be refunded the revenue is reversed equal to the amount originally recognised as revenue for that good or service. Consideration of returns and refunds is made when calculating the transaction price to be allocated to the performance obligation. For more details on this variable consideration refer to the Critical accounting judgements and key sources of estimation uncertainty section on page 131.

The revenue recognition policy applied up to 31 December 2017 was as follows:

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Sales of goods are normally recognised when substantially all of the risks and rewards of ownership have transferred to the customer.

Revenue from contracts to provide services is recognised by reference to the stage of completion of the contracts in the same way as for long-term contracts. This is normally measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion.

Statement of accounting policies continued

IN RESPECT OF THE GROUP'S CONSOLIDATED FINANCIAL STATEMENTS

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

The accounting policy applied up to 31 December 2017 for long-term contracts is noted below. This was replaced by IFRS 15, which is discussed above.

Where the outcome of a long-term contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is normally measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer, or when it is considered probable that the customer will approve the variation and the amount of revenue arising from the variation.

Where the outcome of a long-term contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

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

Research and development

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Any internally generated intangible asset arising from development activities is recognised only if an asset is created that can be identified, it is probable that the asset created will generate future economic benefit and the development cost of the asset can be measured reliably.

Internally generated assets are amortised on a straight-line basis over their useful lives. Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Other intangible assets

Costs associated with producing or maintaining computer software programmes for sale are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, that will generate economic benefits exceeding costs beyond one year and that can be measured reliably, are recognised as intangible assets. Capitalised software development expenditure is stated at cost less accumulated amortisation and impairment losses. Amortisation is provided on a straight line basis over the estimated useful life of the related asset (see note 15).

Acquired computer software licences for use within the Group are capitalised as intangible assets on the basis of the costs incurred to acquire and bring to use the specific software.

Patents and trademarks are stated initially at historical cost. Patents and trademarks have definite useful lives and are carried at cost less accumulated amortisation and impairment losses.

Intangible assets arising from a business combination whose fair value can be reliably measured are separated from goodwill and amortised over their remaining estimated useful lives.

Impairment of fixed assets

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash generating unit to which the asset belongs. An intangible asset with an indefinite useful life is tested for impairment annually and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing the value in use, the estimated future cash flows are discounted to their present value. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, except for goodwill.

Property, plant and equipment

Property, plant and equipment is shown at original historical cost, net of depreciation and any provision for impairment.

Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows:

Freehold buildings	40 to 50 years
Short leasehold improvements	over remaining period of lease
Plant and machinery	3 to 20 years

Freehold land and assets under construction are not depreciated.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals under operating leases, where the Group acts as either lessee or lessor, are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

Leases continued

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Inventories

Inventories are valued at the lower of cost (determined on a first-in, first-out basis and including an appropriate proportion of overheads incurred in bringing the inventories to their present location and condition) and net realisable value. Provision is made for any obsolete, slow-moving or defective items.

Trade receivables

Trade receivables are initially measured at fair value then subsequently remeasured at amortised cost less any impairment. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss when there is objective evidence that the asset is impaired.

Amounts receivable from over time contract customers

For a contract recognised over time under IFRS 15 the control of the product may be passed to the customer before the customer is invoiced. At this point revenue is recognised and an asset is recorded on the balance sheet as an amount receivable from over time contract customers. The amount receivable from over time contract customers is classified as a current asset when it is to be invoiced within twelve months, otherwise it is recorded as a non-current asset. This asset is transferred to trade receivables once the customer is invoiced, following which cash is expected to be received per the agreed contractual terms. Refer to note 19 for details on the average debtor days.

Amounts due to over time contract customers

For a contract recognised over time under IFRS 15, a payment may be received from the customer before the control of the product is passed to the customer. At this point a liability is recorded on the balance sheet as an amount due to over time contract customers, which is recognised net of any refunds expected to be paid. This liability is derecognised when the control is passed to the customer and revenue can be recorded. Amounts due to over time contract customers is recorded as a current liability when the revenue is expected to be recognised within the next 12 months, otherwise it is classified as a non-current liability.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, call deposits and bank overdrafts, where there is right of set off. Bank overdrafts are presented as current liabilities to the extent that there is no right of offset with cash balances.

Assets held for sale

Assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Foreign currency

Transactions denominated in foreign currencies are recorded in the local currency at the actual exchange rates at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in the income statement.

The trading results and cash flows of overseas undertakings are translated into Sterling, which is the functional currency of the Company, using the average rates of exchange during the relevant financial period. The balance sheets of overseas subsidiary undertakings are translated into Sterling at the rates ruling at the year end. Exchange differences arising from the retranslation of the opening balance sheets and results are classified as equity and transferred to the Group's translation reserve.

Goodwill and fair value adjustments on the acquisition of foreign entities are treated as assets and liabilities of the foreign entity and translated at the closing rate. The Group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of transition to IFRSs as Sterling denominated assets and liabilities.

Borrowing costs

Borrowing costs are recognised in profit or loss in the period in which they are incurred, except where they relate to qualifying assets, in which case they are capitalised.

Government grants

Government grants are recognised in the income statement so as to match them with the expenditure towards which they are intended to contribute, to the extent that the conditions for receipt have been met and there is reasonable assurance that the grant will be received.

Government assistance provided in the form of below-market rate of interest loans are treated as government grants. The benefit of the below-market rate of interest is calculated as the difference between the proceeds received and the fair value of the loan and is matched against the related expenditure. The fair value of the loan is calculated using prevailing market interest rates.

Retirement benefit costs

The Group provides pensions to its employees and Directors through defined benefit and defined contribution pension schemes. The schemes are funded and their assets are held independently of the Group by trustees.

For defined benefit retirement schemes, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each balance sheet date. The actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and presented in the statement of comprehensive income.

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

Curtailment gains or losses are recognised immediately in the income statement.

Statement of accounting policies continued

IN RESPECT OF THE GROUP'S CONSOLIDATED FINANCIAL STATEMENTS

Retirement benefit costs continued

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets.

Payments to defined contribution retirement schemes are charged as an expense as they fall due.

Trade payables

Trade payables are initially measured at fair value then subsequently remeasured at amortised cost.

Loans and overdrafts

Interest-bearing loans and overdrafts are recorded at the proceeds received, net of direct issue costs where there is a facility commitment. In these circumstances, issue costs are deducted from the value of the loan and amortised over the life of the commitment. Where there is no facility commitment, issue costs are written off as incurred. Finance charges including premiums payable on settlement or redemption are accounted for on an accruals basis in profit or loss using the effective interest rate method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Share-based payments

The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest and adjusted for the effect of non-market-related conditions.

Fair value is measured by use of a Black-Scholes model for the share option plans and a stochastic model for awards made under the 2007 Long-Term Incentive Plan.

The credits in respect of equity-settled amounts are included in equity.

Provisions

Provisions, including property-related and contract-related provisions, are recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and where it is probable that an outflow of economic benefits will be required to settle the obligation.

Provision is made for the anticipated cost of repair and rectification of products under warranty, based on known exposures and historical occurrences. Provisions for restructuring costs are recognised when the Group has a detailed formal plan for the restructuring that has been communicated to affected parties.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Taxation

The tax expense represents the sum of the current tax payable and deferred tax.

The current tax payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities.

Derivative financial instruments

IFRS 9

The Group applied IFRS 9 Financial Instruments from 1 January 2018. IFRS 9 replaces the multiple classification and measurement models in IAS 39 'Financial Instruments: Recognition and Measurement'. Management have considered and assessed the expected credit loss requirements applicable to financial assets under IFRS 9 and have concluded that there is no material impact arising from the adoption of an expected credit loss model. This is due to the nature of the Group's customer base which includes a significant proportion from government agencies in major economies for which the expected credit loss is immaterial. Furthermore, the adoption of IFRS 9, based on financial instruments and hedging relationships as at the date of initial application of IFRS 9 did not have a material impact on the Group Consolidated Financial Statements. There is therefore no adjustment to opening retained earnings arising from the adoption of IFRS 9 using the modified retrospective approach.

The policy adopted from 1 January 2018 is as follows:

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 continued

From 1 January 2019 the Group has revised its hedging strategy under IFRS 9 to reduce income statement volatility from re-valuation of US dollar assets and liabilities held on the UK balance sheet. Although the Group has forward foreign exchange contracts in place to reduce the currency exposure arising from the net US dollar cash generation of its UK businesses, the balance sheet, which has carried increasing US dollar denominated assets from certain long-term programmes, has not been hedged prior to the conversion of those assets into cash. From 1 January 2019 the net investment hedge has been revised to eliminate this volatility.

Classification and measurement

All financial instruments are initially measured at fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs.

IFRS 9 divides all financial assets that were previously in the scope of IAS 39 into two classifications – those measured at amortised cost and those measured at fair value. Where assets are measured at fair value, gains and losses are either recognised entirely in profit or loss (fair value through profit or loss, FVTPL), or recognised in other comprehensive income (fair value through other comprehensive income, FVTOCI).

A debt instrument is measured at amortised cost if: a) the objective is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual cash flows under the instrument solely represent payments of principal and interest. A debt instrument is measured at FVTOCI if: a) the objective is to hold the financial asset both for the collection of the contractual cash flows and selling financial assets, and b) the contractual cash flows under the instrument solely represent payments of principal and interest. All other debt instruments must be measured at FVTPL.

Hedge accounting

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 IFRS 9. When hedge accounting is used, the relevant hedging relationships will be classified as fair value hedges, cash flow hedges or net investment hedges. In order to qualify for hedge accounting, the hedge relationship must meet the following effectiveness criteria at the beginning of each hedged period:
- there is an economic relationship between the hedged item and the hedging instrument;
- the effect of credit risk does not dominate the value changes that result from that economic relationship; and
- the hedge ratio of the hedging relationship is the same as that actually used in the economic hedge.

If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio but the risk management objective for that designated hedging relationship remains the same, the hedge ratio of the hedging relationship is adjusted so that it meets the qualifying criteria.

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 permissible under IFRS 9.

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. 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.

Impairment

The amount of expected credit losses is updated at each reporting date.

For the year ended 31 December 2017, derivative financial instruments were accounted for according to IAS 39; the 2017 accounting policy is noted below.

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.

Statement of accounting policies continued

IN RESPECT OF THE GROUP'S CONSOLIDATED FINANCIAL STATEMENTS

Operating profit

Operating profit is stated after charging restructuring costs but before investment income and finance costs.

Exceptional items

When items of income or expense are material and they are relevant to an understanding of the entity's financial performance, they are disclosed separately within the financial statements. Such exceptional items include material costs or reversals arising from a restructuring of the Group's operations, material creation or reversals of provisions, and material litigation settlements.

Non-statutory and underlying performance measures

In the analysis of the Group's operating results, earnings per share and cash flows, information is presented to provide readers and stakeholders with additional performance indicators that are prepared on a non-statutory basis. This 'underlying' presentation is regularly reviewed by management to identify items that are unusual and other items relevant to an understanding of the Group's performance and long-term trends with reference to their materiality and nature. The non-statutory performance measures are consistent with how business performance is planned and reported within the internal management reporting to the divisional management teams, Executive Committee and to the Board. Some of the measures are used for setting remuneration targets. The Group also uses 'organic' performance measures for the order book, order intake and the income statement. Explanations of how they are determined, and how they reconcile to IFRS statutory measures, are set out below. This additional non-statutory information is not uniformly defined by all Companies and may not be comparable with similarly titled measures and disclosures by other organisations.

The non-statutory disclosures should not be viewed in isolation or as an alternative to the equivalent statutory measure. Information for separate presentation is considered as follows:

- Contract losses arising in the ordinary course of trading are not separately presented; however, losses (and subsequent reversals) are separately disclosed in situations of a material dispute which are expected to lead to arbitration or legal proceedings. Significant legal charges and expenses are also separately disclosed; these are the charges arising from investigations and settlement of litigation that are not in the normal course of business.
- One-off GMP Equalisation charge arising on defined benefit pension scheme.
- Material costs or reversals arising from a significant restructuring of the Group's operations, such as the S3 programme and costs of closure of product lines, businesses or facilities, 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-related 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 IFRS 9. This creates volatility in the valuation of the outstanding instruments as exchange rates move over time. This has a minimal impact on profit over the full term of the instruments, but can cause significant volatility on particular balance sheet dates. Consequently, the gain or loss is presented separately.
- The defined benefit pension net interest charge arising in accordance with IAS 19 is presented separately.

The related tax effects of the above items are reflected when determining underlying earnings per share, as set out in note 13.

The Group is cash-generative and reinvests funds to support the continuing growth of the business. It seeks to use an accurate and appropriate measure of the funds generated internally while sustaining this growth. For this, the Group uses underlying operating cash flow, rather than cash generated by operations, as its preferred indicator of cash generated and available to cover non-operating expenses such as tax and interest payments. Management believes that using cash generated by operations, with the exclusion of net expenditure on property, plant and equipment and outflows for capitalised product development and other intangibles, would result in an under-reporting of the true cash cost of sustaining a growing business.

EBITDA is the underlying operating profit before depreciation charges and before amortisation arising on internally generated intangible assets and on other, non-acquired, intangible assets. The figure is adjusted to remove the EBITDA generated by businesses up to the date of their disposal in the period.

Net debt comprises loans and overdrafts less cash and cash equivalents. The determination of net debt is set out in note 28.

Total shareholder return is annual shareholder return (capital growth plus dividends paid, assuming dividends reinvested) over a rolling five year period.

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

Organic measures

The divisional management teams, the Executive Team and the Board review and compare current and prior year Group and divisional revenue and underlying operating profit at constant exchange rates and exclude the impact of acquisitions and disposals from these organic performance measures. The order intake and order book are also reviewed and compared in the same way.

The constant exchange comparison retranslates the prior year reported results from the prior year's average exchange rates into the current year's average exchange rates, and in the case of underlying operating profit adjusts for the impact of exchange rate movements on prior year-end US dollar net assets held in GBP functional currency entities.

The impact of business acquisitions is excluded for the first 12 months of ownership, from the date of completion of purchase. For disposals, comparative figures are adjusted to reflect the comparable period of ownership.

Company balance sheet

31 DECEMBER 2018

	Note	2018 £'000	2017 £'000
Fixed assets			
Property, plant and equipment	39	**613**	511
Investments	40	**748,244**	815,144
		748,857	815,655
Current assets			
Debtors: Amounts falling due within one year	41	**5,187**	11,352
		5,187	11,352
Creditors: Amounts falling due within one year	43	**(260,887)**	(191,081)
Net current liabilities		**(255,700)**	(179,729)
Total assets less current liabilities		**493,157**	635,926
Creditors: Amounts falling due after more than one year	44	**(67,582)**	(164,734)
Net assets		**425,575**	471,192
Capital and reserves			
Share capital	46	**3,574**	3,887
Share premium account	47	**201,033**	200,911
Capital redemption reserve	47	**314**	–
Retained earnings brought forward	47	**141,683**	352,681
Profit and loss for year	47	**81,552**	(83,706)
Own shares	47	**(2,581)**	(2,581)
Shareholders' funds		**425,575**	471,192

The financial statements of Ultra Electronics Holdings plc, registered number 02830397, were approved by the Board of Directors and authorised for issue on 6 March 2019.

On behalf of the Board,

S. PRYCE, Chief Executive Officer
A. SHARMA, Group Finance Director

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

Company statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2018

	Share capital £'000	Share premium account £'000	Capital redemption reserve £'000	Profit and loss account £'000	Own shares £'000	Total £'000
Balance at 1 January 2017	3,523	64,020	–	386,958	(2,581)	451,920
Retained profit for the year	–	–	–	(83,706)	–	(83,706)
Total comprehensive income for the year	–	–	–	(83,706)	–	(83,706)
Issue of share capital	352	133,195	–	–	–	133,547
Equity-settled employee share schemes	12	3,696	–	682	–	4,390
Dividends paid	–	–	–	(34,959)	–	(34,959)
Balance at 31 December 2017	**3,887**	**200,911**	**–**	**268,975**	**(2,581)**	**471,192**
Balance at 1 January 2018	**3,887**	**200,911**	**–**	**268,975**	**(2,581)**	**471,192**
Retained profit for the year	–	–	–	81,552	–	**81,552**
Total comprehensive income for the year	**–**	**–**	**–**	**81,552**	**–**	**81,552**
Issue of share capital	–	–	–	–	–	**–**
Equity-settled employee share schemes	1	122	–	1,493	–	**1,616**
Shares purchased in buy-back	(314)	–	314	(91,902)	–	**(91,902)**
Dividends paid	–	–	–	(36,883)	–	**(36,883)**
Balance at 31 December 2018	**3,574**	**201,033**	**314**	**223,235**	**(2,581)**	**425,575**

Notes to accounts – Company

FOR THE YEAR ENDED 31 DECEMBER 2018

39 Property, plant and equipment

	Plant and machinery £'000
Cost	
At 1 January 2017	2,573
Disposals	(518)
At 1 January 2018	**2,055**
Additions	116
At 31 December 2018	**2,171**
Accumulated depreciation	
At 1 January 2017	1,535
Charge	9
At 1 January 2018	**1,544**
Charge	14
At 31 December 2018	**1,558**
Net book value	**613**
At 31 December 2018	
At 31 December 2017	511

40 Investments

a) Principal subsidiary undertakings

The Company owns either directly or indirectly 100% of the ordinary share capital of a number of subsidiary undertakings as set out in note 36.

b) Investment in subsidiary undertakings

	Total £'000
At 1 January 2018	**815,144**
Additions	**1,280**
Impairments	**(68,180)**
At 31 December 2018	**748,244**

The impairments arose following review of the recoverability of investments within the corporate Company structure.

41 Debtors

	2018 £'000	2017 £'000
Amounts falling due within one year:		
Amounts due from subsidiary undertakings	**3,485**	8,785
Deferred tax assets	**804**	505
Other receivables	**538**	1,747
Prepayments	**360**	315
	5,187	11,352

Notes to accounts – Company continued

31 DECEMBER 2018

42 Deferred tax

Movements in the deferred tax asset were as follows:

	2018 £'000	2017 £'000
Beginning of year	**505**	30
Credit to the profit and loss account	**299**	475
End of year	**804**	505

The deferred tax balances are analysed as follows:

	2018 £'000	2017 £'000
Other temporary differences relating to current assets and liabilities	**804**	505
Deferred tax asset	**804**	505

These balances are shown as follows:

	2018 £'000	2017 £'000
Debtors: Amounts falling due within one year	**804**	505

Deferred tax assets, in excess of offsetting tax liabilities, are recognised for loss carry forwards and deductible temporary differences to the extent that the utilisation against future taxable profits is probable. At the balance sheet date the Company had deferred tax assets of £1.2m (2017: nil) that have not been recognised as their recovery is uncertain.

43 Creditors: amounts falling due within one year

	2018 £'000	2017 £'000
Bank loans and overdraft	**207,353**	72,283
Amounts owed to subsidiary undertakings	**39,948**	112,208
Other payables	**3,536**	1,089
Accruals	**10,050**	5,501
	260,887	191,081

The bank loans are unsecured. Interest was predominantly charged at 0.96% (2017: 1.20%) over base or contracted rate.

44 Creditors: amounts falling due after more than one year

	2018 £'000	2017 £'000
Borrowings	**67,582**	164,734
	67,582	164,734

The financial risk management objectives and policies of the Company are managed at a Group level; further information is set out in note 22.

45 Borrowings

Borrowings fall due as analysed below:

	2018 £'000	2017 £'000
Bank loans and overdraft		
Amounts due in less than one year		
Bank loans and overdrafts	**160,316**	72,283
Unsecured loan notes	**47,037**	–
	207,353	72,283
Amounts due after more than one year		
Bank loans	**17,582**	120,375
Unsecured loan notes	**50,000**	44,359
	67,582	164,734

The loan notes are unsecured and due for repayment in 2019. Interest was charged at 3.11% (2017: 3.60%).

46 Called-up share capital

The movements are disclosed in note 26.

47 Equity reserve

The profit and loss account includes £65,400,000 (2017: £65,400,000) which is not distributable. A net foreign exchange loss of £12,063,000 was taken to reserves in the year (2017: £23,707,000 gain). Further details in respect of dividends are presented in note 12 and in respect of share-based payments in note 26.

The Company holds 235,247 own shares (2017: 235,245).

48 Related parties

Transactions with Corvid Holdings Limited are set out in note 33.

Statement of accounting policies

FOR THE COMPANY ACCOUNTS

A summary of the Company's principal accounting policies, all of which have been applied consistently throughout the year and preceding year in the separate financial information presented for the Company, are set out below:

Basis of accounting

The Company accounts have been prepared under the historical cost convention and in accordance with FRS 101 Reduced Disclosure Framework. No profit and loss account is presented for the Company, as permitted by section 408 of the Companies Act 2006. As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to share-based payments, financial instruments, capital management, presentation of a cash flow statement and certain related-party transactions. The Company's retained profit for the year is disclosed in note 47.

Fixed assets and depreciation

Property, plant and equipment are shown at original historical cost, net of depreciation and any provision for impairment. Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows:

Plant and machinery	3 to 20 years

Taxation

UK Corporation tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future, or a right to pay less tax in the future, have occurred at the balance sheet date. Temporary differences are differences between the Company's taxable profits and its results as stated in the financial statements. These arise from including gains and losses in tax assessments in different periods from those recognised in the financial statements. A net deferred tax asset is regarded as recoverable, and therefore recognised, only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is not discounted.

Retirement benefit costs

The Company participates in a defined benefit plan that shares risks between entities under common control. The details of this UK scheme, for which Ultra Electronics Limited is the sponsoring employer, are set out in note 30. There is no contractual agreement or stated policy for charging the net benefit cost to Ultra Electronics Holdings plc.

Investments

Fixed asset investments are shown at cost less provision for impairment. Assessment of impairments requires estimates to be made of the value-in-use of the underlying investments. These value-in-use calculations are dependent on estimates of future cash flows and long-term growth rates. The criteria used in this assessment are consistent with those set out in note 14 and the critical accounting estimates and assumptions as set out below.

Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Group has adequate resources to continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Strategic Report on page 42.

Foreign currency

Transactions denominated in foreign currencies are recorded in the local currency at the actual exchange rate at the date of the transaction (or, where appropriate, at the rate of exchange in a related forward exchange contract). Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date (or, where appropriate, at the rate of exchange in a related forward exchange contract). Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in the profit and loss account.

Share-based payments

The Company issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of the grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Company's estimate of shares that will eventually vest. Further disclosure in relation to share-based payments is given in note 26.

Related parties

The Remuneration of the Directors, who are considered to be the key management personnel of the Company, is disclosed in the audited part of the Directors' Remuneration Report on pages 70–71.

Loans and overdrafts

Interest-bearing loans and overdrafts are recorded at the proceeds received, net of direct issue costs where there is a facility commitment. In these circumstances, issue costs are deducted from the value of the loan and amortised over the life of the commitment. Where there is no facility commitment, issue costs are written off as incurred. Finance charges including premiums payable on settlement or redemption are accounted for on an accruals basis in profit or loss using the effective interest rate method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Critical accounting judgements and key sources of estimation uncertainty

In the application of the Company's accounting policies, the Directors are required to make judgements (other than those involving estimates) that have a significant impact on the accounts recognised and to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical accounting judgements in applying the Company's accounting policies

There were no critical accounting judgements that would have a significant effect on the amounts recognised in the Parent Company financial statements.

Critical accounting estimation and assumptions

Impairments to investments in subsidiary undertakings

Following the review of the recoverability of investments within the corporate company structure, an impairment was identified due to the calculated value-in-use being in excess of the book value of certain investments. The value-in-use is calculated by discounting the forecast cash flows of each investment to present value. The Directors consider the investments in the US business to be most sensitive to the achievement of the forecast cash flows and to the discount rate applied in calculating the present value of the future cash flows. A 0.1% increase in the discount rate would increase the impairment charge by £3.6m, and a 1% reduction in forecast future cash flows would increase the impairment charge by £5.9m.

Footnote

The narrative in some of this report includes two figures for 2017 revenue and underlying operating profit to present the result as stated in the 2017 annual report, and the result as if presented under IFRS 15. Refer to note 37. A reconciliation is set out in note 2 between operating profit and underlying operating profit, between profit before tax and underlying profit before tax and between cash generated by operations and underlying operating cash flow. The calculation for underlying earnings per share is set out in note 13. Further detail on non-statutory performance measures is set out on page 138.

underlying operating profit is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, acquisition and disposal related costs net of contingent consideration adjustments, and significant legal charges and expenses. IFRS operating profit was £65.3m (2017: £61.5m).

organic growth (of revenue, profit or orders) is the annual rate of increase that was achieved at constant currencies, assuming that acquisitions made during the prior year were only included for the same proportion of the current year, and adjusted for disposals made during the prior year to reflect the comparable period of ownership.

underlying operating margin is the underlying operating profit as a percentage of revenue.

net finance charges exclude fair value movements on derivatives, defined benefit pension interest charges and discount on provisions.

underlying profit before tax is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, fair value movements on derivatives and the loss on closing out a foreign currency derivative contract, defined benefit pension finance charges and GMP equalisation, acquisition and disposal related costs net of contingent consideration adjustments, loss on disposal, and significant legal charges and expenses.

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, and excluding the cash outflows from the S3 programme, acquisition and disposal related payments and significant legal charges and expenses.

operating cash conversion is underlying operating cash flow as a percentage of underlying operating profit.

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

net debt comprises loans and overdrafts less cash and cash equivalents.

bank interest cover is the ratio of underlying operating profit to finance costs associated with borrowings.

underlying order book growth excludes the impact of foreign exchange and the order book arising on acquisition.

underlying order intake includes orders from acquisitions since acquisition date.

underlying earnings per share is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, fair value movements on derivatives and the loss on closing out a foreign currency derivative contract, defined benefit pension finance charges and GMP equalisation, acquisition and disposal related costs net of contingent consideration adjustments, loss on disposal, significant legal charges and expenses and before related taxation. Basic EPS 43.6p (2017: 66.2p).

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

Shareholder information

FIVE-YEAR REVIEW

Financial highlights

	2014* £m	2015* £m	2016* £m	2017* £m	**2018 £m**
Revenue					
Aerospace & Infrastructure	198.6	193.2	204.7	203.2	**196.2**
Communications & Security	224.4	239.3	259.0	242.7	**252.6**
Maritime & Land	290.7	293.8	322.1	329.5	**317.9**
Total revenue	713.7	726.3	785.8	775.4	**766.7**
Underlying operating profit[1]					
Aerospace & Infrastructure	29.6	28.7	32.4	32.6	**30.0**
Communications & Security	37.0	40.4	39.7	28.2	**29.9**
Maritime & Land	51.5	50.9	59.0	59.3	**52.8**
Total underlying operating profit[1]	118.1	120.0	131.1	120.1	**112.7**
Margin[1]	16.5%	16.5%	16.7%	15.5%	**14.7%**
Profit before tax	21.5	34.8	67.6	60.6	**42.6**
Profit after tax	6.5	25.0	58.3	48.9	**32.4**
Underlying operating cash flow[2]	83.1	81.3	120.4	116.5	**89.3**
Free cash flow before dividend payments, acquisitions and financing[3]	52.8	48.4	86.0	65.3	**67.6**
Net debt at year-end[4]	(129.5)	(295.6)	(256.7)	(74.5)	**(157.4)**
Underlying earnings per share (p)[5]	123.1	123.9	134.6	116.7	**109.5**
Dividend per share (p)	44.3	46.1	47.8	49.6	**51.6**
Average employee numbers	4,787	4,843	4,466	4,172	**4,119**

1 Underlying operating profit is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, acquisition and disposal related costs net of contingent consideration adjustments, and significant legal charges and expenses.
2 Cash generated by operations and dividends from associates, less net capital expenditure, R&D, and excluding cash outflows from the S3 programme, acquisition and disposal related payments and significant legal charges and expenses. See note 2 for reconciliation to cash generated by operations.
3 Free cash flow before dividends paid, acquisitions and financing has been adjusted to include the purchase of LTIP shares, which are included in financing activities. Prior periods have been re-stated to include dividend receipts from equity-accounted investments.
4 Loans and overdrafts less cash and cash equivalents.
5 Underlying earnings per share is before the S3 programme, amortisation of intangibles arising on acquisition, impairment charges, fair value movements on derivatives and the loss on closing out a foreign currency derivative contract, defined benefit pension finance charges and GMP equalisation, acquisition and disposal related costs net of contingent consideration adjustments, loss on disposal, significant legal charges and expenses and before related taxation.

* Not prepared under IFRS 15.

Financial Calendar

6 March 2019	Preliminary results announced
12 April 2019	Preliminary record date
3 May 2019	Annual General Meeting
9 May 2019	Final Dividend payment date
6 August 2019	Interim Results announced
20 August 2019	Interim Record date
20 September 2019	Interim Dividend payment date

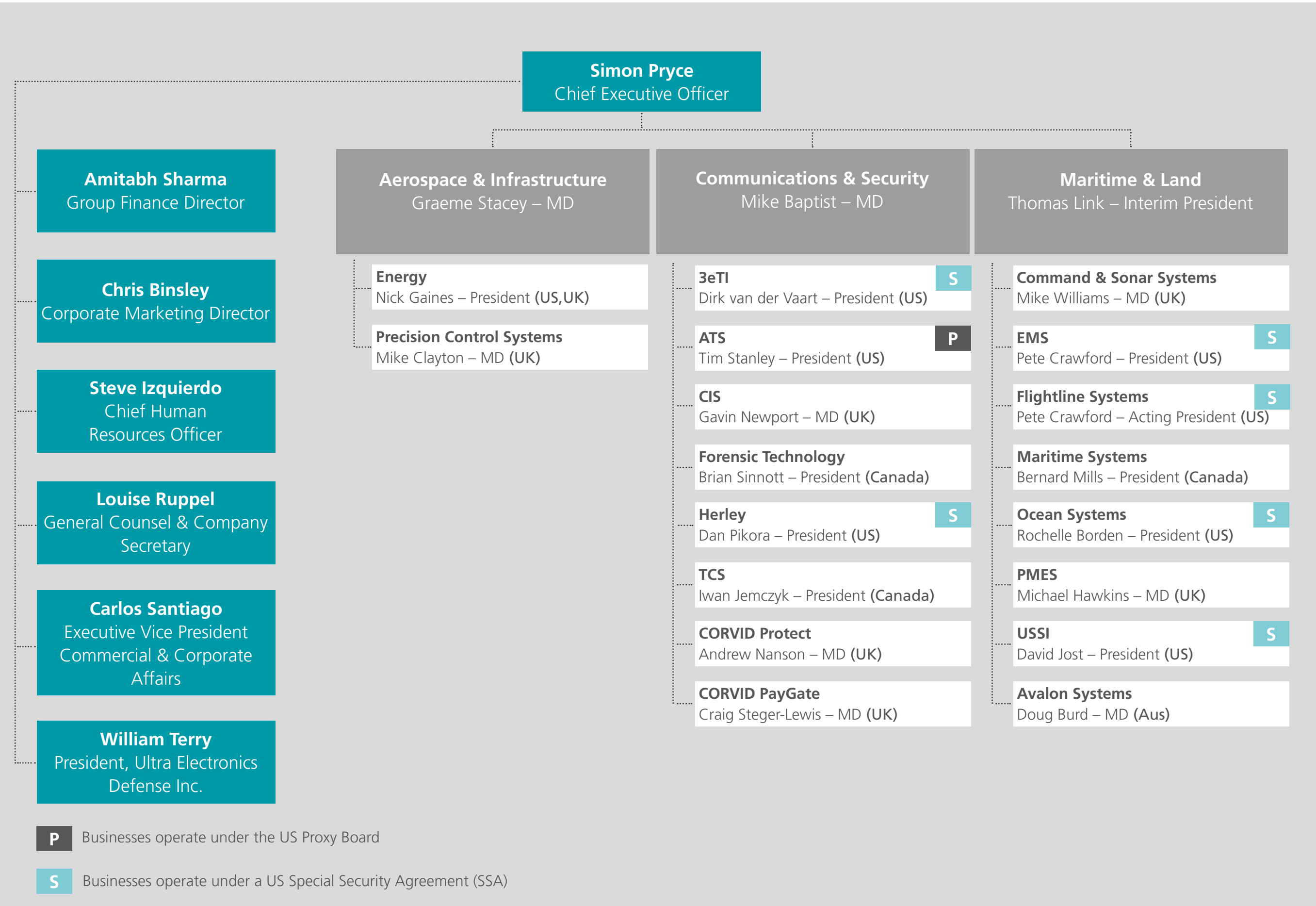
Annual General Meeting

All shareholders are invited to attend the Annual General Meeting on 3 May 2019, where they will have the opportunity to meet with Directors, all of whom will attend the meeting, and to ask questions. The notice of the meeting and accompanying papers are expected to be sent to shareholders on 27 March 2019. Voting at the Annual General Meeting is conducted by way of a show of hands. Proxy votes lodged for each Annual General Meeting are announced at the meeting and published on the Group's website (www.ultra-electronics.com).

Electronic communication with shareholders is preferred wherever possible since this is both more efficient and environmentally friendly. However, shareholders may opt to receive hard copy communications if they wish.

Shareholder information continued

ULTRA'S ORGANISATIONAL STRUCTURE



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