

C H E M R I N G   G R O U P   P L C



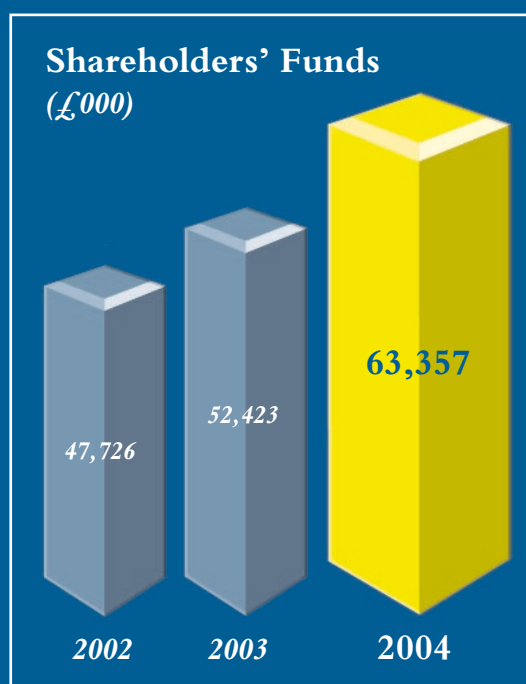
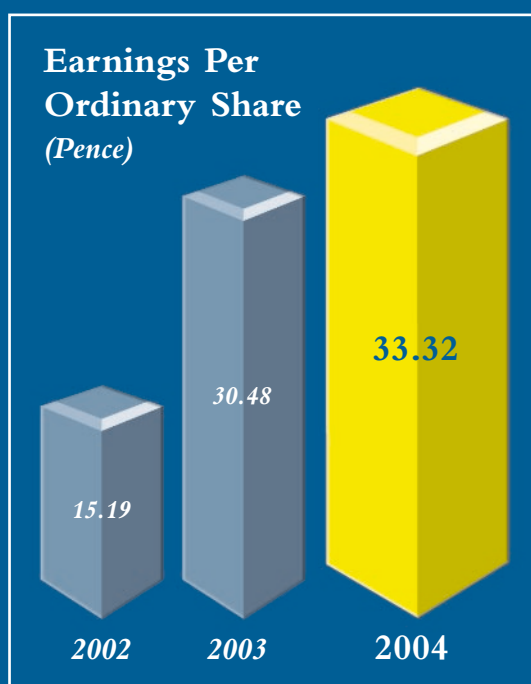
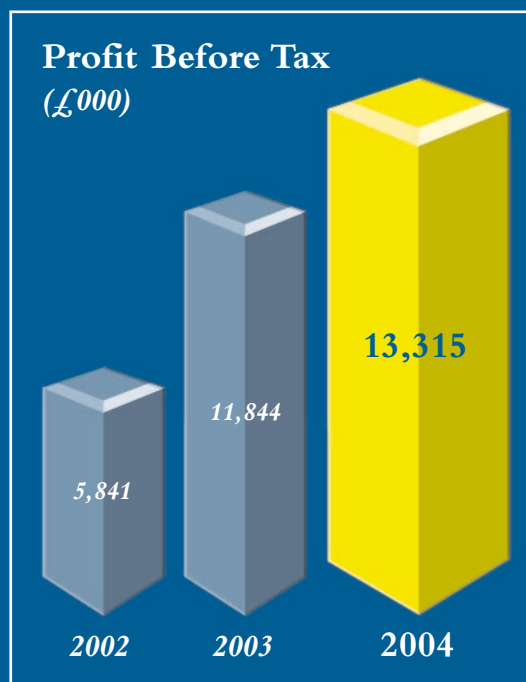
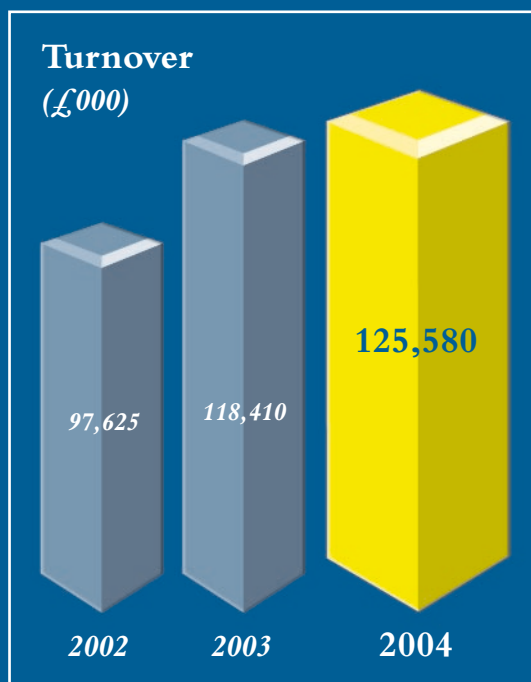
F I N A N C I A L   S T A T E M E N T S

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## Financial Highlights



# Summary Financial Information

	2004	2003	2002
	<i>£000</i>	<i>As restated<sup>1</sup></i> <i>£000</i>	<i>As restated<sup>1</sup></i> <i>£000</i>
<b>Turnover</b>			
Countermeasures	78,724	64,264	47,023
Military pyrotechnics	19,788	19,540	17,942
Marine safety and security	27,068	26,366	21,345
Continuing operations	125,580	110,170	86,310
Discontinued operations	-	8,240	11,315
	<b>125,580</b>	<b>118,410</b>	<b>97,625</b>
<b>Operating profit/(loss)</b>			
- Continuing	16,927	14,026	7,431
- Discontinued	-	(216)	684
	<b>16,927</b>	<b>13,810</b>	<b>8,115</b>
<b>Profit/(loss) before taxation</b>			
- Continuing	14,005	11,463	5,299
- Discontinued	(690)	381	542
	<b>13,315</b>	<b>11,844</b>	<b>5,841</b>
<b>Dividend per ordinary share</b>	<b>9.00p</b>	7.40p	6.70p
<b>Basic earnings per ordinary share – continuing<sup>2</sup></b>	<b>35.02p</b>	29.51p	13.78p
<b>Basic earnings per ordinary share</b>	<b>33.32p</b>	30.48p	15.19p
<b>Diluted earnings per ordinary share</b>	<b>33.14p</b>	30.05p	15.03p
<b>Net debt (£000)</b>	<b>30,008</b>	38,681	47,277
<b>Shareholders' funds (£000)</b>	<b>63,357</b>	52,423	47,726

<sup>1</sup> See Note 5.

<sup>2</sup> See Note 13.

## Statement by the Chairman

I am pleased to report that the Group's profit before tax from continuing operations rose by 22% to £14.0 million (2003\*: £11.5 million) during the year, earnings per share from continuing operations increased by 19% to 35.02p (2003\*: 29.51p), and net debt decreased by £8.7 million to £30.0 million, a 22% reduction.

Group turnover from continuing operations increased by 14% to £125.6 million (2003\*: £110.2 million). A significant proportion of the Group's turnover is now generated in the US and, at constant rates of exchange, the reported Group turnover would have been approximately £7.0 million higher, a 20% increase on last year's reported turnover.

It was a very good year for most of the Group. Each of the Group's countermeasures businesses performed at a record level, with a 23% increase in combined turnover to £78.7 million. Unfortunately, the issues affecting the marine division, to which I referred in my interim statement, resulted in an unacceptable performance by that business.

After a vast amount of effort and substantial cost, we finally settled the Kilgore insurance claim against Royal and Sun Alliance (RSA) for a sum which the Board believed was acceptable when taking all issues into account. This leaves certain amounts outstanding, for which we are now pursuing a claim against our former insurance brokers, Willis, concerning their placement of the insurance cover for Kilgore and their subsequent handling of the claim. Discussions are

in progress and, in anticipation of an acceptable resolution to these discussions, the Group has carried forward in its balance sheet a reasonable estimate of the final recovery.

During the year the Company raised approximately £5.7 million (net of expenses) by way of a placing of ordinary shares. This, together with the final receipt from RSA, helped to reduce Group borrowings to a very satisfactory debt/equity ratio of 47%.

### Business Activities

The Group's countermeasures businesses have historically all been built on satisfying the military's requirements to protect aircraft and helicopters. However, in recent years, UK-based Chemring Countermeasures has developed a strong business in naval countermeasures for protecting ships, throughout NATO and other countries, and our US companies are now also entering what for them is a new market for US Navy ships. Considerable attention is currently being given by the military to the protection of land platforms and their personnel. The Group is admirably

placed to participate in developments in this field utilising technology both from the countermeasures businesses and from PW Defence, and taking advantage of the ability of our defence companies to pool their resources in search of solutions.

Alloy Surfaces had another record year. Since the opening of its production plant for special material decoys in 1999, the business has increased its post-tax earnings ten-fold. With the opening of a second facility this month and an opening order book double that of last year, Alloy Surfaces is well placed to continue its impressive growth.

Last year the Group announced that Alloy Surfaces had been included in one of the three consortia selected by the US Department of Homeland Security to find solutions to protect commercial aircraft. To the surprise of the consortium including Alloy Surfaces, it was not selected to proceed to the next stage. This leaves the US without "a decoy solution" in this particular initiative, despite the fact that decoys are currently the only proven economic solution. Discussions have however now been re-opened to

Results	2004 £000	2003* £000
Operating profit – continuing operations	16,927	14,026
Profit before tax – continuing operations	14,005	11,463
Profit before tax	13,315	11,844
Basic earnings per ordinary share – continuing operations	35.02p	29.51p
Basic earnings per ordinary share	33.32p	30.48p

## Statement by the Chairman

- continued

enable Alloy Surfaces to participate in the development of an effective countermeasure for commercial aircraft application utilising its special material decoys.

Kilgore had an excellent year, demonstrating its singular ability as the volume producer of the industry. In the last two years Kilgore has delivered three and a half million flares to the US military and to export customers. In the year under review, the business doubled post-tax earnings, fully justifying the Group's acquisition and subsequent investment in this operation. During the year, Kilgore was successful in winning a significant proportion of a major new contract (with options over an additional four year period) from the US Army. A newcomer to the industrial base in the US has challenged the award to Kilgore and the other successful bidder but precedent suggests that this challenge will not succeed. Kilgore has a strong order book for the next year and, in addition to the decoy business, has grown its military pyrotechnics sales.

Chemring Countermeasures' strong first half performance continued during the second half of the year, producing an excellent full year result. However, the business does not enjoy the benefits of a strong domestic order book, and exports account for two-thirds of sales. This business takes months and at times years to secure orders, and will do well to match 2004 earnings in 2005.

PW Defence had a quieter year. Many of PW Defence's products are used by

the military for training, and when a sizeable proportion of the military is involved on active duty, training suffers, with a resultant dip in orders. There are signs that activity will return to normal levels in 2005.

Pains Wessex Australia had a very good year both for military and marine products, supporting the Group's UK and US manufacturing companies. Pains Wessex Australia has also received an encouraging boost to its own manufacturing activities, by securing an agreement for indigenous production of military pyrotechnic products for the Australian Government.

I have previously commented on the stability of the profitability of the marine pyrotechnics and lights businesses, and registered disappointment at the progress of the growing marine electronics business in achieving satisfactory levels of profit. The combined pyrotechnics and lights businesses performed well in the year, with the slightly weaker pyrotechnics performance offset by strong sales of lights. The pyrotechnics business suffered whilst the divisional management focused on the issues affecting the marine electronics business but this has been rectified for 2005.

The marine electronics business had a bad year, and three significant issues combined to create an overall loss in the marine division. The business decided to cease active marketing of one product, due to price pressures in the market, which required the write-off of £0.8 million of R&D costs.

A second product, which was in great demand, could not be manufactured at a competitive price, and it was therefore decided to introduce a Mk2 version with significantly enhanced features at a substantially reduced cost. Unfortunately, the business was seriously let down by a sub-contract software development house, and the new product has only just been introduced to the market. We are expecting excellent sales of this product in 2005.

Of greatest concern however was that during the early part of 2004 external trial results were published in the US, which claimed that our world beating GPS PLBs (personal locating beacons) and GPS EPIRBs were not performing to specification. We vigorously disputed this assertion and in further tests proved that our products met technical specification, the only ones in the world to so do. It was acknowledged however that enhancements to the GPS performance would be beneficial. We therefore proceeded to make some minor design modifications and offered an upgrade for units in service. This event was not only very costly in terms of management time but also led to a temporary sharp reduction in sales in the US, currently the major market for these products.

As shareholders would expect, major changes have now taken place in the marine division, including management restructuring. A thorough review of its profitability and investment is underway, to enable the Board to decide on the most profitable future strategy for the marine business.



## Balance Sheet and Cash Flow

After several years of hard work, I am satisfied that the Group has now achieved a respectable balance sheet, an acceptable level of debt and sound cash flow, principally as a result of the strong performance of the countermeasures businesses.

## Dividends

I indicated last year that, following resolution of the Kilgore insurance claim, the Board would review its dividend policy. Accordingly, this year the Board is recommending a final dividend of 6.20p per ordinary share, a 28% increase on the final dividend for last year. This, together with the interim dividend of 2.80p paid in September 2004, gives a total dividend for the year of 9.00p, a 22% increase on last year. The dividend is over 3.5 times covered.

## Employees

Once again I would like to thank all our employees for their considerable efforts in making this such a successful year. The new operating and financial review due to be introduced shortly may require in future years a far fuller

statement of our employment practices, but I am sure will not alter the directors' appreciation of the contribution everyone makes to the success of the Group.

## The Board and Corporate Governance

During the year the Group has continued to plan the future structure of the Board and senior management.

Two new independent non-executive directors have been appointed.

Air Marshal Sir Peter Norriss, whose experience of the military, not least its procurement practices, is proving very valuable, as is Ian Much with his years of relevant experience as a chief executive of public companies.

Recently it was announced that Dr David Price will join us in April 2005 as Chief Executive, with David Evans becoming Non-Executive Deputy Chairman after thirteen years as Managing Director and Chief Executive of the Group. The Board conveys its thanks to David Evans for his major contribution to the success of the Group. David Price joins us from a senior position in Rolls-Royce, with years of previous experience in

defence electronics, and we believe he will be of great benefit in assisting the Board to deliver its future strategy.

General Sir John Stibbon will retire as a non-executive director at the Annual General Meeting after eleven years of diligent service, through both the bad and good times. The Board will miss his pertinent questioning of difficult issues and we wish him well in retirement.

The demands placed on public companies to meet the ever increasing bureaucracy of corporate governance reporting, even with some licence granted to the smaller company, are becoming more and more difficult to justify, in value terms. In 2005, through the principle of "comply or explain", I hope we will achieve a clean bill of health.

## Prospects

Our defence businesses have entered 2005 with strong order books and great confidence forming the base for another year of excellent results. Resolution of the issues affecting our marine electronics business will result in these products contributing to Group profitability. I have every confidence in the outcome for next year.

**K C Scobie - Chairman**  
**8 February 2005**

\* All comparisons are for the full year to 31 October 2003 as restated following the adoption of FRS5 Application Note G and UITF Abstract 38 (See Note 5 to the Financial Statements)



## Review by the Chief Executive

### Overview

Group turnover from continuing operations increased 14% to £125.6 million, assisted by a 23% increase in the turnover of the countermeasures business to £78.7 million. The turnover of the Group's US businesses was \$106 million (2003\*: \$74 million), contributing 47% to the total Group turnover. The US performance is evidence of our prominent position in the US countermeasures market.

Overall, military pyrotechnics turnover was at a similar level to last year. However, UK activity was lower as training requirements reduced with the

deployment of forces in Iraq and Afghanistan. In contrast, US activity increased as we delivered our strategy to increase Kilgore's range of military pyrotechnics products. Although the turnover of the marine safety and security business was marginally up on last year, profitability was adversely impacted by issues affecting the marine electronics products.

Operating profit from continuing operations increased by 21% to £16.9 million during the year. The defence order book ended the year at £91.5 million, and increased further to £102.5 million by the end of December 2004, providing excellent

order cover for the current financial year. Our focus on operational cash flow resulted in £14.5 million of cash inflow during the year, which reduced the Group's debt by £8.7 million and gearing to 47%.

### Operational Review

#### COUNTERMEASURES

**Countermeasures turnover increased to £78.7 million, up £14.4 million**

Continuing growth in the countermeasures business reflects the Group's position as the worldwide market leader in providing expendable decoys to protect valuable military platforms, particularly to the US Department of Defense (US DoD). This is now by far the largest customer, representing in excess of 60% of our total countermeasures turnover, and growing. All three of our countermeasures operations increased turnover in 2004.

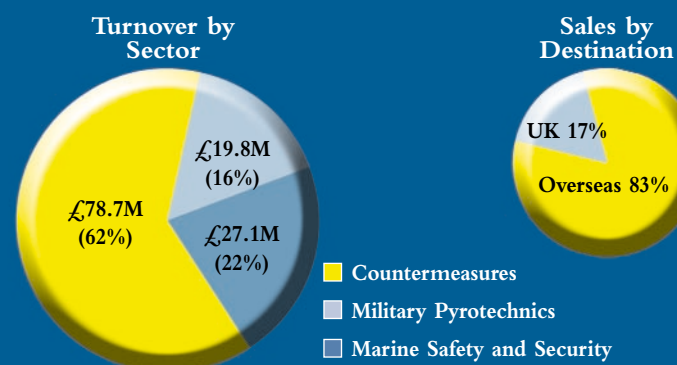
There is continuing strong demand, particularly in the US, for our products to protect military aircraft from missile attack. Our decoys are in use in the Iraq and Afghanistan campaigns, where there are threats to both helicopters and fixed wing transport aircraft.

Alloy Surfaces' second plant and new technology centre is now complete, and its current order book, deliverable in 2005, is double that of last year. Further investment in equipment and facilities will ensure that Alloy Surfaces satisfies the increasing demand for its decoys. Alloy Surfaces' exports in the year included sales to Canada, Australia and Japan, and six other countries are now trialling its decoys.

### The Group's activities are covered under the following headings:

<b>Countermeasures:</b>	Chemring Countermeasures, Alloy Surfaces, Kilgore, Pains Wessex Australia
<b>Military Pyrotechnics:</b>	PW Defence, Kilgore, Pains Wessex Australia
<b>Marine Safety and Security:</b>	McMurdo Marine, ICS Electronics, McMurdo Pains Wessex, Oroquieta, Pains Wessex Australia

### Turnover by Business Area for the year ended 31 October 2004





In November 2004, the UK Ministry of Defence (UK MoD) awarded Alloy Surfaces a contract for BOL-IR decoys valued at \$5.9 million, with further options valued at \$6.4 million, which could be exercised in 2005.

Kilgore was successful in winning \$18.4 million of decoy orders from the US Air Force in November 2004. The contract also provides the US DoD with options to place further orders over a four year period from 2005 to 2008, which, if taken up, could bring the total value of the contract to over \$104 million. Kilgore is in production on the new F22 decoy, and is developing decoys for the Joint Strike Fighter and the B52 bomber. New naval IR decoy manufacturing facilities were completed in the year to enable Kilgore to deliver its first naval decoy export order in 2005. Kilgore is also supporting the US Navy on future ship expendable decoys.

Our UK-based business, Chemring Countermeasures, had another excellent year with turnover growth of 24%. Export sales were two-thirds of the total, demonstrating the prominent position of the business in the worldwide market. Demand is increasing throughout the world for Chemring Countermeasures' IR and RF aircraft decoys, including variants to protect the Typhoon and other new fighter aircraft.

During the year, the UK MoD awarded Chemring Countermeasures a £12 million contract for the design and supply of an improved shipborne RF countermeasure, for deployment in Royal Navy frigates, destroyers and larger ships. Following an initial design

certification phase, deliveries under the contract are anticipated to commence in 2008.

As a result of our policy to invest in research and development, as well as production facilities, our countermeasures businesses have grown significantly over the last four years, and have the order book to support future growth. This investment policy will continue, to ensure the protection of the Group's prominent position as the international market leader in countermeasures, and to enable us to pursue the many opportunities available to us by offering our customers the most comprehensive RF and IR countermeasures solutions.

#### ■ MILITARY PYROTECHNICS Military Pyrotechnics turnover increased to £19.8 million, up £0.3 million

Our military pyrotechnics business is a leading supplier of specialist military pyrotechnic products used in illumination, screening, signalling and training. Overseas sales were 75% of total military pyrotechnics turnover.

At our UK operation, PW Defence, demand from the UK MoD was lower because of deployment of armed forces overseas, reducing UK training. In 2003, the UK business also benefited from a significant order for military vehicle protection grenades into the US, which was not repeated at the same level this year. However, this was partially offset with increased sales to the Middle East and the Far East.

PW Defence is currently supporting the UK MoD on an operational requirement for a pyrotechnic product

to create a distraction in crowd threatening scenarios. Products have been successfully tested and initial orders are anticipated this year. Given the Iraq experience, urban battlefield training is attracting increased focus, particularly in the US, and this presents an opportunity for our military pyrotechnic expertise.

Kilgore's military pyrotechnics sales increased by \$3.0 million during the year, and should increase further this year following the award of a development and initial production contract for improved air-deployed flares, which enhance a pilot's ability to see targets whilst using night vision goggles. Annual requirements could be in the region of \$7 million to \$9 million.

Kilgore is the main supplier to the US Navy of Mk58 pyrotechnic marine location markers, and is involved in supporting future military vehicle protection in the high profile US Army Future Combat Systems programme.

#### ■ MARINE SAFETY AND SECURITY Marine Safety and Security turnover increased to £27.1 million, up £0.7 million

The Group is a leading supplier of legislated marine electronic and safety equipment worldwide for commercial and leisure markets. The marine safety and security business is made up of three product groups - electronics, marine safety lights and pyrotechnics.

Growth in 2004 was disappointing, particularly after three years of good growth where electronics had been the main driver. Further growth in electronics turnover in 2004 had been expected to come from increased sales of personal locating beacons (PLBs) with

## Review by the Chief Executive

- continued

global positioning system (GPS) capability, and automatic identification system (AIS) transponders.

Unfortunately however, the GPS PLB and GPS EPIRB were impacted by external trials of the products in the US. The trials highlighted that, despite our products meeting technical specification, enhancements to the GPS performance would be beneficial. A decision was therefore taken to make some minor design modifications, and offer upgrades to the units currently in service. Despite this, the publicity generated by the précis of the trials report adversely affected sales volumes and resulted in additional costs being incurred, which impacted profitability in the year.

In September 2004, the upgraded PLB was by far the best performing beacon in tests carried out by the state of Vermont in conjunction with Air Force Rescue Coordination Centre (AFRCC), with a GPS fix being acquired in less than two minutes. McMurdo's GPS EPIRB has also been credited with several successful rescues in 2004, the most notable being the four British rowers rescued off the Isles of Scilly.

Delays in completing the development of a lower cost Mk2 AIS transponder also impacted turnover and profitability in the year, as the business continued to sell the lower margin Mk1 variant. The product is heavily software dependent and issues arose during the complex independent approval testing, which necessitated frequent software modifications and delayed final approval. European approval was secured in December 2004, and the



product is now competitively placed to support future marine profitability. US Coast Guard approval is in place and FCC approval is pending; these approvals will enable us to pursue the heavily-policed US market.

Demand for lights products was high in the year, particularly for military customers. However, increased competition in international pyrotechnics markets resulted in a small loss of market share, which we aim to recover.

The Group has invested significantly in the development of new electronics products over the last three years to improve the product range and reduce manufacturing costs. This investment is written-off over three years.

Demand for 406MHz EPIRBs and PLBs will increase due to a combination of the phasing-out of 121.5MHz beacons, and increasing use of 406MHz PLBs for marine, land, government, utilities and aviation use. Demand will also increase for AIS technology as its place in increased policing of the maritime arena is recognised.

### Strategy

The Group's strategy is to focus on growing our niche businesses, where we are recognised international market leaders, by continuing to invest in research and development and manufacturing capability to enhance and protect our strong market presence. We will support this strategy with complementary acquisitions to increase our product range, services and technical competence as opportunities arise.

**D R Evans - Chief Executive**  
**8 February 2005**

\* All comparisons are for the full year to 31 October 2003 as restated following the adoption of FRS5 Application Note G and UITF Abstract 38 (See Note 5 to the Financial Statements)

## Review by the Finance Director

### Operating Results

Turnover from continuing operations was £125.6 million (2003\*: £110.2 million), an increase of 14%. Net operating margins from continuing operations were 13.5% (2003\*: 12.7%). Net operating profits from continuing operations were £16.9 million (2003\*: £14.0 million), an increase of 21%.

Profit before tax from continuing operations was £14.0 million (2003\*: £11.5 million), an increase of 22%. Profit before tax was £13.3 million (2003\*: £11.8 million), an increase of 13%.

The discontinued operations in 2003 – Kembrey Wiring Systems and the Chemical Coatings division of Alloy Surfaces – generated a turnover of £8.2 million and operating losses of £0.2 million. As Kembrey Wiring Systems was sold in the first week of November 2003, its turnover and results were not material to the Group and are not separately disclosed.

### Research and Development

Research and development expenditure totalled £6.0 million (2003\*: £4.7 million), an analysis of which is set out below. The Group's policy is to write-off capitalised development costs over a three year period. Amortisation of

development costs was £1.6 million (2003\*: £1.2 million).

### (Loss)/Profit on Disposal

On 8 November 2003, the entire issued share capital of Kembrey Wiring Systems Limited was sold for a net asset value of £1.9 million before costs, generating a loss on disposal of £0.7 million. £1.2 million was received on completion of the sale, with £0.4 million received during the 2004 calendar year, and a further £0.3 million receivable in November 2005.

In July 2003, a profit of £0.7 million was made on the disposal of the Chemical Coatings division of Alloy Surfaces.

In 2003, £0.6 million was accounted for as a net profit on disposal of assets which were destroyed in the April 2001 incident at Kilgore.

### Interest

The interest charge for the year was £3.1 million (2003\*: £3.4 million). Interest was covered 5.5 times (2003\*: 4.1 times) by operating profits from continuing operations.

### Taxation

The tax charge of £3.8 million (2003\*: £3.5 million) represents a rate of 29% (2003\*: 30%). Despite significant profits arising in the US, where there is a

higher tax regime, the Group has benefited from tax credits on research and development expenditure and these, together with the release of surplus provisions relating to prior years, have reduced the tax rate.

### Change of Accounting Policies

As reported at the half year, the Group has changed its revenue recognition criteria to comply with FRS5 Application Note G. Sales to US Government agencies are now recognised when formally accepted by the US Government. The change reduced previously reported profits for the financial year ended 31 October 2003 by £152,000, and resulted in a prior year adjustment of £771,000 to reduce shareholders' funds at 31 October 2002.

In addition, UITF Abstract 38 relating to the treatment of ESOP shares has been adopted. As a result, a prior year adjustment of £174,000 to reduce shareholders' funds at 31 October 2002 was required.

### Pensions

In accordance with FRS17 *Accounting for pension costs*, the Group has disclosed the additional information required in Note 9 of the financial statements. Under FRS17, the calculated deficit on the Group's two defined benefit pension schemes after tax was £12.3 million (2003\*: £10.8 million).

Actuarial valuations as at 6 April 2003 for the two defined benefit schemes – the Staff Pension Scheme and the Executive Pension Scheme – were completed during the year. Taking into account the results of these valuations, employers' contributions to the Staff Pension Scheme were increased to

### Research and Development

	2004 £m	2003* £m
Customer funded research and development	2.4	1.9
Non-funded research and development	2.2	1.6
Capitalised development costs	1.4	1.2
Total research and development expenditure	6.0	4.7

## Review by the Finance Director

- continued

16% from 11.5% with effect from January 2004, and it was also agreed that the Group would make additional contributions to the two schemes totalling £35,000 per month. The cash impact of the increase in contributions is in the region of £0.7 million per annum. Employee contributions have also been increased to 8% from 6% on both schemes.

### Shareholder Returns

Basic earnings per ordinary share from continuing operations were 35.02p (2003\*: 29.51p), an increase of 19%. Basic earnings per ordinary share were 33.32p (2003\*: 30.48p), an increase of 9%.

The dividend per ordinary share of 9.00p (2003\*: 7.40p) is covered 3.5 times (2003\*: 4.1 times).

The total shareholder return for the Group over the five years to 31 October 2004 has outperformed the FTSE Small Cap Index for the same period by 139%.

Shareholders' funds at the year end were £63.4 million (2003\*: £52.4 million).

### Cash Flow and Net Debt

Operating cash flow was £14.5 million (2003\*: £18.1 million), with £20.2 million of operating cash flow generated in the second half of the year, compared to an out flow in the first half of £5.7 million.

Working capital balances reduced in the second half and this, together with the £5.1 million receipt from Royal and Sun Alliance, assisted with net debt reduction.

Fixed asset expenditure in the year was £5.6 million (2003\*: £5.5 million), £0.5 million of which related to the

investment in a second facility for Alloy Surfaces. A further £1.4 million has been spent in the first quarter of the current financial year to complete this investment.

Net debt was reduced by 22% to £30.0 million (2003\*: £38.7 million). Gearing is 47% (2003\*: 74%).

During the year the repayment profile of £2.0 million of medium term debt was extended by two years to 31 October 2008, providing additional headroom in the Group's cash facilities.

In January 2005, the Group converted \$15.0 million of overdraft into term debt, repayable over five years.

### Share Capital

In March 2004, the Company issued 1,371,780 ordinary shares, raising £5.7 million cash net of expenses. This placing principally provided funds to assist with capital investment, in particular at Alloy Surfaces.

180,824 ordinary shares were issued during the year following the exercise of executive share options. 28,988,576 (2003\*: 27,435,972) ordinary shares were in issue at 31 October 2004.

### Foreign Exchange

The Group's principal foreign exchange exposure is to the US dollar. During the year sterling appreciated by 9% against the dollar.

At constant exchange rates, sales would have been approximately £7.0 million higher than reported. The impact on dollar earnings translated into sterling has been mitigated by partial hedging of sterling against the dollar. The net impact on operating profits, after this hedging, is approximately £0.5 million.

Forward exchange currency contracts have been entered into for the next two financial years to reduce the Group's exposure to further depreciation of the US dollar against sterling.

### International Financial Reporting Standards

International Financial Reporting Standards (IFRS) came into effect on 1 January 2005. The Group's first set of financial statements reported under IFRS will be for the year ending 31 October 2006. A preliminary assessment of the impact on the Group has been made, and the potential impact of certain items is set out below:

#### ■ Goodwill Amortisation

No change, as the Group already carries out an annual impairment test and does not charge any amortisation.

#### ■ Development Costs

Development costs are capitalised under SSAP13, and no change to reported numbers is envisaged.

#### ■ Deferred Tax

The Group does discount deferred tax liabilities. Without the discounting, the tax charge is likely to rise by approximately 1% per annum.

#### ■ Pensions

Under the current proposals, surpluses or deficits arising from actuarial valuations will be recorded on the balance sheet.



**P A Rayner - Finance Director**  
**8 February 2005**

\* All comparisons are for the full year to 31 October 2003 as restated following the adoption of FRS5 Application Note G and UITF Abstract 38 (See Note 5 to the Financial Statements)

# Directors and Professional Advisers

## Non-Executive Chairman

### **Kenneth C Scobie<sup>\*\*\*</sup>**

Joined the Group as Non-Executive Chairman in June 1997. Former Chairman of Allied Leisure plc and the Executive Board of the Scottish Rugby Union. Chairman and Chief Executive of a wide range of industrial companies since 1972.

Aged 66.

## Executive Directors

### **David R Evans**

#### **Chief Executive<sup>+</sup>**

Joined the Group in 1987 as Managing Director of the Countermeasures business and appointed to the Board in 1988. Became Chief Executive in 1999. Managing Director of the Marconi torpedo business prior to joining the Group.

Aged 58.

### **Timothy W Hayter**

#### **Chief Operating Officer**

Joined the Group in November 2001 as Chief Operating Officer. Chartered Engineer. Formerly employed by Rolls-Royce plc and Dynacast International Limited.

Aged 45.

### **Paul A Rayner FCA**

#### **Finance Director**

Joined the Group in June 1994 and acted as Finance Director to several Group companies before being appointed to the Board in August 1999. Formerly a Senior Audit Manager with Deloitte & Touche.

Aged 43.

## Non-Executive Directors

### **Peter J Molony<sup>\*\*\*</sup>**

Chief Executive of the Group from July 1997 to January 1999. Previous appointments include Finance Director of Scottish & Newcastle plc and Rolls-Royce plc.

Aged 67.

### **Ian F R Much<sup>#</sup>**

Joined the Group as a non-executive director in December 2004. Currently a non-executive director of Manchester United plc. Previous appointments include Chief Executive of De La Rue plc and T&N plc, and non-executive director of Admiral plc and Camelot plc.

Aged 60.

### **Air Marshal Sir Peter Norriss**

#### **KBE CB AFC MA FRAeS<sup>#</sup>**

Joined the Group as a non-executive director in May 2004. Currently Chairman of Microturbo Limited. Formerly Deputy Chief Executive of Defence Procurement (Operations) and a non-executive director of the DERA Board. Immediate past President of the Royal Aeronautical Society.

Aged 60.

### **General Sir John Stibbon KCB OBE<sup>+-</sup>**

Joined the Group as a non-executive director in December 1993. Formerly Non-Executive Chairman of ITT Defence Limited and Chief Royal Engineer.

Aged 70.

## Secretary

### **Sarah Ellard ACIS**

## Professional Advisers

### **Auditors**

Deloitte & Touche LLP, Southampton

### **Solicitors**

Ashurst, London

Seyfarth Shaw, Washington

### **Bankers**

Bank of Scotland, Southampton

### **Stockbrokers**

Investec Henderson Crosthwaite, London

## Headquarters and Registered Office

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Website: [www.chemring.co.uk](http://www.chemring.co.uk)

## Registration Number

86662

## Registrars

Computershare Investor Services PLC

The Pavilions

Bridgwater Road

Bristol BS13 8AE

*Membership of Board committees during year:*

\*Audit ~Remuneration + Nomination

# Appointed to Audit, Nomination and Remuneration Committees following the year end

# Directors' Report

for the year ended 31 October 2004

Your directors present the financial statements of the Group for the year ended 31 October 2004.

## Principal Activities

The principal activities of the Group are the design, manufacture and sale of countermeasures, military pyrotechnics, and marine safety and security products.

## Review of the Year and Results

A review of the year can be found in the Chairman's Statement, the Chief Executive's Review and the Finance Director's Review on pages 3 to 10.

## Dividends

The directors recommend a final dividend of 6.20p per ordinary share, which together with the interim dividend of 2.80p per ordinary share paid in September 2004, gives a total for the year of 9.00p (2003: 7.40p).

## Directors and their Interests

The present directors are shown on page 11.

Air Marshal Sir Peter Norriss was appointed as a director on 1 May 2004, and Mr I F R Much was appointed as a director on 1 December 2004. Both of these directors will be seeking re-appointment under Article 87.1 of the Company's Articles of Association at the forthcoming Annual General Meeting on 24 March 2005. Neither director has a service contract with the Company.

Mr T W Hayter and Mr P J Molony will be retiring by rotation at the Annual General Meeting and will be offering themselves for re-election. Details of Mr Hayter's service contract with the Company are set out in the Directors' Remuneration Report on page 16.

Mr Molony does not have a service contract with the Company.

Having attained the age of seventy, General Sir John Stibbon will be retiring at the Annual General Meeting and will not be offering himself for re-election. He does not have a service contract with the Company.

None of the directors had a beneficial interest in any contract of significance to which the Group was a party during the year to 31 October 2004.

Information required as to directors' shareholdings is set out in the Directors' Remuneration Report.

## Substantial Shareholdings

At 7 February 2005 the following interests in the ordinary share capital of the Company exceeding 3% had been notified to the Company under the provisions of section 198 of the Companies Act 1985:

<i>Name</i>	<i>% Interest</i>
Deutsche Bank AG	9.8
Standard Life Group	5.8
Prudential Corporation PLC	4.7
Legal & General Investment Management	4.3

## Employees

The Group pursues a policy of employee communication through meetings (including team briefings and works councils) and in-house magazines by which employees are made aware of the progress of the Group and the companies in which they work.

The Group employs disabled persons wherever circumstances permit, and full and fair consideration is given to applications for employment by disabled persons having regard to their particular aptitudes and disabilities. Disabled persons in employment receive equal treatment to that afforded to other employees.

## Environment

The Group recognises that environmental issues are of fundamental importance to a successful and responsible business strategy, and it is committed, through a process of continual improvement, to minimising the environmental impact of its operations. In line with this commitment, the Group's businesses are striving towards:

- designing and developing products which have the minimal environmental impact during their manufacture, use and subsequent disposal;
- minimising energy usage and waste wherever practicable;
- reusing or recycling materials wherever practicable;
- purchasing goods and services from environmentally responsible suppliers;
- monitoring progress on environmental matters using external and internal auditing.

## Charitable and Political Donations

Charitable donations amounting to £3,750 (2003: £3,650) were made during the year. No political donations were made during the year (2003: £nil).



## Policy on Payment of Suppliers

It is the policy of the Group that each of the Group companies should agree appropriate terms and conditions for its transactions with suppliers. These will range from standard written terms to individually negotiated contracts. Creditor days of the Group as at 31 October 2004 amounted to 59 days (2003: 79 days).

## The Chemring 1998 Executive Share Option Scheme

On 8 July 2004, options were granted over 115,000 ordinary shares to certain directors and senior employees of the Group. During the year options over 180,824 ordinary shares were exercised. Additional information is set out in Note 23.

## The Chemring Group PLC Share Based Incentive Scheme ("the ESOP")

No options were granted in the year to 31 October 2004. During the year options on 3,192 shares were exercised. There were no options outstanding under the ESOP at 31 October 2004.

## Share Capital

Under the provisions of section 80 of the Companies Act 1985 ("the Act") the Board is prevented from exercising its powers under the Articles of Association ("the Articles") to allot shares without an authority in terms of the Act contained either in the Articles or in a resolution of the shareholders in general meeting. The authority, when given, can last for a maximum period of five years, but your Board proposes that renewal should be sought at each annual general meeting. Such proposal is set out as resolution 9 in the Notice of the Annual General Meeting.

Section 89 of the Act requires that an allotment of shares for cash may not be made unless the shares are first offered to existing shareholders on a pre-emptive basis in accordance with the terms of the Act. In accordance with general practice, to ensure that small issues of shares can be made without the necessity of convening a general meeting, your Board proposes that advantage be taken of the provisions of section 95 of the Act to disapply the Act's pre-emptive requirements. Accordingly, a special resolution (set out as resolution 10 in the Notice of Annual General Meeting) will be proposed which, if passed, will have the effect of granting the directors the power to allot not more than 5% of the present issued ordinary share capital free of the requirements of section 89 of the Act. No issue of these shares will be made which would effectively alter the control of the Company without prior approval of the shareholders in general meeting.

## Statement of Directors' Responsibilities

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the Group's profit or loss for that period. It is also the directors' responsibility to maintain adequate accounting records which disclose with reasonable accuracy the financial position of the Company and the Group, to ensure that the financial statements comply with the Companies Act 1985, safeguard the assets of the Company and the Group, and prevent and detect fraud and other irregularities, and prepare the financial statements on a going concern basis.

The directors confirm that suitable accounting policies, consistently applied and supported by reasonable and prudent

judgments and estimates, have been used in the preparation of the financial statements, and that applicable accounting standards have been followed.

## Close Company Provisions

As far as the directors are aware, the close company provisions of the Taxes Acts do not apply to the Group nor has there been any change in that respect since 31 October 2004.

## Auditors

A resolution to re-appoint Deloitte & Touche LLP as auditors will be proposed at the Annual General Meeting.

## Annual General Meeting

The resolutions to be proposed at the Annual General Meeting to be held on 24 March 2005, together with explanatory notes, appear in the separate Notice of Annual General Meeting sent to all shareholders.

Approved by the Board of Directors on 8 February 2005.

## Signed on behalf of the Board

**S L Ellard - Secretary**



# Directors' Remuneration Report

for the year ended 31 October 2004

This report sets out the information required by the Directors' Remuneration Report Regulations 2002 ("the Regulations"). As required by the Regulations, the Directors' Remuneration Report will be submitted to shareholders for approval at the Annual General Meeting on 24 March 2005.

## Unaudited Information

### Remuneration Committee

During the year under review the Remuneration Committee comprised Mr K C Scobie (Committee Chairman), Mr P J Molony and General Sir John Stibbon. Following the year end, Mr Scobie and General Sir John Stibbon resigned as members of the Committee, and Air Marshal Sir Peter Norriss and Mr I F R Much were appointed as members. Mr Much was also appointed as Chairman of the Committee.

The Committee's principal responsibilities are:

- determining, agreeing with the Board and reviewing from time to time the overall policy for the remuneration of the Chairman, the executive directors, the Company Secretary and certain other senior executives in the Group, and their individual remuneration packages and any changes thereto;
- approving the terms and conditions of employment, and any changes thereto, of the executive directors;
- approving any compensation payments for executive directors;
- approving the design of, and determining targets for, any

performance-related pay schemes operated by the Group;

- reviewing the design of all share incentive plans for approval by the Board and the Company's shareholders;
- overseeing any major changes in employee benefits structures across the Group.

Under the revised structure of the Committee, none of the Committee members has any personal financial interest in the matters reserved for the Committee, nor do they have any conflicts of interest arising from cross-directorships, and they are not involved in the day to day running of the Group's business. Therefore, they are regarded by the Board as independent.

The Committee met three times during the year. The Chief Executive attends meetings by invitation but is not present during any discussions relating to his own remuneration.

The terms of reference of the Committee were available on request from the Company Secretary during the year. Revised terms of reference were adopted following the year end, and these are now available on the Company's website or on request from the Company Secretary.

### Advisers

During the year the Committee received advice on remuneration matters from New Bridge Street Consultants LLP and Aon Consulting. Aon Consulting also provides investment consultancy services for the Group's UK pension schemes.

The Committee also consults internally with the Chief Executive and the Company Secretary.

### Remuneration Policy for Executive Directors

The Committee's policy is to provide executive remuneration packages which are competitive, but not excessive, by reference to market rates, reflect the performance of the business against financial objectives, and which take into account the individual contribution and performance of each executive director. Remuneration packages comprise the following elements:

- (i) basic salary and benefits, including pensions;
- (ii) annual bonuses linked to the Group's financial performance; and
- (iii) awards of share options linked to the long term growth of the Group.

The Committee aims to align the interests of executive directors with those of shareholders, by ensuring that a significant proportion of remuneration is performance-related. This is achieved through the performance-related elements of annual bonuses and share options.

### Basic Salaries and Benefits

The executive directors' basic salaries are reviewed annually by the Committee, and adjustments made, if appropriate, taking into account individual performance and comparable salary levels in manufacturing companies of a similar size and in other companies within the aerospace and defence sector. The Committee refers to published salary surveys and also reviews the remuneration information presented in the annual reports of companies in the reference group.

The main taxable benefits for executive directors are company cars, fuel for private motoring and private medical insurance.

### Annual Bonuses

The Company operates an annual performance-related bonus plan for the executive directors. Under this arrangement, bonuses are paid based upon the achievement of pre-determined targets for earnings per share and reductions in the Group's net indebtedness. The maximum bonus which can be earned is 45% of basic salary. Bonuses are non-pensionable.

The performance measures for the bonus plan are reviewed annually by the Committee. It is anticipated that the bonus plan will continue to be based upon earnings per share and reduction of net debt in 2005.

### Share Option Scheme

The Company operates an executive share option scheme, The Chemring 1998 Executive Share Option Scheme, under which both Inland Revenue approved and unapproved options may be granted. Participation in this scheme is extended to the executive directors and senior management of the Group. In determining whether to grant options to an individual and the number of options to be granted, the Committee takes into account their level of seniority within the organisation and the anticipated contribution by that individual to the long term performance of the Group.

Options are granted at the market price of the Company's ordinary shares on the date of grant.

In order to align the interests of participants in the scheme with those of

the Company's shareholders, options can only be exercised under the scheme subject to a performance condition.

The Committee believes that a performance condition linked to growth in earnings per share is an appropriate basis upon which to reward the executive directors for a measurable increase in the performance of the Group, as this is considered to most closely align the interests of the directors with those of the Company's shareholders. However, with regards to the options granted during the year, the Committee did not deem it appropriate to link the growth in earnings per share to growth in RPI in the UK, given that a significant proportion of the Group's profits are now generated overseas.

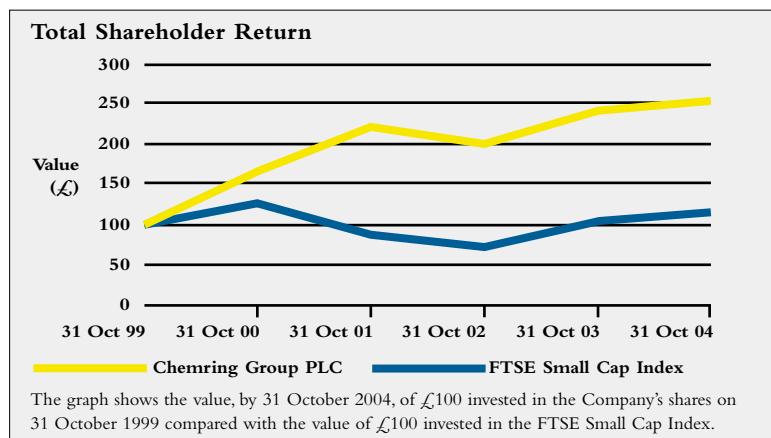
The Committee will ensure that a consistent basis of measurement of earnings per share is used during the transition to international financial reporting standards.

### Long Term Incentive Scheme

The Company previously operated a long term incentive scheme known as The Chemring Group PLC Share Based Incentive Scheme. This scheme is not being utilised for executive directors at present.

### Performance Graph

The following graph shows a comparison of the Company's total shareholder return (TSR) over the last five financial years against a "broad equity market index", as required by the



The Committee has agreed that any options granted in 2005 will be subject to a challenging performance condition linked to growth in earnings per share, taking into account the forecast performance of the Group over the three year period following the date of grant. The Committee has also agreed that, for future option grants, if the applicable performance condition is not met after three years, no re-testing will be permitted.

Regulations. The FTSE Small Cap Index has been selected by the Committee for this comparison because it provides the most appropriate measure of performance of listed companies of a similar size to the Company.

### Pensions

Mr Evans and Mr Rayner are members of The Chemring Group Executive Pension Scheme ("the Executive Scheme"). This is an approved final

# Directors' Remuneration Report

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salary scheme providing, at retirement, a pension of up to two-thirds of salary, subject to Inland Revenue limits. The Executive Scheme also provides life assurance cover, dependants' pensions and lump sum payments on death-in-service. Members of the Executive Scheme were required to make monthly contributions to the scheme at the rate of 6% of pensionable salary up until 31 January 2004, and at the rate of 8% thereafter.

Mr Evans' benefits under the Executive Scheme accrue based on a pension of two-thirds final pensionable salary with no cash commutation, and a 50% spouse's pension, in respect of his membership of the scheme from 10 August 1987 to 5 April 1993. For service thereafter, his benefit accrual is based on a pension of 50% final pensionable salary plus 1.5 times final pensionable salary as cash, and a two-thirds spouse's pension. For service accrued from 1 February 2004 the spouse's pension reduces to 50%. Any excess of cash over the Inland Revenue permitted maximum is converted back to pension at the rate of £12 cash to £1 pension. On death-in-service, Mr Evans' dependants would receive a lump sum payment of four times basic salary and, in addition a spouse's pension would be payable, as calculated above. Mr Evans has a normal retirement age of 60.

Mr Rayner's pension under the Executive Scheme accrues at 1/80th of final pensionable salary for each year of membership, and he also accrues a cash lump sum at 3/80ths of final pensionable salary for each year of membership. A two-thirds spouse's pension is payable in respect of service accrued to 31 January 2004, reducing to 50% for service accrued thereafter, and

on death-in-service, Mr Rayner's dependants would receive a lump sum payment of two times basic salary and, in addition a spouse's pension would be payable, as calculated above. Mr Rayner is subject to the earnings cap in respect of his membership of the Executive Scheme.

All pensions in payment in respect of pensionable service accrued under the Executive Scheme after 6 April 1993 are increased by the lower of RPI or 5% per annum.

Mr Hayter is a member of The Chemring Group Staff Pension Scheme ("the Staff Scheme"). The Staff Scheme is also an approved final salary scheme but is contracted out of the State Second Pension. Members of the Staff Scheme were required to make monthly contributions to the scheme at the rate of 6% of pensionable salary up until 31 January 2004, and at the rate of 8% thereafter. Mr Hayter's benefits under the Staff Scheme accrue in an identical manner to that in which Mr Rayner accrues benefits under the Executive Scheme, as set out above. Mr Hayter is also subject to the earnings cap.

Both Mr Hayter and Mr Rayner have a normal retirement age of 65.

## Service Contracts

Mr Evans has a service contract with the Company dated 10 December 1991, which is due to expire on his 60th birthday on 27 October 2006. The contract was terminable on two years' notice by the Company but this notice period is now reducing as Mr Evans approaches his retirement date. The contract also contains a provision whereby the Company may terminate on one year's notice if Mr Evans persistently fails,

without reasonable cause, to comply with the terms of the contract or to discharge his duties satisfactorily. The contract does not contain an express provision for payment in lieu of notice. The contract is terminable on twelve months' notice by Mr Evans. The Committee believes that the notice provisions in Mr Evans' contract remain appropriate and in line with the requirements of the Company, particularly as the contract will expire in 2006 in any event. Mr Evans' current contract will remain in place for its unexpired term when he takes up the appointment of Non-Executive Deputy Chairman in April 2005.

Mr Hayter and Mr Rayner have rolling service contracts dated 12 December 2001 and 27 August 1999 respectively. These provide for termination by either party on twelve months' notice. The Company may however terminate without notice and make a payment in lieu of notice equal to the sum of twelve months' pay, including the value of any contractual benefits. There are no other provisions relating to compensation on early termination.

It is the Committee's general policy that all new executive directors appointed in the future will have service contracts with the Company which are terminable on a maximum of twelve months' notice. The service contracts will contain provisions permitting the Company to make any termination payments by instalments, and will require directors to mitigate their loss in such circumstances.

## Policy on Outside Appointments

With the specific approval of the Board in each case, executive directors may accept external appointments as non-executive directors of other companies, provided that they do not

detract from their responsibilities to the Group, and may retain any related fees paid to them. None of the executive directors currently holds any external appointments.

### Appointment of New Chief Executive

As previously announced, a new Chief Executive, Dr David Price, will be appointed with effect from 4 April 2005. In this position, Dr Price will receive a basic salary of £250,000 per annum and will be provided with the usual taxable benefits – company car, fuel for private motoring and private medical insurance. He will also be entitled to participate in The Chemring Group Staff Pension Scheme (subject to the Inland Revenue earnings cap) and the annual performance-related bonus plan applicable to executive directors.

Dr Price's service contract with the Company will be terminable on twelve months' notice by either party. The Company may however terminate without notice and make a payment in lieu of notice equal to the sum of the salary due for the unexpired notice period plus the fair value of any contractual benefits. Any such sum may be paid in instalments, and in these circumstances there is a requirement to mitigate loss.

In addition to the above, the Company has agreed to make a one-time award of 125,000 restricted ordinary shares to Dr Price shortly after he takes up his appointment as Chief Executive. Subject to Dr Price remaining in post, 50% of these shares will vest in March 2006 and the remaining 50% will vest in March 2007, but there will be no other performance condition. This award was necessary in order to secure the appointment of Dr Price, and is intended to compensate him for

the loss of the options and performance shares he holds in his current employment. The Company also intends to grant executive share options to the value of £250,000 to Dr Price under The Chemring 1998 Executive Share Option Scheme, subject to a performance condition to be agreed by the Committee.

### Non-Executive Directors and Chairman

Fees for the non-executive directors are determined annually by the Board, having regard to the practice of other companies and the particular demands of the Group. Each of the non-executive directors, with the exception of Mr Scobie, currently receives a fee of £25,000 per annum. The Company provides private medical insurance for Mr Scobie, Air Marshal Sir Peter Norriss and General Sir John Stibbon, and their respective spouses.

With the exception of Mr Scobie, the non-executive directors do not have service contracts with the Company. Mr Much and Air Marshal Sir Peter Norriss, who have been appointed since the publication of the Higgs Report, both have letters of appointment covering, amongst other items, their terms of appointment and expected time commitment. These letters of appointment provide for an initial three year appointment, unless terminated earlier by and at the discretion of either party upon three months' written notice, and anticipate that, subject to satisfactory performance and re-election by the shareholders, two three-year terms will be served as a non-executive director. Since the year end, Mr Molony has also entered into a revised letter of appointment covering these items, save that his letter of appointment provides

for a two year appointment commencing on 1 January 2005. General Sir John Stibbon will retire as a non-executive director at the Annual General Meeting on 24 March 2005, having attained the age of seventy, and has not therefore entered into a revised letter of appointment.

Mr Scobie has a rolling service contract with the Company terminable on twelve months' notice by either party. His remuneration under the contract, part of which is paid to his company for consultancy services, is £80,000 per annum. His time commitment under the contract is two to four days per month, not to exceed a total of fifty days per year. Additional services are paid for at the rate of £1,000 per day.

The non-executive directors do not participate in the Company's bonus or share option schemes. However, a long term incentive scheme, known as The Chemring Group Phantom Share Option Scheme, was established in 1997 to secure the appointment of Mr Scobie as Chairman at a difficult time when the Group was undergoing a fundamental reorganisation. Mr Scobie, who will be the only participant in the scheme, acquired a contractual entitlement on his appointment to the grant of phantom options over 141,025 ordinary shares in the Company at a notional exercise price of 78p per share. On exercise of the phantom options at least three years after the date of grant, Mr Scobie will be entitled to a cash payment from the Company equivalent to the difference between the then current market value of the ordinary shares less the total exercise price. The options have met the performance condition linked to growth in earnings per share. It is not envisaged that any further awards will be made under this scheme.

# Directors' Remuneration Report

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## Audited Information

### Directors' Emoluments

The emoluments of all the directors who served during the year are shown below:

	Salaries and fees		Cash bonuses		Taxable benefits		Total	
	2004 £000	2003 £000	2004 £000	2003 £000	2004 £000	2003 £000	2004 £000	2003 £000
<b>Executives</b>								
D R Evans	201	175	51	20	27	24	279	219
T W Hayter	151	122	40	18	17	70	208	210
P A Rayner	144	112	37	16	15	16	196	144
<b>Non-executives</b>								
P J Molony	41	20	-	-	-	-	41	20
P C Norriss	13	-	-	-	1	-	14	-
K C Scobie	82	57	-	-	1	-	83	57
J Stibbon	30	20	-	-	2	2	32	22
<b>Total remuneration</b>	<b>662</b>	<b>506</b>	<b>128</b>	<b>54</b>	<b>63</b>	<b>112</b>	<b>853</b>	<b>672</b>

Amounts shown above in the salaries and fees column relate to basic salary in the case of executive directors and fees in the case of non-executive directors.

Mr Molony receives a fee of £25,000 per annum for his services as a non-executive director. During the year however, Mr Molony received additional fees of £16,125 in respect of his services as Non-Executive Chairman of Kembrey Wiring Systems Limited during 2000 and 2001. Mr Molony had previously agreed to defer payment of this amount until the disposal of the business was completed in November 2003.

Mr Scobie's remuneration includes payments to his company, K C Scobie Limited, in respect of his consultancy services. In addition to the remuneration shown above, Mr Scobie has a long term incentive scheme, details of which are given on page 17, in respect of which the Group had accrued £441,000 (2003: £420,000) as at 31 October 2004. £21,000 (2003: £152,000) was charged to the profit and loss account during the year in respect of Mr Scobie's long term incentive scheme, reflecting the increase in the Group's share price during the period and the increase in the cash amount to be paid to Mr Scobie on exercise of his phantom options.

General Sir John Stibbon receives a fee of £25,000 per annum for his services as a non-executive director. Additional fees of £5,000 were paid to him during the year in recognition of the significant additional services he provided on pensions-related matters during 2003 and 2004.

### Directors' Share Interests

The interests of the directors in the ordinary shares of the Company at 1 November 2003, or date of appointment if later, and 31 October 2004 are shown below. All are beneficial holdings.

	2004 Number	2003 Number
D R Evans	100,497	85,997
T W Hayter	5,000	5,000
P J Molony	-	-
P C Norriss	-	-
P A Rayner	12,000	11,500
K C Scobie	134,864	134,864
J Stibbon	-	-

No movements have taken place between 31 October 2004 and 8 February 2005.

Mr Much has no interests in the ordinary shares of the Company.

In addition to the interests detailed above, by the virtue of section 324 of the Companies Act 1985, all the executive directors are technically deemed to be interested in all of the shares held by the Trustee of The Chemring Group PLC Share Based Incentive Scheme. 43,274 ordinary shares were held by the Trustee at 31 October 2004.

The holdings by the executive directors of share options granted under The Chemring 1998 Executive Share Option Scheme at 1 November 2003 and 31 October 2004 are shown below.

	<i>At 1 Nov 2003</i>	<i>Granted during the year</i>	<i>Number of share options Lapsed during the year</i>	<i>Exercised during the year</i>	<i>At 31 Oct 2004</i>	<i>Exercise price (p)</i>	<i>Market price at date of exercise (p)</i>	<i>Date from which exercisable</i>	<i>Expiry date</i>
D R Evans	100,000	-	-	100,000	-	236	417.5	3 Feb 2003	2 Feb 2010
T W Hayter	54,000	-	-	-	54,000	380.5	-	23 Jan 2005	22 Jan 2012
	-	25,000	-	-	25,000	436.5	-	8 July 2007	7 July 2014
P A Rayner	50,000	-	-	-	50,000	236	-	3 Feb 2003	2 Feb 2010
	-	25,000	-	-	25,000	436.5	-	8 July 2007	7 July 2014

Mr Evans made a theoretical gain of £181,500 on the exercise of his options during the year.

## Share Options

The exercise of outstanding share options is subject to the Company meeting pre-set performance targets. For options first exercisable prior to 2007, the target requires the Company's average annual earnings per share to grow by at least RPI + 3% over a three year period prior to exercise. For options first exercisable in 2007, the target requires the Company's average annual earnings per share to increase by at least 5% over the period of three, four or five years following grant.

The market price of the ordinary shares at 31 October 2004 was 390.5p. During the year, the ordinary shares traded within the range 346.5p to 466p.

## Pensions

The following table sets out the pension benefits accrued by the executive directors during the year.

	<i>Total benefit accrued at 31 Oct 2003</i>	<i>Transfer value of accrued benefit at 31 Oct 2003</i>	<i>Increase in accrued benefit during year before inflation</i>	<i>Total benefit accrued at 31 Oct 2004</i>	<i>Transfer value of accrued benefit at 31 Oct 2004</i>	<i>Increase in accrued benefit during year after inflation</i>	<i>Transfer value of increase in accrued benefit after inflation (less members' con- tributions)</i>	<i>Increase in transfer value during year (less members' con- tributions)</i>
	<i>Pension (£p.a.)</i>	<i>Cash (£)</i>	<i>(£)</i>	<i>Pension (£p.a.)</i>	<i>Cash (£)</i>	<i>Pension (£p.a.)</i>	<i>Cash (£)</i>	<i>(£)</i>
D R Evans	84,715	115,978	1,495,990	19,407	7,174	104,122	123,152	1,832,159
								16,611
T W Hayter	2,475	7,425	18,954	1,350	4,050	3,825	11,475	47,263
								1,268
P A Rayner	11,653	34,959	134,976	1,628	4,884	13,281	39,843	162,120
								1,244
								3,347
								275,793
								320,264
								20,249
								19,084

i) Transfer values represent liabilities of the applicable scheme, and do not represent sums paid to the individuals.

ii) Transfer values have been calculated on the basis of actuarial advice. During the year, the basis on which transfer values are calculated was updated. For consistency, all transfer values have been calculated on the new basis, based on financial conditions at the respective dates.

## Approval of the Directors' Remuneration Report

The Directors' Remuneration Report was approved by the Board on 8 February 2005.

**Signed on behalf of the Board**

**K C Scobie - Chairman**

## Statement on Corporate Governance

In July 2003, the Financial Reporting Council issued a revised Combined Code on Corporate Governance, which applied to the Company with effect from 1 November 2003. This statement sets out how the Company has applied the main and supporting principles of good governance set out in Section 1 of the revised Combined Code, and whether or not the Company has complied throughout its accounting period with the provisions of Section 1 of the revised Combined Code.

### The Board

The Board currently comprises the Chairman, Chief Executive, Chief Operating Officer, Finance Director and four non-executive directors. The Board considers that two of the current non-executive directors, Mr Much and Air Marshal Sir Peter Norriss, are independent in character and judgment, and meet the criteria for independence set out in the revised Combined Code. The Board also considers that Mr Molony is independent, notwithstanding that he received additional remuneration from the Company during the year. This additional remuneration, amounting to £16,125, was paid in respect of Mr Molony's services as Non-Executive Chairman of Kembrey Wiring Systems Limited during 2000 and 2001. Mr Molony had previously agreed to defer payment of this amount until the disposal of the business was completed in November 2003, and the Board does not consider that this affected his independence during the year under review. The directors' biographical details are set out on page 11.

The Board, which meets at least ten

times a year, approves the Group's long-term goals and strategies and provides overall financial and organisational control. The Board has a formal schedule of matters specifically reserved to it for consideration and approval, including approval of the Group's corporate plan; approval of the annual operating budgets; acquisitions, disposals and major capital expenditure; financing and treasury; reviewing the Group's systems of financial control and risk management; approving appointments to the Board and approving policies relating to directors' remuneration; and maintaining an effective dialogue with shareholders. All directors take decisions objectively in the interests of the Company.

The Board delegates certain responsibilities to the Executive Committee, including implementation of the Group's strategies and policies as determined by the Board; monitoring of operational and financial results against budget; allocation of resources across the Group within the overall plan approved by the Board; capital expenditure within limits imposed by the Board; and developing and implementing risk management systems. Further details of the Executive Committee are set out in the section of this report covering Board Committees.

Procedures are in place covering the content, presentation and timely delivery of papers to the Board for each Board meeting, to ensure that directors have sufficient information to make expedient and considered decisions in fulfillment of their fiduciary duties. Where directors have concerns which cannot be resolved

about the running of the Company or a proposed action, such concerns are recorded in the Board minutes.

Each director has full access to the advice and services of the Company Secretary who, under the direction of the Chairman, is responsible for maintaining good information flows within the Board and its committees, assisting with induction and keeping the directors informed about changes to their duties and responsibilities, and advising the Board on all governance matters. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

All directors are entitled to take independent professional advice in furtherance of their duties at the Company's expense, if the need should arise.

An internal induction programme on the Group's operations and its strategic and business plans is provided for newly-appointed directors. The Company Secretary also provides detailed information on directors' legal duties and responsibilities on appointment, and updates the Board on a regular basis with regards to regulatory changes affecting the directors and the Group's operations generally. Directors are continually updated on the Group's businesses and the matters affecting the market in which they operate. The Company meets the cost of appropriate external training for directors, the requirement for which is kept under review by the Chairman.

The Company separates the roles of Chairman and Chief Executive in accordance with the recommendations



of the revised Combined Code. Since the year end, the division of responsibilities between the Chairman and the Chief Executive, and their respective job descriptions, have been set out in writing and agreed by the Board.

In addition to chairing the Board, the Chairman is responsible for ensuring that the Board is kept properly informed and is consulted on all decisions reserved to it; promoting constructive relations between the executive and non-executive directors; ensuring that the development needs of directors are identified and the performance of the Board evaluated on a regular basis; and ensuring effective communication with shareholders and acting as a conduit to ensure that the views of shareholders are communicated to the Board. The Chairman has no significant business commitments other than his chairmanship of the Company.

The non-executive directors perform an essential role in safeguarding shareholders' interests. They actively participate in the development of strategic objectives and monitor the performance of executive management in achieving these objectives. The non-executive directors also review financial performance, and consider the integrity of the financial information produced by the Group and whether the financial controls and risk management systems are robust and defensible. They meet regularly with the management of the Group's operating companies. In addition to participating in Board meetings, the non-executive directors are the members of the standing committees set up to deal with audit and the

remuneration of executive directors and senior management. The Board is satisfied that the present balance of executive and non-executive influence which exists is appropriate for the Company, taking into account its size and status.

The Board has not appointed a Senior Independent Director, as it does not consider this to be appropriate at the present time in view of the size of the Board.

During the financial year, the Chairman met regularly with the non-executive directors without the executives present. The non-executive directors did not meet formally without the Chairman present during the year but this recommendation will be considered during 2005 under the revised structure of the Board.

Mr Much and Air Marshal Sir Peter Norriss, who have been appointed as non-executive directors since the publication of the Higgs Report, both have letters of appointment covering, amongst other items, their terms of appointment and expected time commitment. These letters of appointment provide for an initial three year appointment, unless terminated earlier by and at the discretion of either party upon three months' written notice, and anticipate that, subject to satisfactory performance and re-election by the shareholders, two three-year terms will be served as a non-executive director. Since the year end, Mr Molony has also entered into a revised letter of appointment covering these items, save that his letter of appointment provides for a two year appointment

commencing on 1 January 2005.

General Sir John Stibbon will retire as a non-executive director at the Annual General Meeting on 24 March 2005, having attained the age of seventy, and has not therefore entered into a revised letter of appointment. The non-executive directors' letters of appointment are available for inspection on request to the Company Secretary.

In accordance with the revised Combined Code and the Company's Articles of Association, all directors submit themselves for re-election every three years. The papers accompanying the Notice of Annual General Meeting include a statement from the Chairman confirming that the performance of each director seeking re-election at the meeting continues to be effective and that each such director continues to demonstrate commitment to their role.

The Board undertook an evaluation of its performance and composition during the year, as a result of which two new independent non-executive directors were appointed. Since the year end, the Company has also announced the appointment of a new Chief Executive with effect from April 2005, allowing Mr Evans to take up an appointment as Non-Executive Deputy Chairman. Mr Evans will be considered non-independent in this role. A formal process for annual evaluation of the performance of the Board, its committees and individual directors will be introduced in 2005, when the restructured Board is fully in place.

The Company maintains directors and officers liability insurance in respect of legal action against its directors.

# Statement on Corporate Governance

- continued

## Meetings Attendance

The following table shows the attendance of directors at meetings of the Board, the Audit Committee, the Nomination Committee and the Remuneration Committee during the year:

	Board (10 meetings)	Audit Committee (2 meetings)	Nomination Committee (3 meetings)	Remuneration Committee (3 meetings)
K C Scobie	10	2	3	3
D R Evans	10	-	3	-
T W Hayter	10	-	-	-
P J Molony	9	2	3	3
Air Marshal Sir Peter Norriss <sup>1</sup>	5	-	-	-
P A Rayner	10	-	-	-
General Sir John Stibbon	9	2	-	3

<sup>1</sup> Air Marshal Sir Peter Norriss was appointed as a director on 1 May 2004

## Board Committees

Since the year end and following the appointment of two new independent non-executive directors, the Board has reviewed and revised the terms of reference of the Audit Committee, the Nomination Committee and the Remuneration Committee, to reflect the recommendations made in the Higgs Report and Sir Robert Smith's report on audit committees. The terms of reference of these Committees are posted on the Company's website and are available on request from the Company Secretary.

## Audit Committee

During the year the members of the Audit Committee were Mr Scobie, Mr Molony and General Sir John Stibbon. Mr Scobie acted as Chairman of the Committee. Since the year end, Mr Scobie and General Sir John Stibbon have resigned as members of the Committee and Mr Much and Air Marshal Sir Peter Norriss have been appointed as members. Mr Molony will take over the Chairmanship of the Committee with effect from 9 February 2005. The membership of the Committee now satisfies the requirements of the revised Combined Code, comprising three independent non-executive directors, two of whom have recent and relevant financial experience.

The Committee meets at least three times a year and operates within formal written terms of reference. As referred to above, the terms of reference have been updated since the year end and are now available on the Company's website. Prior to this, the terms of reference were available on request from the Company Secretary.

Meetings of the Committee are attended, at the invitation of the Committee, by the external auditors, the Chairman, the Finance Director and representatives from the Group finance function. The Company Secretary acts as secretary to the Committee and minutes of meetings are circulated to all Board members.

The Committee is authorised to seek any information it requires from any employee of the Company in order to perform its duties, and to obtain any outside legal or other professional advice it requires at the Company's expense.

The Committee monitors the integrity of the Group's financial statements and the effectiveness of the external audit process. It is responsible for ensuring that an appropriate relationship between the Group and the external auditors is maintained, including reviewing non-audit services and fees. The Committee keeps under review

the effectiveness of the Group's internal controls and financial risk management systems, and on an annual basis, considers the need for a dedicated internal audit function. From 2005, the Committee will review annually its terms of reference and its effectiveness, and recommend to the Board any changes required as the result of such review.

During the year, the Committee, operating under its previous terms of reference, discharged its responsibilities by:

- reviewing the Group's draft 2003 financial statements and 2004 interim results statement prior to Board approval, and reviewing the external auditors' detailed reports thereon;
- reviewing the appropriateness of the Group's accounting policies, and reviewing various accounting matters raised by management and the external auditors in the context of financial disclosures;
- reviewing the potential impact in the Group's financial statements of certain matters such as impairments of fixed asset values and proposed International Financial Reporting Standards;
- reviewing the external auditors' plan for the 2003 financial statements and 2004 interim results, including key risks on the accounts, confirmation of auditor independence and the

proposed audit fee, and approving the terms of engagement for the audit;

- reviewing the requirement for a dedicated internal audit function.

During the year the Committee also reviewed the arrangements by which employees may, in confidence, raise concerns about possible improprieties in financial reporting or other matters.

The Company does not have a dedicated internal audit department. Despite this, it is felt that the financial record keeping in the Group is robust and capable of highlighting significant departures from procedures. Other areas of risk which might normally be carried out by an internal audit department are in the main covered by the Board as a whole or by the activities of other committees reporting in to the Board. Accordingly, the Board has confirmed that it does not consider it necessary to establish a dedicated internal audit department at this stage.

The Board has accepted the Committee's recommendation that Deloitte & Touche LLP be re-appointed as auditors at the forthcoming Annual General Meeting.

The Committee keeps under review the level of non-audit services which are provided by the external auditors, to ensure that this does not impair their independence and objectivity. The Committee, in conjunction with the Finance Director, also ensures that the Group maintains a sufficient choice of appropriately qualified audit firms. During the year, work of a consultancy nature was sourced from the external auditors only where there was no direct conflict with their role as external auditors and where there were clear efficiencies and value added benefits for the Company. Details of the amounts paid to the external auditors during the year for audit and other services are set

out in the notes to the financial statements on page 38.

### Nomination Committee

A Nomination Committee was established during the year to deal specifically with matters relating to the recruitment and appointment of a new Chief Executive and two new non-executive directors. The members of this Committee during the year were Mr Scobie (Committee Chairman), Mr Evans and Mr Molony.

With regards to the recruitment and appointment of the new directors to the Board, the Committee considered the specific knowledge and expertise which would be of benefit to the Group's current operations and future strategy, and provided a brief to external search agents based upon its conclusions. The search agents put forward a short list of candidates for the Committee to interview before making its recommendations to the Board. The Board also then interviewed preferred candidates prior to making any formal offers of appointment.

Since the year end, the Nomination Committee has been reconstituted and new terms of reference adopted. Mr Evans and Mr Molony have resigned as members of the Committee, and Mr Much and Air Marshal Sir Peter Norriss have been appointed as members. Mr Scobie will continue to act as Chairman of the Committee but, in accordance with the Committee's new terms of reference, will not be permitted to chair meetings when the Committee is dealing with the appointment of his successor.

### Remuneration Committee

Following changes to the membership of the Remuneration Committee after the year end, the Committee now comprises solely independent non-executive directors,

Mr Molony, Mr Much and Air Marshal Sir Peter Norriss, and is chaired by Mr Much. The Remuneration Committee met three times during the year. Further details on the Committee and the Company's policy on directors' remuneration are included within the Directors' Remuneration Report.

### Executive Committee

The Chief Executive, Mr Evans, chairs the Executive Committee, which meets monthly. The other members are the Chief Operating Officer, the Finance Director and the Company Secretary. The Executive Committee is responsible for the executive day-to-day running of the Company, submission to the Board of strategic plans and budgets for the Group's operations, and monitoring the day-to-day performance of the Group as a whole.

### Relations with Shareholders

The Company maintains an active dialogue with institutional shareholders through regular briefing meetings and formal presentations following the release of interim and annual results. Meetings are usually attended by the Chairman, the Chief Executive and the Finance Director. However, the non-executive directors are offered the opportunity to meet with major shareholders and attend meetings if so requested by major shareholders. Communication with private investors is achieved largely through the medium of the interim report and the financial statements.

The Company's website ([www.chemring.co.uk](http://www.chemring.co.uk)) provides financial and business information on the Group.

The directors are provided with reports and other written briefings from the Company's principal shareholders and analysts, and are regularly informed by the Company

# Statement on Corporate Governance

- continued

Secretary about changes to significant shareholdings.

It is the Company's policy that all directors should attend and make themselves available to take questions from shareholders or address any concerns at the Annual General Meeting. At other times of the year, the directors can be contacted via the Company's head office.

All substantial issues, including the adoption of the annual report and financial statements, are proposed on separate resolutions at the Annual General Meeting. The number of proxy votes received for and against each resolution, together with the number of abstentions, are indicated after votes have been dealt with on a show of hands. The Notice of the Annual General Meeting is sent to shareholders at least twenty working days before the meeting.

## Financial Reporting

The statement of directors' responsibilities in respect of the financial statements and accounting records maintained by the Company is set out on page 13.

## Internal Control

The Board has continued to review the effectiveness of the Group's systems of internal control, including financial, operational and compliance controls, and risk management systems.

The Board acknowledges its responsibility for the Group's systems of internal control and attaches considerable importance to these systems, which are designed to meet the Group's particular needs and identify those risks to which it is exposed. However, the systems can only provide reasonable, not absolute, assurance against material misstatement, loss or mismanagement of the Group's assets.

In carrying out its review of the effectiveness of the Group's systems of internal control, the Board has taken into consideration the following key features of the Group's risk management systems and control procedures which operated during the year:

- The Board assesses the key risks associated with achievement of the Group's business objectives as part of the annual strategic planning process. Out of this process, each business establishes a three year plan and annual budget, which are subject to approval by the Board. The performance of each business against budget and prior years is reviewed on a monthly basis at both operational level and by the Board. Achievement of strategic business objectives and the associated risks are monitored by the Board on an ongoing basis.
- All businesses hold monthly operating meetings, which are attended by at least one main Board director, either in person or, in the case of the overseas companies, by video conference. In the case of the US businesses, formal Board meetings are held quarterly and these are attended by main Board directors and external non-executive directors appointed in the US. The US non-executive directors are available to provide guidance and monitor governance in the US businesses throughout the year.
- Each business is required to comply with the Group's accounting policy manual, which sets out formal procedures for incurring certain types of expenditure and making contractual commitments. Compliance with the accounting policy manual is reviewed by both the Audit Committee and the full Board.
- The Board retains primary responsibility for acquisitions and disposals, and financing arrangements

for the Group. Treasury management, IT strategy, insurance and significant legal matters are dealt with centrally from the Group head office, and the Board receives regular reports on each of these items. Reviews of the Group's pensions, insurance and risk management arrangements are carried out by external advisors on a regular basis.

- A dedicated Group Safety, Health and Environment Manager, supported by a Group Health and Safety Management Committee, co-ordinates and controls the activities of each business in relation to health and safety and environmental matters, which are a key focus for the Board in view of the nature of the Group's operations. A sub-committee of the main Board also focuses specifically on safety at the Group sites where energetic materials are handled. External auditors carry out an annual review of the health and safety management systems at each of the Group's operations.
- A Risk Management Committee co-ordinates and reports to the Board on the risk control procedures implemented by each business at an operational level.

The Board confirms that it has reviewed the effectiveness of the Group's systems of internal control and risk management which were in place during the financial year ended 31 October 2004, and it confirms that systems of internal control and risk management compliant with the revised Combined Code and the Turnbull Guidance were in place throughout the year and have remained in place up to the date of approval of these financial statements. Notwithstanding this, the Board will continue to take steps to embed internal control and risk management further into the operations of the Group and to deal with any areas of improvement which come to the attention of management and the Board.

## Compliance with the Provisions of the Revised Combined Code

Throughout the year ended 31 October 2004, the Company has been in compliance with the code provisions set out in Section 1 of the revised Combined Code on Corporate Governance issued by the Financial Reporting Council in July 2003, with the following exceptions (references to the relevant sections of the revised Combined Code are given in brackets):

■ The non-executive directors did not meet without the Chairman present to formally appraise the Chairman's performance during the year. This will be addressed as part of the formal process for annual evaluation of the performance of the Board, its committees and individual directors, which will be introduced in 2005, when the restructured Board is fully in place (A.1.3).

■ The division of responsibilities between the Chairman and the Chief Executive, and their respective job descriptions, were set out in writing and discussed during the year but were not formally agreed by the Board until after the year end (A.2.1).

■ Prior to the appointment of Air Marshal Sir Peter Norriss in May 2004, the Company did not have at least two independent non-executive directors on the Board. Mr Much was appointed as an additional independent non-executive director in December 2004 (A.3.2).

■ The Board has not nominated a non-executive director as the senior independent director as it does not consider this to be appropriate at the present time in view of the size of the Board. This requirement will be kept under review (A.3.3).

■ A Nomination Committee was constituted during the year but the majority of members were not independent non-executive directors, as recommended by the revised Combined Code. Since the year end, the membership of the Committee has been revised and new terms of reference approved by the Board to satisfy the requirements of the revised Combined Code. The terms of reference have been made available on the Company's website and on request from the Company Secretary since the year end (A.4.1).

■ Mr Molony's letter of appointment was not revised to include those matters specified in the revised Combined Code until after the year end. General Sir John Stibbon's letter of appointment has not been revised as he will be retiring at the Annual General Meeting (A.4.4 and A.7.2).

■ A formal evaluation of the performance of the Board, its committees and individual directors was not carried out during the year but an annual process will be introduced in 2005, when the restructured Board is fully in place (A.6.1).

■ Mr Scobie's appointment as Non-Executive Chairman is not for a specified term; however, he is subject to retirement by rotation (A.7.2).

■ Mr Evans has a service contract with a notice period in excess of one year, details of which are disclosed in the Directors' Remuneration Report. The contract will expire in October 2006, and the notice period, which was originally two years, is therefore reducing as the expiry date approaches (B.1.6).

■ The Remuneration Committee did not comprise at least two independent directors and was chaired by Mr Scobie during the year. Since the year end, the membership of the Committee has been revised and new terms of reference approved by the Board to satisfy the requirements of the revised Combined Code (B.2.1).

■ The Audit Committee did not comprise at least two independent directors and was chaired by Mr Scobie during the year. Since the year end, the membership of the Committee has been revised and new terms of reference approved by the Board to satisfy the requirements of the revised Combined Code (C.3.1 and C.3.2).

As explained above, the directors have addressed most of these areas of non-compliance since the year end and following the appointment of Mr Much as an additional independent non-executive director. The Company will therefore report significantly improved compliance with the revised Combined Code for the financial year ending 31 October 2005.

## Going Concern

The directors have acknowledged the latest guidance on going concern and, after making appropriate enquiries, have formed a judgment at the time of approving the financial statements that there is a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Approved by the Board of Directors on 8 February 2005.

## Signed on behalf of the Board

**S L Ellard - Secretary**

# Independent Auditors' Report on the Financial Statements

for the year ended 31 October 2004

## Independent Auditors' Report to the Members of Chemring Group PLC

We have audited the financial statements of Chemring Group PLC for the year ended 31 October 2004 which comprise the profit and loss account, the balance sheets, the cash flow statement, the statement of total recognised gains and losses, and the related Notes 1 to 28, together with the reconciliation of movements in shareholders' funds and the notes to the consolidated cash flow statement. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditors' 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.

### Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with

applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the Directors' Remuneration Report. Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the July 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control

cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the Directors' Report and the other information contained in the annual report for the above year as described in the contents section including the unaudited part of the Directors' Remuneration Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

### Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report described as having been audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors'



Remuneration Report described as having been audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report described as having been audited.

**Uncertainty relating to insurance claim**

In forming our opinion, we have considered the adequacy of the disclosure made in Note 6 concerning the amounts recognised under a claim against the Group's then insurance brokers concerning the insurance for Kilgore Flares Company LLC and their subsequent handling of the claim. The future settlement of this claim could result in a shortfall, or a surplus, when compared with the recorded debtor at 31 October 2004. It is not possible to quantify the effect, if any, of this uncertainty. Details of the circumstances relating to this uncertainty and the amount of the related debtor recorded at 31 October 2004 is disclosed in Note 6. Our opinion is not qualified in this respect.

**Opinion**

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 October 2004 and of the profit of the Group for the year then ended; and the financial statements and that part of the Directors' Remuneration Report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

**Deloitte & Touche LLP**  
**Chartered Accountants and**  
**Registered Auditors**  
**Southampton**

**8 February 2005**



# Consolidated Profit and Loss Account

for the year ended 31 October 2004

	2004			2003		
	Continuing operations	Discontinued operations	Total operations	Continuing operations	Discontinued operations	Total operations
	As restated <sup>1</sup>			As restated <sup>1</sup>		
Note	£000	£000	£000	£000	£000	£000
<b>2 Turnover</b>	<b>125,580</b>	<b>-</b>	<b>125,580</b>	<b>110,170</b>	<b>8,240</b>	<b>118,410</b>
<b>4 Operating profit/(loss)</b>	<b>16,927</b>	<b>-</b>	<b>16,927</b>	<b>14,026</b>	<b>(216)</b>	<b>13,810</b>
Associated undertaking	151	-	151	178	-	178
(Loss)/profit on disposal:						
<b>6 - insurance claim</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>565</b>	<b>-</b>	<b>565</b>
<b>27 - sale of subsidiary undertaking/division</b>	<b>-</b>	<b>(690)</b>	<b>(690)</b>	<b>-</b>	<b>724</b>	<b>724</b>
<b>Profit/(loss) on ordinary activities before interest</b>	<b>17,078</b>	<b>(690)</b>	<b>16,388</b>	<b>14,769</b>	<b>508</b>	<b>15,277</b>
<b>10 Interest payable</b>	<b>(3,073)</b>	<b>-</b>	<b>(3,073)</b>	<b>(3,306)</b>	<b>(127)</b>	<b>(3,433)</b>
<b>Profit/(loss) on ordinary activities before taxation</b>	<b>14,005</b>	<b>(690)</b>	<b>13,315</b>	<b>11,463</b>	<b>381</b>	<b>11,844</b>
<b>11 Tax on profit/(loss) on ordinary activities</b>	<b>(4,029)</b>	<b>207</b>	<b>(3,822)</b>	<b>(3,387)</b>	<b>(113)</b>	<b>(3,500)</b>
<b>Profit/(loss) on ordinary activities after taxation</b>	<b>9,976</b>	<b>(483)</b>	<b>9,493</b>	<b>8,076</b>	<b>268</b>	<b>8,344</b>
Equity minority interest			15			23
<b>Profit for the financial year</b>			<b>9,508</b>			<b>8,367</b>
<b>12 Dividends</b>			<b>(2,690)</b>			<b>(2,034)</b>
<b>24 Retained profit</b>			<b>6,818</b>			<b>6,333</b>
<b>13 Basic earnings per ordinary share – continuing operations</b>	<b>35.02p</b>			<b>29.51p</b>		
<b>13 Basic earnings per ordinary share</b>			<b>33.32p</b>			<b>30.48p</b>
<b>13 Diluted earnings per ordinary share</b>			<b>33.14p</b>			<b>30.05p</b>
<b>12 Dividend per ordinary share</b>			<b>9.00p</b>			<b>7.40p</b>

<sup>1</sup> See Note 5.

# Additional Financial Performance Statements

for the year ended 31 October 2004

	2004	2003
	£000	As restated <sup>1</sup> £000
<b>Statement of total recognised gains and losses</b>		
Profit for the financial year	9,508	8,367
Currency translation differences on foreign currency net investments	(1,945)	(1,636)
Total recognised gains and losses relating to the year	7,563	6,731
Prior year adjustment (see Note 5)	(1,097)	-
<b>Total recognised gains and losses since last annual report and financial statements</b>	<b>6,466</b>	<b>6,731</b>
<b>Reconciliation of movements in shareholders' funds</b>		
Profit on ordinary activities after taxation	9,493	8,344
Equity minority interest	15	23
Dividends	(2,690)	(2,034)
Retained profit	6,818	6,333
Other recognised losses	(1,945)	(1,636)
Ordinary shares issued	77	-
Share premium arising	5,984	-
Net addition to shareholders' funds	10,934	4,697
Opening shareholders' funds as previously stated	53,520	48,671
Prior year adjustment (see Note 5)	(1,097)	(945)
Opening shareholders' funds as restated	52,423	47,726
<b>Closing shareholders' funds</b>	<b>63,357</b>	<b>52,423</b>

The historical cost profit and loss for the year is not materially different to that shown on the previous page.

<sup>1</sup> See Note 5.

# Consolidated Balance Sheet

as at 31 October 2004

		2004		2003
		£000	£000	As restated <sup>1</sup> £000
	Note			
<b>Fixed assets</b>				
Intangible assets:				
Development costs	14	2,841		2,996
Goodwill	14	27,984		28,442
			30,825	31,438
Tangible assets	15		41,810	42,879
Investments	16		1,073	1,063
			73,708	75,380
<b>Current assets</b>				
Stock	17	25,090		24,962
Debtors	18	27,036		30,059
Cash at bank and in hand		9,933		5,821
		62,059		60,842
Creditors due within one year	19	(49,915)		(57,199)
<b>Net current assets</b>			12,144	3,643
<b>Total assets less current liabilities</b>			85,852	79,023
Creditors due after more than one year	20		(18,174)	(21,489)
Provisions for liabilities and charges	22		(4,057)	(4,832)
Equity minority interest			(264)	(279)
			63,357	52,423
<b>Capital and reserves</b>				
Called-up share capital	23		1,511	1,434
<b>Reserves</b>				
Share premium account	24	26,710		20,726
Special capital reserve	24	12,939		12,939
Revaluation reserve	24	2,410		2,446
Revenue reserves	24	19,787		14,878
			61,846	50,989
<b>Shareholders' funds</b>			63,357	52,423
Attributable to equity shareholders			63,295	52,361
Attributable to non-equity shareholders			62	62
			63,357	52,423

These financial statements were approved by the Board of Directors on 8 February 2005.

Signed on behalf of the Board

D R Evans

P A Rayner

# Parent Balance Sheet

as at 31 October 2004

		2004	2003
			<i>As restated<sup>1</sup></i>
		£000	£000
Note		£000	£000
<b>Fixed assets</b>			
Tangible assets	15	895	932
Investments	16	34,660	37,018
		<u>35,555</u>	<u>37,950</u>
<b>Current assets</b>			
Debtors	18	48,289	54,897
Cash at bank and in hand		341	96
		<u>48,630</u>	<u>54,993</u>
Creditors due within one year	19	<u>(27,376)</u>	<u>(41,075)</u>
<b>Net current assets</b>		<u>21,254</u>	<u>13,918</u>
<b>Total assets less current liabilities</b>		<b>56,809</b>	<b>51,868</b>
Creditors due after more than one year	20	(12,951)	(15,559)
Provisions for liabilities and charges	22	(340)	-
		<u>43,518</u>	<u>36,309</u>
<b>Capital and reserves</b>			
Called-up share capital	23	1,511	1,434
<b>Reserves</b>			
Share premium account	24	26,710	20,726
Special capital reserve	24	12,939	12,939
Revenue reserves	24	<u>2,358</u>	<u>1,210</u>
		<u>42,007</u>	<u>34,875</u>
<b>Shareholders' funds</b>		<u>43,518</u>	<u>36,309</u>
Attributable to equity shareholders		43,456	36,247
Attributable to non-equity shareholders		<u>62</u>	<u>62</u>
		<u>43,518</u>	<u>36,309</u>

These financial statements were approved by the Board of Directors on 8 February 2005.

Signed on behalf of the Board

**D R Evans**

**P A Rayner**

<sup>1</sup> See Note 5.

# Consolidated Cash Flow Statement

for the year ended 31 October 2004

			2004		2003
		£000	£000	£000	£000
	Note				
Net cash inflow from operating activities	A		14,462		18,084
Returns on investments and servicing of finance	B		(3,045)		(3,420)
Taxation			(2,291)		(686)
Capital expenditure	B		(5,580)		(5,497)
Acquisitions and disposals	B		485		1,475
Equity dividends paid			(2,219)		(1,866)
<b>Cash inflow before use of liquid resources and financing</b>			<b>1,812</b>		<b>8,090</b>
Financing – issue of shares	B	6,061		-	
– decrease in debt	B	(4,478)		(5,645)	
			<b>1,583</b>		<b>(5,645)</b>
<b>Increase in cash</b>	C		<b>3,395</b>		<b>2,445</b>
<b>Reconciliation of net cash flow to movement in net debt</b>					
Increase in cash			3,395		2,445
Cash outflow from the decrease in debt			4,478		5,645
Change in net debt resulting from cash flows			7,873		8,090
New finance leases			(354)		(1,153)
Translation difference			1,157		1,964
Amortisation of debt finance costs			-		(305)
Cash disposed with subsidiary undertaking			(3)		-
Movement in net debt			8,673		8,596
Opening net debt			(38,681)		(47,277)
<b>Closing net debt</b>			<b>(30,008)</b>		<b>(38,681)</b>

# Notes to the Consolidated Cash Flow Statement

for the year ended 31 October 2004

## A. RECONCILIATION OF OPERATING PROFIT/(LOSS) TO NET CASH FLOW FROM OPERATING ACTIVITIES

	2004			2003		
	Continuing operations	Discontinued operations	Total operations	Continuing operations <i>As restated<sup>1</sup></i>	Discontinued operations	Total operations <i>As restated<sup>1</sup></i>
	£000	£000	£000	£000	£000	£000
Operating profit/(loss)	16,927	-	16,927	14,026	(216)	13,810
Amortisation charge	1,555	-	1,555	1,210	-	1,210
Depreciation charge	3,229	-	3,229	3,229	66	3,295
Loss on sale of tangible fixed assets	128	-	128	-	-	-
(Increase)/decrease in stock	(1,169)	-	(1,169)	(5,132)	375	(4,757)
Decrease/(increase) in debtors	1,116	-	1,116	(1,931)	325	(1,606)
(Decrease)/increase in creditors	(7,324)	-	(7,324)	6,107	25	6,132
	<u>14,462</u>	<u>-</u>	<u>14,462</u>	<u>17,509</u>	<u>575</u>	<u>18,084</u>

<sup>1</sup> See Note 5.

## B. ANALYSIS OF CASH FLOWS

	2004	2003
	£000	£000
<b>Returns on investments and servicing of finance</b>		
Interest paid	(3,148)	(3,516)
Preference dividend paid	(4)	(4)
Dividend from associate	107	100
<b>Net cash outflow from returns on investments and servicing of finance</b>	<u>(3,045)</u>	<u>(3,420)</u>
<b>Capital expenditure and financial investment</b>		
Purchase of intangible fixed assets	(1,404)	(1,208)
Purchase of tangible fixed assets	(4,176)	(4,289)
<b>Net cash outflow from capital expenditure and financial investment</b>	<u>(5,580)</u>	<u>(5,497)</u>
<b>Acquisitions and disposals</b>		
Acquisitions of subsidiary undertakings (see Note 26)	(580)	-
Receipts from sale of subsidiary undertaking/division (see Note 27)	1,065	1,475
<b>Net cash inflow from acquisitions and disposals</b>	<u>485</u>	<u>1,475</u>
<b>Financing</b>		
Issue of ordinary share capital	6,061	-
Capital elements of finance lease payments	(1,313)	(1,194)
Debt due within one year:		
- bank loans	(5,057)	(4,451)
Debt due within one year:		
- bank loans	1,892	-
<b>Net cash inflow/(outflow) from financing</b>	<u>(4,478)</u>	<u>(5,645)</u>
	<u>1,583</u>	<u>(5,645)</u>



# Notes to the Consolidated Cash Flow Statement

- continued

## C. ANALYSIS OF NET DEBT

	<i>At</i>		<i>Other</i>	<i>Exchange</i>	<i>At</i>
	<i>1 Nov 2003</i>	<i>Cash flow</i>	<i>non-cash</i>	<i>movement</i>	<i>31 Oct 2004</i>
	<i>£000</i>	<i>£000</i>	<i>changes</i>	<i>£000</i>	<i>£000</i>
			<i>£000</i>		
Cash at bank and in hand	5,821	4,394	(3)	(279)	<b>9,933</b>
Overdrafts	(16,766)	(999)	-	302	<b>(17,463)</b>
	(10,945)	3,395	(3)	23	<b>(7,530)</b>
Debt due within one year	(6,260)	5,057	(2,000)	133	<b>(3,070)</b>
Debt due after one year	(18,065)	(1,892)	2,000	902	<b>(17,055)</b>
Finance leases	(3,411)	1,313	(354)	99	<b>(2,353)</b>
	<u>(38,681)</u>	<u>7,873</u>	<u>(357)</u>	<u>1,157</u>	<u><b>(30,008)</b></u>

Other non-cash changes represent the movement of debt due after one year to within one year and the disposal of cash balances with subsidiary undertakings (see Note 27).

# Notes to the Financial Statements

for the year ended 31 October 2004

## 1. ACCOUNTING POLICIES

The financial statements have been prepared in accordance with applicable United Kingdom accounting standards. The particular accounting policies adopted are described below.

### Accounting convention

The financial statements are prepared under the historical cost convention as modified by the revaluation of property.

### Basis of consolidation

The financial statements consolidate those of the Parent with the Group's share of the results and post acquisition reserves of all its subsidiary and associated undertakings. All companies within the Group make up their financial statements to the same date. No profit and loss account is presented for the Parent as provided by section 230 of the Companies Act 1985.

### Revenue recognition

Sales comprise the net value of deliveries made, work completed or services rendered during the year. Sales are recognised when title passes, or when the right to consideration, in exchange for performance, has been completed. For bill and hold arrangements revenue is recognised when the risks and rewards are transferred to the customer, typically on formal acceptance. Long term contracts continue to be accounted for in accordance with SSAP 9 (revised), whereby income is recognised based on the right to consideration over the course of the contract.

### Acquisitions

On the acquisition of a business, fair values are attributed to the Group's share of net separable assets. Where the cost of acquisition exceeds the fair values attributable to such net assets, the difference is treated as purchased goodwill and capitalised in the balance sheet in the year of acquisition.

The results and cash flows relating to an acquired business are included in the consolidated profit and loss account and the consolidated cash flow statement from the date of acquisition.

### Intangible fixed assets

The purchased goodwill of the Group is regarded as having an indefinite useful economic life and, in accordance with FRS10, is not amortised but is subject to annual tests for impairment. This represents a departure, for the purpose of giving a true and fair view, from the requirements of schedule 4:21 of the Companies Act 1985, which requires goodwill to be amortised. In the opinion of the Board, it is not possible to determine a finite useful economic life for goodwill arising, due to the inherent durability of the corporate profile in the countermeasures, military and marine industries, and the continued market position within these chosen business sectors. The complexities of the processes, technologies and regulatory barriers to entry support and corroborate this position. Since it is not possible to identify any finite useful economic life, it is not possible to quantify any amortisation which would be charged. In reviewing the carrying value of goodwill of the various businesses, the Board has considered the separate plans and cashflows of these businesses consistent with the requirements of FRS11, and is satisfied that these demonstrate that no impairment has occurred. Accordingly no charge for impairment is required.

Research, development, patent and licence costs are charged to the profit and loss account as incurred, except where a major project is undertaken and it is reasonably anticipated that costs will be recovered through future commercial activity. Such costs are written-off over three years.

### Tangible fixed assets

No depreciation is provided on freehold land. On other assets depreciation is provided at rates calculated to write down their cost or valuation to their estimated residual values by equal instalments over their estimated useful economic lives, which are considered to be:

- Freehold buildings      -   up to 50 years
- Leasehold buildings    -   the period of the lease
- Plant and equipment   -   up to 10 years

# Notes to the Financial Statements

- continued

## 1. ACCOUNTING POLICIES - continued

### Fixed asset investments

Except as stated below, investments held as fixed assets are stated at cost less provision for impairment.

In the consolidated financial statements, shares in the associated undertaking are accounted for using the equity method of accounting. The consolidated profit and loss account includes the Group's share of the profit and attributable taxation of the associated undertaking. In the consolidated balance sheet, the shares in the associated undertaking are shown as the Group's share of net assets.

### Stock

Stock is stated at the lower of cost and net realisable value. Raw materials are stated at their purchase price, while work in progress and finished goods comprise the cost of materials, labour and overheads applicable to the stage of production.

### Current taxation

Current tax, including UK corporation tax and foreign tax, is provided for at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

### Deferred taxation

Deferred taxation is provided in full at the anticipated tax rates on differences arising from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred taxation is not provided on timing differences arising from the revaluation of fixed assets where there is no commitment to sell the asset. Deferred tax assets and liabilities are discounted.

### Special capital reserve

The special capital reserve was created as part of a capital reduction scheme involving the cancellation of the share premium account which was approved by the Court in 1986 and is in accordance with the requirements of the Companies Act 1985.

### Foreign currency

Transactions of the UK companies denominated in foreign currencies are translated into sterling at the rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rates ruling at that date. These translation differences are dealt with in the profit and loss account.

Trading results of overseas subsidiary undertakings are translated into sterling at an average rate for the period and net assets are translated at the rate ruling at the balance sheet date. Exchange differences arising between average rate and closing rate and from the translation of the opening net investment in overseas companies and matched long term foreign currency borrowings are taken directly to reserves.

### Pensions

The Group operates defined benefit pension schemes which cover the majority of UK employees. The cost of providing pensions is estimated on the basis of independent actuarial advice and is charged to the profit and loss account over the expected service lives of the participating employees. The accounting policy follows the funding policy except where an actuarial valuation indicates a deficiency or surplus. Such deficiencies or surpluses are for funding purposes dealt with as advised by the actuary. For accounting purposes they are spread over the expected remaining service lives of the participating employees.

The Group also operates money purchase pension arrangements for overseas employees, the costs of which are charged to the profit and loss account as incurred.

## 1. ACCOUNTING POLICIES - *continued*

### Leased assets

Where the Group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over the shorter of the estimated useful economic life and the lease term. Future instalments under such leases, net of finance charges, are included in creditors. The finance element of the instalments is charged to the profit and loss account at a constant rate of charge on the remaining balance of the obligation.

All other leases are operating leases and the rental charges are taken to the profit and loss account on a straight line basis over the life of the lease.

## 2. ANALYSIS OF TURNOVER, PROFIT AND NET ASSETS

			2004			2003
	<i>Continuing</i>	<i>Discontinued</i>	<i>Total</i>	<i>Continuing</i>	<i>Discontinued</i>	<i>Total</i>
	<i>operations</i>	<i>operations</i>	<i>operations</i>	<i>operations</i>	<i>operations</i>	<i>operations</i>
				<i>As restated<sup>1</sup></i>		<i>As restated<sup>1</sup></i>
	£000	£000	£000	£000	£000	£000
<b>Turnover by destination</b>						
UK	20,774	-	20,774	22,292	6,337	28,629
USA	53,016	-	53,016	42,275	1,120	43,395
Australia	14,259	-	14,259	12,089	-	12,089
Europe	14,661	-	14,661	16,640	783	17,423
Rest of world	22,870	-	22,870	16,874	-	16,874
<b>Total</b>	<b>125,580</b>	<b>-</b>	<b>125,580</b>	<b>110,170</b>	<b>8,240</b>	<b>118,410</b>

			2004			2003
	<i>Continuing</i>	<i>Discontinued</i>	<i>Total</i>	<i>Continuing</i>	<i>Discontinued</i>	<i>Total</i>
	<i>operations</i>	<i>operations</i>	<i>operations</i>	<i>operations</i>	<i>operations</i>	<i>operations</i>
				<i>As restated<sup>1</sup></i>		<i>As restated<sup>1</sup></i>
	£000	£000	£000	£000	£000	£000
<b>Turnover by origin</b>						
UK	58,952	-	58,952	56,883	7,120	64,003
USA	59,555	-	59,555	44,998	1,120	46,118
Australia	5,609	-	5,609	7,049	-	7,049
Europe	1,464	-	1,464	1,240	-	1,240
<b>Total</b>	<b>125,580</b>	<b>-</b>	<b>125,580</b>	<b>110,170</b>	<b>8,240</b>	<b>118,410</b>

An analysis of turnover by business area is given in the summary financial information on page 2 and forms part of these financial statements. An analysis of profit and net assets has not been given since in the opinion of the directors this would be seriously prejudicial to the commercial interests of the Group.

The results of Kembrey Wiring Systems Limited (see Note 27) and Alloy Surfaces Chemical Coatings, a division of Alloy Surfaces Company, Inc., which was disposed of in the prior year, as previously reported, are included within discontinued operations.

<sup>1</sup> See Note 5.

# Notes to the Financial Statements

- continued

## 3. COST OF SALES, GROSS PROFIT AND OPERATING EXPENSES

	2004			2003		
	Continuing operations	Discontinued operations	Total operations	Continuing operations <i>As restated<sup>1</sup></i>	Discontinued operations	Total operations <i>As restated<sup>1</sup></i>
	£000	£000	£000	£000	£000	£000
Cost of sales	92,178	-	92,178	81,890	6,870	88,760
Gross profit	33,402	-	33,402	28,280	1,370	29,650
<b>Operating expenses:</b>						
Distribution costs	3,678	-	3,678	3,112	-	3,112
Administrative expenses	12,797	-	12,797	11,142	1,586	12,728
Total operating expenses	16,475	-	16,475	14,254	1,586	15,840

<sup>1</sup> See Note 5.

## 4. OPERATING PROFIT/(LOSS)

	2004 £000	2003 £000
Operating profit/(loss) is stated after charging:		
Depreciation		
- owned assets	2,592	2,685
- leased assets	637	610
Amortisation		
- intangible assets	1,555	1,210
Operating lease rentals		
- other	362	440
- plant and equipment	1,002	1,138
Loss on disposal of tangible fixed assets	128	-
Parent company audit fee	30	30

During the year £6,030,000 (2003: £4,742,000) of research and development costs were incurred by the Group, of which £1,404,000 (2003: £1,208,000) was capitalised (see Note 14).

	2004 £000	2003 £000
<b>Auditors' remuneration</b>		
<b>Services as auditors:</b>		
Statutory audit	130	130
Audit-related regulatory reporting	27	29
<b>Further assurance services:</b>		
Agreed upon procedures	-	3
Accounting advice	-	8
Tax compliance	86	54
<b>Tax services:</b>		
Tax advisory	88	136
<b>Other non-audit services:</b>		
Corporate finance	100	18
	<b>431</b>	<b>378</b>

Included within the above are £118,000 (2003: £84,000) of tax advisory and corporate finance fees relating to acquisitions and disposals.

## 5. PRIOR YEAR ADJUSTMENT

FRS5 Application Note G has been adopted in the year. As a result, a prior year adjustment of £771,000 to reduce shareholders' funds at 31 October 2002 is required. Prior to adoption, the Group recognised a sale, under bill and hold arrangements, when production of goods had been completed but external testing and acceptance of products by US Government agencies was awaited. Following the adoption of FRS5 Application Note G, sales are only recognised upon acceptance by US Government agencies.

The adoption of FRS5 Application Note G resulted in a reduction to the previously reported profit after tax for the financial year ended 31 October 2003 of £152,000 after a tax credit of £78,000 (see Note 11), a reduction to the previously reported turnover for the financial year ended 31 October 2003 of £2,147,000, an increase in the reported profit after tax for the current year of £626,000 and an increase in the reported turnover for the current year of £2,856,000.

In addition, as stated in Note 1, UITF Abstract 38 has been adopted in the year. The Group holds a number of shares in an ESOP trust which was previously shown within other debtors (see Note 18). As a result of the adoption of UITF Abstract 38 these shares are now shown as a reduction to shareholders' funds and a prior year adjustment of £174,000 to reduce shareholders' funds at 31 October 2002 is required.

## 6. INSURANCE CLAIM

Following the manufacturing incident at Kilgore Flares Company LLC on 18 April 2001, resulting in material damage and suspension of operations, the Group lodged a claim with its insurers for property damage and business interruption. As previously reported, at 31 October 2003, payments totalling £5,700,000 had been received from the Group's insurers. On 3 August 2004 the Group received a further payment of £5,056,000 in settlement of the claim with the Group's insurers, bringing the total received to £10,756,000.

The Group is now pursuing a claim against its former insurance brokers, concerning the insurance cover for Kilgore Flares Company LLC and the brokers' subsequent handling of the claim.

At 31 October 2004 the Board has made an estimate of the additional proceeds which it believes the Group is entitled to receive from its insurance brokers, after taking advice from its professional advisers, of which £678,000 has been recognised in the consolidated profit and loss account in these financial statements.

The balance of the claim that had not been recovered from the Group's insurance brokers at the year end was £2,689,000 (2003:£7,486,000), which has been included within other debtors. Foreign exchange movements of £419,000 have been recognised through the statement of total recognised gains and losses in these financial statements, due to the claim being denominated in US dollars.



# Notes to the Financial Statements

- continued

## 7. EMPLOYEES

The average number employed by the Group within each category of persons was:

	<b>2004</b>	2003
	<b>Number</b>	Number
Production	<b>1,426</b>	1,423
Sales and administration	<b>207</b>	218
	<b><u>1,633</u></b>	<u>1,641</u>

The costs incurred in respect of these employees were:

	<b>£000</b>	£000
Wages and salaries	<b>35,723</b>	33,707
Social Security costs	<b>3,845</b>	3,965
Other pension costs	<b>2,969</b>	1,815
	<b><u>42,537</u></b>	<u>39,487</u>

## 8. DIRECTORS' EMOLUMENTS

Disclosures on directors' remuneration, share options, long term incentive schemes, pension contributions and pension entitlements required by the Companies Act 1985 and those specified for audit by the UK Listing Authority are set out in the Directors' Remuneration Report on pages 14 to 19, and that information which is described as having been audited forms part of these audited financial statements.

## 9. PENSIONS

### Pension arrangements

The pension cost figures used in these financial statements comply with the current accounting standard SSAP 24 *Accounting for pension costs*. FRS17 *Retirement benefits* has been issued and transitional requirements continue to apply.

Within the UK the Group operates two defined benefit schemes, the Chemring Group Staff Pension Scheme (the "Staff Scheme") and the Chemring Group Executive Pension Scheme (the "Executive Scheme"), as detailed below. The overseas arrangements are all defined contribution schemes. The assets of the schemes are held in separate trustee administered funds.

### Regular pension costs - SSAP 24

The total pension costs for the Group for the year ended 31 October 2004 were £2,969,000 (2003: £1,815,000). Disclosures given relate to the Group as the pension assets and liabilities of the Parent cannot be separately identified. These costs include £729,000 (2003: £1,016,000) paid to money purchase pension schemes for overseas employees.

The costs of the defined benefit schemes are assessed in accordance with the advice of a qualified actuary using the attained age method. Contributions to the schemes are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the Group.

The last actuarial valuation of the Staff Scheme was carried out as at 6 April 2003. The main assumptions used by the actuary in carrying out this valuation were as follows: return on investments of 6.7% per annum pre-retirement and 5.2% per annum post-retirement; increase in salaries of 3.6% per annum; and increase in pension accrued after 6 April 1993 of 2.6% per annum.

At the date of the last actuarial valuation, the market value of the assets of the Staff Scheme was £15,616,000, which was sufficient to cover 55% of the benefits that had accrued to members. Following the valuation, it was agreed that the Group would pay contributions at the rate of 16% of pensionable salaries with effect from 1 January 2004, plus an additional monthly contribution of £15,000. Members' contributions were increased from 6% to 8% of pensionable salary with effect from 1 February 2004.

## 9. PENSIONS – *continued*

The last actuarial valuation of the Executive Scheme was carried out as at 6 April 2003. The main assumptions used by the actuary in carrying out this valuation were as follows: return on investments of 6.7% per annum pre-retirement and 5.2% per annum post-retirement; increase in salaries of 4.6% per annum; and increase in pension accrued after 6 April 1993 of 2.6% per annum.

At the date of the last actuarial valuation, the market value of the assets of the Executive Scheme was £2,484,000, which was sufficient to cover 47% of the benefits that had accrued to members. Following the valuation, it was agreed that the Group would pay increased contributions at the rate of 32% of pensionable salaries, together with additional payments of £20,000 per month. Members are required to make contributions at the rate of 8% of pensionable salary. The Executive Scheme is closed to new entrants. The Group's contribution rate over the average remaining service lives of the members of the Executive Scheme takes account of the deficit disclosed by the valuation.

Included within other debtors (see Note 18) is £252,000 (2003: £263,000) in respect of pension contributions to defined benefit schemes, being the difference between amounts recognised as costs and amounts paid or funded directly.

### FRS17 disclosures

Under the transitional arrangements of FRS17, the Group is required to disclose the following information about the schemes and the figures that would have been shown in the Group balance sheet if FRS17 applied in full today.

Full actuarial valuations for the Staff Scheme and the Executive Scheme as at 6 April 2003 have been prepared and updated to 31 October 2004 by a qualified actuary, using the projected unit valuation method.

The total assets and liabilities of the Staff Scheme and the Executive Scheme updated to 31 October 2004 in accordance with FRS17, along with the expected rates of return on assets were as follows:

	<i>Long term rate of return expected</i>	<i>2004 Value £000</i>	<i>Long term rate of return expected</i>	<i>2003 Value £000</i>	<i>Long term rate of return expected</i>	<i>2002 Value £000</i>
Equities	6.8%	12,858	7.1%	12,395	6.7%	10,938
Bonds	5.4%	9,248	5.1%	7,195	4.7%	7,230
Other assets	4.8%	638	5.1%	731	4.7%	113
Total market value of assets		22,744		20,321		18,281
Present value of scheme liabilities		(38,821)		(34,450)		
Deficit in schemes		(16,077)		(14,129)		
Related deferred tax		3,790		3,331		
<b>Net pension liability</b>		<b>(12,287)</b>		<b>(10,798)</b>		

If the FRS17 net deficit in respect of the two schemes of £12,287,000 at 31 October 2004 (2003: £10,798,000) had been accounted for as a liability of the Group at that date, the balance on the Group's profit and loss reserve at that date would have been reduced from £19,787,000 to £7,500,000 (2003: £14,878,000 to £4,080,000).

# Notes to the Financial Statements

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## 9. PENSIONS – continued

The figures shown above were calculated on the basis of the following assumptions:

	2004	2003	2002
Discount rate	5.9%	6.1%	6.1%
Rate of increase in salaries	3.9–4.9%	3.9–4.9%	3.4–4.4%
Rate of increase in deferred pensions	2.9%	2.9%	4.4–5.0%
Rate of increase in pensions in payment (where applicable)	2.9%	2.9%	2.4%
Inflation assumption	2.9%	2.9%	2.4%

### Analysis of movement in the deficit in the schemes during the year:

	2004	2003	2002
	£000	£000	£000
Opening deficit in the schemes	(14,129)	(13,467)	(9,137)
Current service cost	(680)	(802)	(785)
Contributions	1,780	1,030	889
Other finance costs	(782)	(851)	(468)
Actuarial losses	(2,266)	(39)	(3,966)
Closing deficit in the schemes	<u>(16,077)</u>	<u>(14,129)</u>	<u>(13,467)</u>

Amounts that would have been included within the financial statements for the year ended 31 October 2004 had FRS17 been applied are as follows:

### Amounts included within operating profit:

	2004	2003
	£000	£000
Current service cost	<u>(680)</u>	<u>(802)</u>

### Amounts included as other finance costs:

	2004	2003
	£000	£000
Expected return on scheme assets	1,331	1,093
Discount on scheme liabilities	<u>(2,113)</u>	<u>(1,944)</u>
Net charge	<u>(782)</u>	<u>(851)</u>

Amounts that would have been included within the statement of total recognised gains and losses for the year ended 31 October 2004 had FRS17 been applied are shown below, expressed in monetary amounts and as a percentage of:

- (i) scheme assets at the balance sheet date;
- (ii) present value of the scheme liabilities at the balance sheet date.

	2004		2003
	£000	%	£000
Difference between actual and expected return on scheme assets (i)	(372)	(1.6)	455
Experience gains and losses arising on scheme liabilities (ii)	(902)	(2.3)	2,517
Effects of changes in assumptions underlying the present value of the scheme liabilities (ii)	<u>(992)</u>	<u>(2.6)</u>	<u>(3,011)</u>
Total actuarial losses	<u>(2,266)</u>	<u>(5.8)</u>	<u>(39)</u>

## 10. INTEREST PAYABLE

	2004			2003		
	<i>Continuing operations</i>	<i>Discontinued operations</i>	<i>Total operations</i>	<i>Continuing operations</i>	<i>Discontinued operations</i>	<i>Total operations</i>
	£000	£000	£000	£000	£000	£000
Bank overdraft interest	1,466	-	1,466	914	127	1,041
Loan stock interest (see Note 19)	2	-	2	2	-	2
Medium term loan interest	1,333	-	1,333	1,809	-	1,809
Finance lease interest	272	-	272	276	-	276
Amortisation of debt finance costs	-	-	-	305	-	305
	<u>3,073</u>	<u>-</u>	<u>3,073</u>	<u>3,306</u>	<u>127</u>	<u>3,433</u>

## 11. TAX ON PROFIT ON ORDINARY ACTIVITIES

	2004	2003
	£000	As restated <sup>1</sup> £000
<b>Corporation tax:</b>		
Corporation tax charge for the year	1,019	1,876
Overseas taxation	3,449	491
Under/(over) provision in prior years	383	(388)
Total current tax	<u>4,851</u>	<u>1,979</u>
<b>Deferred tax:</b>		
Timing differences – current year	(59)	1,759
Changes in discount	(225)	-
Over provision in prior years	(796)	(293)
Total deferred tax	<u>(1,080)</u>	<u>1,466</u>
Associate's tax	51	55
Tax on profit on ordinary activities	<u>3,822</u>	<u>3,500</u>

The standard rate of current tax for the year is 30%. The current tax charge for the year is higher (2003: lower) than 30% for the reasons set out in the following reconciliation:

	2004	2003
	£000	As restated <sup>1</sup> £000
Profit on ordinary activities before taxation	<u>13,315</u>	<u>11,844</u>
Tax on profit on ordinary activities at standard rate	3,995	3,553
<b>Factors affecting charge:</b>		
Expenses not deductible for tax purposes net of tax credits	(162)	199
Capital allowances in excess of depreciation	(220)	-
Prior year adjustments	383	(388)
Overseas profits taxed at rates higher than the standard rate	576	374
Deferred tax movements	279	(1,759)
Total current year tax charge	<u>4,851</u>	<u>1,979</u>

<sup>1</sup> See Note 5.

# Notes to the Financial Statements

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## 12. DIVIDENDS

	2004 £000	2003 £000
<b>Dividends on cumulative preference shares of £1 each</b>		
Paid 30 April 2004 3.50p (2003: 3.50p)	2	2
Paid 31 October 2004 3.50p (2003: 3.50p)	2	2
	<u>4</u>	<u>4</u>
<b>Dividends on ordinary shares of 5p each</b>		
Interim paid 24 September 2004 2.80p (2003: 2.55p)	809	700
Final proposed 6.20p (2003: 4.85p)	1,797	1,330
Under provided in previous year	80	-
	<u>2,686</u>	<u>2,030</u>
<b>Total dividends</b>	<u>2,690</u>	<u>2,034</u>

## 13. EARNINGS PER ORDINARY SHARE

The earnings and shares used in the calculations are as follows:

	2004			2003 <i>As restated<sup>1</sup></i>		
	<i>Earnings</i> £000	<i>Ordinary shares Number</i> 000s	<i>EPS</i> Pence	<i>Earnings</i> £000	<i>Ordinary shares Number</i> 000s	<i>EPS</i> Pence
<b>Basic</b>	9,504	28,521	33.32	8,363	27,436	30.48
Additional shares issuable other than at fair value in respect of options outstanding	-	160	(0.18)	-	391	(0.43)
<b>Diluted</b>	<u>9,504</u>	<u>28,681</u>	<u>33.14</u>	<u>8,363</u>	<u>27,827</u>	<u>30.05</u>

Earnings comprise profit for the financial year after deducting preference dividends of £4,000 (2003: £4,000). Ordinary shares are calculated by reference to the average number of shares in issue in the year.

Reconciliation from basic earnings per share to basic earnings per share – continuing:

	2004			2003 <i>As restated<sup>1</sup></i>		
	<i>Earnings</i> £000	<i>Ordinary shares Number</i> 000s	<i>EPS</i> Pence	<i>Earnings</i> £000	<i>Ordinary shares Number</i> 000s	<i>EPS</i> Pence
<b>Basic</b>	9,504	28,521	33.32	8,363	27,436	30.48
Profit/(loss) on ordinary activities after taxation – discontinued operations	483	-	1.70	(268)	-	(0.97)
<b>Basic – continuing</b>	<u>9,987</u>	<u>28,521</u>	<u>35.02</u>	<u>8,095</u>	<u>27,436</u>	<u>29.51</u>

<sup>1</sup> See Note 5.

## 14. INTANGIBLE FIXED ASSETS

## GROUP

	<i>Development costs £000</i>	<i>Goodwill £000</i>	<i>Total £000</i>
<b>Cost</b>			
At 1 November 2003	6,184	28,442	34,626
Additions	1,404	-	1,404
Disposals	(1,709)	-	(1,709)
Foreign exchange movements	(37)	-	(37)
Adjustment to deferred consideration (see Note 26)	-	(458)	(458)
At 31 October 2004	5,842	27,984	33,826
<b>Amortisation</b>			
At 1 November 2003	3,188	-	3,188
Charge for the year	1,555	-	1,555
Disposals	(1,709)	-	(1,709)
Foreign exchange movements	(33)	-	(33)
At 31 October 2004	3,001	-	3,001
<b>Net book value</b>			
At 31 October 2004	2,841	27,984	30,825
At 31 October 2003	2,996	28,442	31,438

The movements to goodwill arose on the adjustment of deferred consideration payable on prior year acquisitions. For further details of acquisitions see Note 26.

## 15. TANGIBLE FIXED ASSETS

## (A) GROUP

	<i>Land and buildings £000</i>	<i>Plant and equipment £000</i>	<i>Total £000</i>
<b>Cost or valuation</b>			
At 1 November 2003	20,244	38,217	58,461
Additions	616	3,914	4,530
Disposal of subsidiary undertaking	-	(716)	(716)
Disposals	(38)	(551)	(589)
Foreign exchange movements	(934)	(1,563)	(2,497)
At 31 October 2004	19,888	39,301	59,189
<b>Depreciation</b>			
At 1 November 2003	1,687	13,895	15,582
Charge for the year	363	2,866	3,229
Disposal of subsidiary undertaking	-	(612)	(612)
Disposals	(4)	(457)	(461)
Foreign exchange movements	(52)	(307)	(359)
At 31 October 2004	1,994	15,385	17,379
<b>Net book value</b>			
At 31 October 2004	17,894	23,916	41,810
At 31 October 2003	18,557	24,322	42,879



# Notes to the Financial Statements

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## 15. TANGIBLE FIXED ASSETS – continued

### (B) PARENT

	<i>Land and buildings £000</i>	<i>Plant and equipment £000</i>	<i>Total £000</i>
<b>Cost</b>			
At 1 November 2003 and 31 October 2004	1,168	541	1,709
<b>Depreciation</b>			
At 1 November 2003	271	506	777
Charge for the year	28	9	37
At 31 October 2004	299	515	814
<b>Net book value</b>			
At 31 October 2004	869	26	895
At 31 October 2003	897	35	932

### (C) LAND AND BUILDINGS

	<i>Group</i>		<i>Parent</i>	
	<i>2004 £000</i>	<i>2003 £000</i>	<i>2004 £000</i>	<i>2003 £000</i>
Land and buildings comprise:				
Freehold	18,720	19,076	-	-
Long leasehold	1,168	1,168	1,168	1,168
	<u>19,888</u>	<u>20,244</u>	<u>1,168</u>	<u>1,168</u>
Land and buildings are stated at cost or value:				
30 September 1997 – depreciated replacement cost	5,820	5,820	-	-
At cost	14,068	14,424	1,168	1,168
	<u>19,888</u>	<u>20,244</u>	<u>1,168</u>	<u>1,168</u>

The 1997 land and buildings valuation was carried out by Chestertons, Chartered Surveyors, on the UK properties, on a depreciated replacement cost for the two pyrotechnic sites, and on open market value for the remainder. The effect of the revaluation is to increase annual depreciation by £36,000. In accordance with the transitional requirements of FRS15 this valuation has not been updated.

If stated under historical cost principles the comparable amounts for the total of land and buildings would be:

	<i>Group</i>		<i>Parent</i>	
	<i>2004 £000</i>	<i>2003 £000</i>	<i>2004 £000</i>	<i>2003 £000</i>
Cost	17,791	18,147	1,168	1,168
Accumulated depreciation	(2,307)	(2,036)	(302)	(274)
Historical cost value	<u>15,484</u>	<u>16,111</u>	<u>866</u>	<u>894</u>

All other tangible fixed assets are stated at historical cost. Included in plant and equipment are assets of net book value £3,887,000 (2003: £4,170,000) held under finance leases.

# 15. TANGIBLE FIXED ASSETS – *continued*

## (D) FUTURE CAPITAL EXPENDITURE

	Group		Parent	
	2004	2003	2004	2003
	£000	£000	£000	£000
Contracted for but not provided for	627	444	-	-

# 16. FIXED ASSET INVESTMENTS

## (A) GROUP

	Trade investments	Associated undertaking share of net assets	Total
	£000	£000	£000
At 1 November 2003	10	1,053	1,063
Retained profit of associated undertaking	-	100	100
Dividend received	-	(107)	(107)
Foreign exchange movements	-	17	17
At 31 October 2004	10	1,063	1,073

Results of the associated undertaking relate to the Group's share of the profits of CIRRA S.A. (see below).

## (B) PARENT

	Shares in subsidiary undertakings	Shares in associated undertaking	Loans to subsidiary undertakings	Trade investments	Total
	£000	£000	£000	£000	£000
<b>Cost</b>					
At 1 November 2003	34,681	13	6,250	10	40,954
Disposal (see Note 27)	(1,900)	-	-	-	(1,900)
Reduction in contingent consideration	(458)	-	-	-	(458)
At 31 October 2004	32,323	13	6,250	10	38,596
<b>Provision for impairment</b>					
At 1 November 2003 and 31 October 2004	3,936	-	-	-	3,936
<b>Net book value</b>					
At 31 October 2004	28,387	13	6,250	10	34,660
At 31 October 2003	30,745	13	6,250	10	37,018

# Notes to the Financial Statements

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## 16. FIXED ASSET INVESTMENTS – continued

### (C) SUBSIDIARY AND ASSOCIATED UNDERTAKINGS

The subsidiary and associated undertakings which, in the opinion of the directors, affected the results of the Group are shown below.

Subsidiary undertakings	Country of incorporation	% of issued ordinary share capital controlled by Chemring Group PLC	Activity
Pains Wessex Ltd	England	100	Countermeasures and pyrotechnics
PW Defence Ltd	England	100	Pyrotechnics
McMurdo Ltd	England	100	Marine electronics
I.C.S. Electronics Limited	England	100	Marine electronics
Alloy Surfaces Company, Inc.	Delaware, USA	100	Countermeasures
Kilgore Flares Company LLC	Delaware, USA	100	Countermeasures and pyrotechnics
Pains Wessex Australia Pty Ltd	Australia	100	Countermeasures and pyrotechnics
Pirotécnia Oroquieta S.L.	Spain	51	Pyrotechnics
<b>Associated undertaking</b>			
CIRRA S.A.	France	49	Countermeasures

The entire issued share capital of Kembrey Wiring Systems Limited was disposed of by the Group on 8 November 2003 (see Note 27).

## 17. STOCK

	Group	
	2004	2003
	<i>As restated<sup>1</sup></i>	
	£'000	£'000
Raw materials	10,048	8,346
Work in progress	7,184	7,079
Finished goods	7,858	9,537
	<u>25,090</u>	<u>24,962</u>

There are no significant differences between the replacement costs and the stock values shown above.

<sup>1</sup> See Note 5.

## 18. DEBTORS

	Group		Parent	
	2004	2003	2004	2003
		<i>As restated<sup>1</sup></i>		<i>As restated<sup>1</sup></i>
	£000	£000	£000	£000
Trade debtors	20,511	18,776	53	56
Amounts owed by subsidiary undertakings	-	-	43,068	52,194
Group relief recoverable	-	-	3,210	1,823
Advance corporation tax recoverable	170	170	-	-
Deferred tax asset (see Note 22(b))	-	-	102	-
Other debtors	4,752	10,056	1,151	744
Prepayments and accrued income	1,603	1,057	705	80
	<u>27,036</u>	<u>30,059</u>	<u>48,289</u>	<u>54,897</u>

Included within other debtors are amounts recoverable under an insurance claim relating to an incident at Kilgore Flares Company LLC (see Note 6).

All amounts shown above are due within one year.

<sup>1</sup> See Note 5.

## 19. CREDITORS DUE WITHIN ONE YEAR

	Group		Parent	
	2004	2003	2004	2003
		<i>As restated<sup>1</sup></i>		<i>As restated<sup>1</sup></i>
	£000	£000	£000	£000
Bank overdrafts (see Note 20)	17,463	16,766	14,304	19,261
Bank loans (see Note 20)	3,030	6,220	2,367	5,246
Loan stock – unsecured (see Note 20)	40	40	40	40
Trade creditors	14,957	19,256	244	498
Amounts owed to subsidiary undertakings	-	-	7,191	12,819
Other creditors	3,022	4,648	738	630
Obligations under finance leases (see Note 20)	1,234	1,305	-	-
Corporation tax payable	297	1,257	-	302
Overseas tax payable	2,643	553	-	-
Other taxation and Social Security	1,059	979	39	21
Accruals and deferred income	4,373	4,845	656	928
Proposed dividends	1,797	1,330	1,797	1,330
	<u>49,915</u>	<u>57,199</u>	<u>27,376</u>	<u>41,075</u>

Loan stock is repayable on three months' notice from holders and attracts interest at 1% below base rate. The loan stock is held by certain vendor shareholders of Kembrey Limited (formerly Kembrey Plc), acquired in August 1994, and is guaranteed by National Westminster Bank Plc.

Bank loans and overdrafts held with Bank of Scotland are secured by a full debenture over the assets of the UK businesses and Kilgore Flares Company LLC, and are also subject to cross guarantees between all UK subsidiaries. Bank loans held with Wilmington Trust Corporation (USA) are secured on the related assets purchased with these loans by Alloy Surfaces Company, Inc.. Finance lease obligations are secured on the related assets.

<sup>1</sup> See Note 5.

# Notes to the Financial Statements

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## 20. CREDITORS DUE AFTER MORE THAN ONE YEAR

	<i>Group</i>		<i>Parent</i>	
	<b>2004</b>	2003	<b>2004</b>	2003
	<b>£000</b>	£000	<b>£000</b>	£000
Medium term loan - UK	<b>12,951</b>	14,850	<b>12,951</b>	14,241
- overseas	<b>4,104</b>	3,215	-	-
Obligations under finance leases	<b>1,119</b>	2,106	-	-
Other creditors	-	1,318	-	1,318
	<b>18,174</b>	21,489	<b>12,951</b>	15,559

The average interest rate applicable to the UK medium term loan is 5.0% (2003: 4.7%) and the average rate for the overseas medium term loan is 4.1% (2003: 4.9%) per annum. The overseas medium term loan is secured on the assets of certain of the overseas businesses. Finance lease obligations attract interest rates of between 2% and 3% above base rate. Obligations under finance leases falling due within one to two years included above total £608,000.

An analysis of the Group's borrowings and the maturity profile of these borrowings is as follows:

	<i>Group</i>	
	<b>2004</b>	2003
	<b>£000</b>	£000
Bank loans and overdraft	<b>20,493</b>	16,766
UK medium term loans	<b>5,783</b>	11,644
- sterling denominated	<b>7,168</b>	7,841
- US dollar denominated	<b>4,104</b>	4,188
Overseas medium term loans	-	612
- US dollar denominated	<b>1,195</b>	1,693
- Australian dollar denominated	<b>1,158</b>	1,718
Obligations under finance leases	<b>40</b>	40
- sterling denominated	<b>39,941</b>	44,502
- US dollar denominated		
Unsecured loan stock		
Borrowings falling due within:		
One year	<b>21,767</b>	24,331
One to two years	<b>6,709</b>	7,077
Two to five years	<b>11,006</b>	12,118
After five years	<b>459</b>	976
	<b>39,941</b>	44,502

## 21. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

The Group's financial instruments, other than derivatives, comprise borrowings, cash and various other non-derivative financial instruments such as trade debtors and trade creditors. As permitted by FRS13 *Derivatives and other financial instruments: Disclosures*, short term debtors and creditors have been excluded from all FRS13 disclosures.

The Group uses financial instruments to manage financial and commercial risk wherever it is appropriate to do so.

The main risks arising from the financial instruments of the Group are interest risk, foreign exchange risk and liquidity risk. The Group's policies in respect of the management of these risks, which remained unchanged throughout the year, were as follows :-

**Interest risk:** The Group finances its operations through a mixture of retained profits, bank borrowings and leasing lines of credit. The UK borrowings are denominated in sterling and US dollars and are subject to fixed rates of interest through an amortising LIBOR swap and floating rates of interest linked to Bank of Scotland base rate to provide flexibility. The overseas borrowings are denominated in local currency and are predominantly subject to fixed rates of interest.

**Foreign exchange risk:** Foreign exchange risk can be subdivided into two components, transactional risk and translation risk:

Transactional risk – The Group policy is to hedge significant transactional currency exposures via the use of forward foreign exchange contracts. The measurement and control of this risk is closely monitored on a Group-wide basis.

Translation risk – The Group translates overseas results and net assets in accordance with the accounting policy in Note 1. The translation risk on net assets is controlled by the transfer of currencies between Group companies and the appropriate use of foreign currency borrowings. Translation risk on overseas results is monitored by the Group and controlled by the use of appropriate forward foreign exchange contracts, and other financial instruments, when considered necessary. Any remaining translation differences are dealt with through the Group's statement of total recognised gains and losses.

**Liquidity risk:** Details of the maturity profiles of the Group's funding can be found in Note 20.

The total undrawn committed borrowing facilities at the financial year end amounted to £20,381,000 (2003: £8,291,000).

The Group had open forward foreign exchange contracts with a value of \$15,000,000 and a weighted average exchange rate of \$1.6967 as at 31 October 2004. £672,000 was recognised during the year as a result of marking to market these contracts.



# Notes to the Financial Statements

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## 21. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS – continued

The interest rate risk profile of the Group's financial assets and liabilities is as follows:-

### I) FINANCIAL ASSETS

	2004			2003		
	<i>Floating rate</i>	<i>Fixed rate</i>	<i>Total</i>	<i>Floating rate</i>	<i>Fixed rate</i>	<i>Total</i>
	£000	£000	£000	£000	£000	£000
Sterling	3,300	-	3,300	8,019	-	8,019
US dollar	10,384	-	10,384	3,649	-	3,649
Australian dollar	468	-	468	676	-	676
Other currencies	112	-	112	592	-	592
	<u>14,264</u>	<u>-</u>	<u>14,264</u>	<u>12,936</u>	<u>-</u>	<u>12,936</u>
Offset in the UK			(4,331)			(7,115)
			<u>9,933</u>			<u>5,821</u>
Disclosed as:						
Cash at bank and in hand			<u>9,933</u>			<u>5,821</u>

Financial assets held in the UK enjoy a right of interest offset against overdraft balances. Overseas financial assets have a weighted average interest rate of 1% (2003: 1%).

### II) FINANCIAL LIABILITIES

	2004			2003		
	<i>Floating rate</i>	<i>Fixed rate</i>	<i>Total</i>	<i>Floating rate</i>	<i>Fixed rate</i>	<i>Total</i>
	£000	£000	£000	£000	£000	£000
Sterling	(13,201)	(9,385)	(22,586)	(26,268)	(9,834)	(36,102)
US dollar	(7,853)	(13,093)	(20,946)	(2,873)	(12,030)	(14,903)
Australian dollar	(740)	-	(740)	-	(612)	(612)
	<u>(21,794)</u>	<u>(22,478)</u>	<u>(44,272)</u>	<u>(29,141)</u>	<u>(22,476)</u>	<u>(51,617)</u>
Offset in the UK			4,331			7,115
			<u>(39,941)</u>			<u>(44,502)</u>
Disclosed as:						
Bank loans and overdrafts			(20,493)			(22,986)
Medium term loan	- UK		(12,951)			(13,265)
	- overseas		(4,104)			(4,800)
Obligations under finance leases	- UK		(1,195)			(1,693)
	- overseas		(1,158)			(1,718)
Loan stock			(40)			(40)
			<u>(39,941)</u>			<u>(44,502)</u>

A right of offset exists for currency amounts held within the UK by Bank of Scotland. These are used to offset the interest charged on the UK overdraft which bears interest at 1.75% above LIBOR. Cash at bank and in hand consists primarily of overseas funds which are used as short term intra-group financing as well as an internal exchange rate hedge.

The weighted average interest rate of fixed rate financial liabilities at 31 October 2004 was 5.5% (2003: 6.6%) and the weighted average period of funding was four years (2003: four years).

The Group has two amortising interest rate swaps, from floating to fixed rate, one that expires in 2008 at a rate of 6.14% (sterling) and one that expires in 2007 at a rate of 3.87% (US dollars). Otherwise the Group had no derivative financial instruments outstanding at 31 October 2004. The opinion of the Board is that the fair value of the Group's financial liabilities after taking account of the interest rate swaps is £462,000 (2003: £509,000) higher than the book value. The Board has no intention of realising this liability. The fair value of the financial assets is their book value.

## 22. PROVISIONS FOR LIABILITIES AND CHARGES

## (A) MOVEMENT IN THE YEAR

	<i>Deferred taxation £000</i>	<i>Group Other provisions £000</i>	<i>Total £000</i>	<i>Parent Other provisions £000</i>	<i>Total £000</i>
At 1 November 2003	4,443	389	4,832	-	-
Provided in the year	-	340	340	340	340
Utilised in the year	(1,080)	(103)	(1,183)	-	-
Foreign exchange movements	(21)	-	(21)	-	-
Disposed with subsidiary undertaking	89	-	89	-	-
At 31 October 2004	<u>3,431</u>	<u>626</u>	<u>4,057</u>	<u>340</u>	<u>340</u>

In the Group consolidated balance sheet other provisions are held in respect of amounts payable to the Group's pension schemes following the disposal of Kembrey Wiring Systems Limited in the year (see Note 27) and other reserves.

In the Parent balance sheet the other provision is held in respect of amounts payable to the Group's pension schemes following the disposal of Kembrey Wiring Systems Limited (see Note 27).

## (B) DEFERRED TAX PROVISION/(ASSET) AT YEAR END

Deferred tax provided in the financial statements is as follows:

	<i>Group</i>		<i>Parent</i>	
	<i>2004 £000</i>	<i>2003 £000</i>	<i>2004 £000</i>	<i>2003 £000</i>
Capital allowances in excess of depreciation	2,261	4,755	35	23
Other timing differences	1,994	287	135	234
Discount	(824)	(599)	(272)	(257)
Deferred tax provision/(asset)	<u>3,431</u>	<u>4,443</u>	<u>(102)</u>	<u>-</u>

## 23. CALLED-UP SHARE CAPITAL

	<i>2004 £000</i>	<i>2003 £000</i>
<b>Authorised</b>		
62,500 7% cumulative preference shares of £1 each	62	62
33,000,000 (2003: 30,000,000) ordinary shares of 5p each	<u>1,650</u>	<u>1,500</u>
	<u>1,712</u>	<u>1,562</u>
<b>Issued, allotted and fully paid</b>		
62,500 7% cumulative preference shares of £1 each	62	62
28,988,576 (2003: 27,435,972) ordinary shares of 5p each	<u>1,449</u>	<u>1,372</u>
	<u>1,511</u>	<u>1,434</u>

The 7% cumulative preference shares confer no rights to vote, except on certain specified matters.

# Notes to the Financial Statements

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## 23. CALLED-UP SHARE CAPITAL - continued

### Share options

The following options to subscribe for ordinary shares were outstanding at 31 October 2004.

### THE CHEMRING 1998 EXECUTIVE SHARE OPTION SCHEME

<i>Date of grant</i>	<i>Number of ordinary shares under option</i>	<i>Exercise price per share £</i>	<i>Dates between which options may be exercised</i>
3 Feb 2000	110,000	2.36	3 Feb 2003 - 2 Feb 2010
23 Jan 2002	54,000	3.805	23 Jan 2005 - 22 Jan 2012
5 Feb 2003	100,000	2.285	5 Feb 2006 - 4 Feb 2013
8 Jul 2004	115,000	4.365	8 July 2007 - 7 July 2014

## 24. RESERVES

### (A) GROUP

	<i>Share premium account</i>	<i>Special capital reserve</i>	<i>Revaluation reserve</i>	<i>Revenue reserves</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>As restated<sup>1</sup> £000</i>	<i>As restated<sup>1</sup> £000</i>
At 1 November 2003	20,726	12,939	2,446	14,878	50,989
Ordinary shares issued	6,201	-	-	-	6,201
Share issue costs	(217)	-	-	-	(217)
Retained profit	-	-	-	6,818	6,818
Loss arising from foreign exchange translations	-	-	-	(1,945)	(1,945)
Transfer between reserves	-	-	(36)	36	-
At 31 October 2004	<u>26,710</u>	<u>12,939</u>	<u>2,410</u>	<u>19,787</u>	<u>61,846</u>

The share premium account, special capital reserve and the revaluation reserve are not distributable.

Included within revenue reserves is £1,050,000 of retained profits (2003: £1,040,000) relating to the associated undertaking.

### (B) PARENT

	<i>Share premium account</i>	<i>Special capital reserve</i>	<i>Revenue reserves</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>As restated<sup>1</sup> £000</i>	<i>As restated<sup>1</sup> £000</i>
At 1 November 2003	20,726	12,939	1,210	34,875
Ordinary shares issued	6,201	-	-	6,201
Share issue costs	(217)	-	-	(217)
Retained profit	-	-	706	706
Foreign exchange differences	-	-	442	442
At 31 October 2004	<u>26,710</u>	<u>12,939</u>	<u>2,358</u>	<u>42,007</u>

The share premium account and special capital reserve are not distributable. A loss after taxation of £3,715,000 (2003: £5,071,000) was recognised in the year by the parent company. Dividends of £7,111,000 were received in the year and dividends of £2,690,000 were payable.

<sup>1</sup> See Note 5.

## 25. OBLIGATIONS UNDER NON-CANCELLABLE OPERATING LEASES

	2004 Group		2003 Group	
	<i>Land and buildings</i>	<i>Plant and equipment</i>	<i>Land and buildings</i>	<i>Plant and equipment</i>
	£000	£000	£000	£000
Within one year	352	695	-	651
Two to five years	425	1,374	58	991
More than five years	263	-	263	-
	<u>1,040</u>	<u>2,069</u>	<u>321</u>	<u>1,642</u>

## 26. ACQUISITIONS

## 2001/02 Acquisitions

In accordance with FRS7 *Fair values in acquisition accounting*, fair values and goodwill in respect of acquisitions made in the previous financial year have now been adjusted as follows:

**I.C.S. Electronics Limited**

The fair value of the deferred contingent consideration has been reduced by £458,000. Goodwill is now calculated to be £2,794,000. Deferred consideration payments totalling £580,000 were made during the year.

## 27. DISPOSAL OF SUBSIDIARY UNDERTAKING/DIVISION

The Group disposed of the entire issued share capital of Kembrey Wiring Systems Limited on 8 November 2003. No profit or loss for the subsidiary undertaking for the period from 1 November 2003 to 8 November 2003 was made and therefore recognised. The loss after tax from the subsidiary undertaking for the financial year ended 31 October 2003 was £239,000. An analysis of the assets disposed of is shown below:

	£000
Fixed assets	104
Stock	1,041
Debtors	1,907
Cash	3
Creditors	<u>(1,155)</u>
Consideration:	<u>1,900</u>
Cash	1,215
Deferred consideration	<u>685</u>
	<u>1,900</u>
Pensions costs	(465)
Legal and professional fees	<u>(225)</u>
Loss on disposal	<u>(690)</u>

# Notes to the Financial Statements

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## 27. DISPOSAL OF SUBSIDIARY UNDERTAKING/DIVISION – continued

Cash consideration of £1,215,000 was received on completion, with a further £200,000 received in January 2004 and £242,500 received in November 2004. A further £242,500 is receivable in November 2005.

The Group agreed to pay £465,000 to the Chemring Group Staff Pension Scheme, with £125,000 paid in November 2003, £170,000 paid on 8 November 2004 and £170,000 payable on 8 November 2005.

As previously reported, on 11 July 2003 the Group sold the business and net assets of Alloy Surfaces Chemical Coatings, a division of Alloy Surfaces Company, Inc., realising a profit on disposal of £724,000.

## 28. SELF INSURANCE

The Group is self insured through its captive insurance company CHG Insurance Limited, based in Guernsey. The Group has been self insured at the following levels since 31 October 2001:

- the first £2.5 million of material damage and business interruption cover, subject to a maximum liability of £3.5 million in any one year;
- the first £1 million of public and products liability insurance for the Group's products which are exported to the US.

Insurance cover in respect of these risks at levels over those disclosed above is placed with external insurers.





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