



2005

FINANCIAL STATEMENTS



Chemring Group PLC

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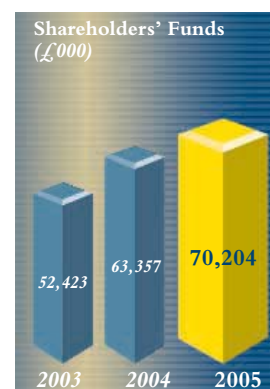
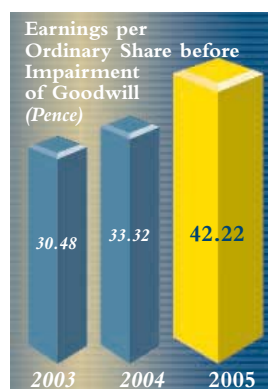
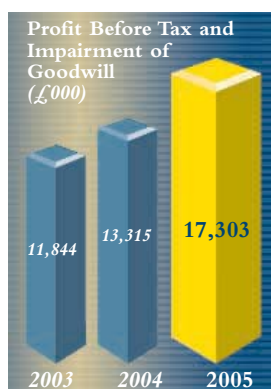
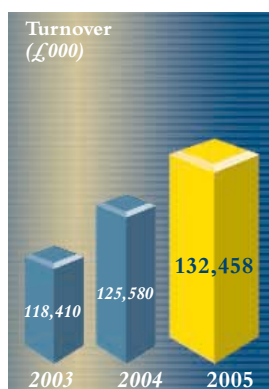
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Summary Financial Information

	2005 £000	2004 £000	2003 £000
Turnover			
Core businesses			
Countermeasures	90,768	78,724	64,264
Energetics	27,923	31,360	31,560
-continuing	2,272	-	-
-acquired	30,195	31,360	31,560
-total			
Total core businesses	120,963	110,084	95,824
Non-core business - Marine	11,495	15,496	14,346
Discontinued operations	-	-	8,240
Total turnover	132,458	125,580	118,410
Operating profit/(loss) before impairment of goodwill			
-continuing	19,324	16,927	14,026
-discontinued	-	-	(216)
-acquired	742	-	-
Total operating profit before impairment of goodwill	20,066	16,927	13,810
Impairment of goodwill	(3,000)	-	-
Total operating profit	17,066	16,927	13,810
Profit before taxation and impairment of goodwill	17,303	13,315	11,844
Profit before taxation	14,303	13,315	11,844
Dividend per ordinary share	10.50p	9.00p	7.40p
Basic earnings per ordinary share before impairment of goodwill¹	42.22p	33.32p	30.48p
Basic earnings per ordinary share	31.90p	33.32p	30.48p
Diluted earnings per ordinary share	31.76p	33.14p	30.05p
Net debt (£000)	52,774	30,008	38,681
Shareholders' funds (£000)	70,204	63,357	52,423

¹ See Note 12.

Financial Highlights



Results

	<i>2005</i>	<i>2004</i>
	<i>£000</i>	<i>£000</i>
Operating profit before impairment of goodwill	20,066	16,927
Operating profit	17,066	16,927
Profit before tax and impairment of goodwill	17,303	13,315
Profit before tax	14,303	13,315
Basic earnings per ordinary share before impairment of goodwill	42.22p	33.32p
Basic earnings per ordinary share	31.90p	33.32p

Statement by the Chairman

On 23 March 2006, Chemring Group PLC will hold its 100th Annual General Meeting, a formidable achievement. As we commence our second century, it is gratifying to report that the Group is in robust health, with excellent earnings, exciting growth prospects, a strong balance sheet and cash flow, and has a coherent commercial strategy for future development. The management team has been strengthened during 2005 and this will continue during 2006, ensuring delivery of our aims.

The acquisitions of Technical Ordnance, Leaffield Engineering and Leaffield Marine, announced separately today, will significantly strengthen the Energetics division.

The Group's profitability has been substantially influenced by another record year for sales and earnings at Alloy Surfaces in the US. The rest of the Countermeasures division delivered excellent results in the second half and this, together with a good performance from the Energetics division, provided a very respectable increase in earnings per ordinary share before impairment of goodwill to 42.22p (2004: 33.32p).

The strength of the Group's underlying performance is masked in part by the Marine division which made losses of £2.5 million in the year, equating to approximately 6p of post-tax earnings. Without these losses, the Group would have been reporting even higher growth in earnings. The Board has now determined that the Marine division is non-core and accordingly will be divested.

Balance Sheet and Cash Flow

With profitable growth during 2005 and a strengthened balance sheet, the Board felt it could increase its debt levels to fund the acquisitions of Nobel Energetics and Comet.

The Board is, however, mindful to ensure the Group does not overburden

itself with debt and as such it was felt that it would be appropriate to raise approximately £27.7 million (before costs) by means of a vendor placing of shares to fund part of the consideration for Technical Ordnance. The balance will be funded with debt. The acquisitions of Leaffield Engineering and Leaffield Marine have also been debt-funded.

Operating cash flow projections are strong for the current financial year, and the Board expects the high debt arising from the recent acquisitions to reduce towards the year end.

Core Businesses

Acquisitions

During the year, with the arrival of the new Chief Executive, Dr David Price, the Board reviewed the Group's strategic direction and confirmed its emphasis on Countermeasures and Energetics. As a direct consequence of this decision, the Board focused efforts on its search for suitable acquisition opportunities to expand the Energetics division, both in Europe and in the US.

Consequently, on 1 September 2005, the Group acquired Nobel Energetics Limited (formerly Troon Investments Limited), a prominent business and pillar of the Energetics industry in the UK, for £22 million (before costs). Nobel Energetics is already showing its potential under the Group's more vigorous marketing approach, and benefiting from our willingness to invest in its product line.

On 30 November 2005, the Group completed the acquisition of Comet GmbH for €9.6 million (£6.6 million before costs). Comet brings a range of complementary products to PW Defence, strengthens our presence in Germany and Eastern Europe, and has products which are, we believe, attractive to the US military and which our operations in the US should be able to exploit. In addition, Comet is a leading supplier of marine pyrotechnics, which will further strengthen our worldwide presence in this market.

"...it is gratifying to report that the Group is in robust health."



The acquisitions of Technical Ordnance, Leaffield Engineering and Leaffield Marine will bring additional annual sales of approximately £25 million to our Energetics division. This division, including Nobel Energetics and Comet, will now have sales in excess of £75 million per annum.

Countermeasures

Our Countermeasures division had an outstanding year, principally as a result of the continuing peace-keeping efforts in Iraq and Afghanistan. The demand for Alloy Surfaces' advanced countermeasure technology has escalated, out-stripping the additional capacity of its second plant, which only became fully operational in April 2005. In order to satisfy increased requirements for the US Department of Defense, the second plant is now being extended and a lease has been taken on a third plant, which will open towards the end of 2006. The ability of Alloy Surfaces' management to commission the second plant during 2005, in less than nine months, whilst maintaining manufacturing efficiency and delivering a massive increase in sales to meet the demands of the US military, is undoubtedly the success story of our year. The challenge for 2006 is to ensure that this exceptional performance continues as Alloy Surfaces adds further to capacity.

Statement by the Chairman

- continued

Energetics

As I alluded to at the half year, PW Defence suffered from a weak order position during the year, partially due to the reduction in training which takes place in the armed forces when they are involved in active combat, combined with delays in export orders on which the business relies. Sales of marine pyrotechnics were restricted by the unexpected cessation of supply from a sole source supplier of a critical component for one product in the range, which also impacted on sales of other products where they are sold as a package.

Non-Core Businesses

Following the restructuring of the Marine division, the Board has reviewed the businesses of marine lights, electronics and coast radio stations, and has determined that they no longer form part of the Group's longer term strategy. They are therefore being offered for sale. The businesses have been restructured, and with new products and opportunities, the Board would expect to receive a proper commercial consideration; otherwise they will remain part of the Group.

As part of the review we have reduced the carrying value of goodwill attributable to the Marine division by £3 million, and taken this as an impairment charge.

Group Strategy

As mentioned above, the Board has reviewed the direction of the Group, taking into account our unique position in the defence industry worldwide. It has determined that it will remain totally focussed on the defence industry, with its commercial activities limited to exploiting any technology arising from its defence products.

The Group will obviously continue with its core Countermeasures business, where it is experiencing

excellent growth and is by some distance the world leader, with more than half of the world decoys market and supplying in excess of 60% of the US military's decoy requirements.

Our second core business is that of Energetics, where the Group already has significant experience and where we believe the worldwide market is highly fragmented and capable of consolidation. The Board believes that good organic growth can be generated in this division, and combined with acquisitions, this could provide excellent returns. The UK Government's recently published

Defence Industrial Strategy would appear to support our strategy in this area.

During the year the Board commissioned a brief consultancy study, essentially to audit its deliberations and to ensure we had identified opportunities in our relevant sectors. It is possible that at some stage the Group will consider adding a third division, probably through acquisition. Such a development would only take place however if the defence technology being acquired had a direct relationship to our two existing divisions.



The Board of Directors

During the year Peter Molony indicated his wish to retire from the Board, on which he had served for eight years, initially for eighteen months as Chief Executive, and subsequently as a non-executive director and Chairman of the Audit Committee. The Board will miss his counsel and contribution, which commenced at a low point in the Group's fortunes. We wish him well in his retirement. The Group is currently searching for a replacement, during which time I have temporarily assumed the Chairmanship of the Audit Committee.

Insurance Claim

In previous reports I have dealt with the issues surrounding our claims against Royal & Sun Alliance, which has now been settled, and against our former insurance brokers, Willis, in connection with the insurance recovery at Kilgore. In good faith the Board responded to proposals from Willis that we should go to mediation, recognising that should this fail it would delay the commencement of Court proceedings. The mediation proved to be an unsatisfactory exercise and there is now no alternative but to go to Court. The Group continues to carry forward in its balance sheet a reasonable estimate for recovery of the claim against Willis at the same level as in 2004.

Corporate Governance

Your Board is doing everything possible, within reason, to comply with the increasing and bureaucratic demands of this subject, which do nothing to improve shareholder returns. I welcome the decision not to implement the Operating and Financial Review, which would have added pages to every annual report and which I suspect would have provided little additional value. Last year the Company generally received a clean bill of health on this subject, and I trust we shall do the same this year.

Communications with Shareholders

The Board has been concerned on a number of occasions in recent years that important information on the progress of the Company which we make public through regulatory announcements is not ultimately

reaching all underlying shareholders. This is because the prominent daily and financial press no longer report such statements from all companies, and those shareholders whose portfolios are managed by financial institutions are not automatically forwarded these important releases. We urge shareholders to register to receive e-mail copies of all announcements on our website (www.chemring.co.uk), which should alleviate the problem.

Employees

This year's results have been produced with a lot of hard work and dedication throughout the Group. We have set numerous challenges for the year ahead. I believe that, as they have this year, all our employees will meet these challenges and ensure another highly successful result. I thank everyone for their efforts.

Performance Share Plan

Following a review by the Remuneration Committee during the year of the Company's remuneration policy for senior executives, shareholder approval will be sought for the introduction of a new long-term share incentive arrangement, the Chemring Group Performance Share Plan, at the forthcoming Annual General Meeting. Further details are set out in the Notice of the Annual General Meeting, which will be sent to shareholders with the Financial Statements.

Pensions

The Board continues to study the implications on pension provision for our UK employees as the Government

introduces more and more disjointed legislation, and increases the cost and compliance burden of maintaining a final salary pension scheme. Notably, the recent appointment of The Pension Regulator, with the ability to veto both Board and shareholder wishes concerning their companies' affairs, the

"I look forward to reporting further dynamic progress of the Group..."

revised method for calculating deficits on the sale of a participating company in a scheme, and the introduction of the Pension Protection Fund, whereby better-funded schemes will subsidise those which fall into decline, give us great cause for concern. This subject is likely to be a continuing feature of my reports.

Dividends

The Board is recommending a final ordinary dividend of 7.30p per ordinary share, an 18% increase on the final dividend for 2004. This, together with the interim dividend of 3.20p paid in September 2005, gives a total dividend for the year of 10.50p, a 17% increase over 2004. The dividend is 3.0 times covered. The shares will be marked "ex dividend" on 22 February 2006 and the dividend is payable on 5 May 2006.

Prospects

Since I became Chairman some eight years ago, the Company's share price has grown from 78p to over 900p in recent weeks. Whilst I cannot predict growth on this scale in future years, the order book and demand for our decoys promises solid growth in Countermeasures, and our concentration on Energetics will produce a strong second division. I look forward to reporting further dynamic progress of the Group, including its newly acquired businesses, at the half year.



K C Scobie
Chairman

1 February 2006

Review by the Chief Executive



Group Results

Group turnover increased 5% during the year to £132.5 million (2004: £125.6 million). Countermeasures remained the dominant business, contributing 69% of total turnover, after achieving a 15% increase in sales to £90.8 million. Most of the growth can be attributed to the dramatic (over 80%) growth in sales at Alloy Surfaces in the US, now the world's largest expendable decoy business.

Turnover in our Energetics division was 4% down on last year at £30.2 million, as a result of reduced sales volumes at Kilgore and PW Defence, principally due to the delayed production of a marine location marker in the US, and competitive pressures in the UK. The acquisition of Nobel Energetics (formerly Troon Investments) made a small contribution in the last quarter.

Our Marine business had a disappointing year with sales down 26% to £11.5 million. Demand for all our main marine products, namely marine safety lights, automatic identification system (AIS) transponders and beacons, was lower than expected.

The Group operating margin before impairment of goodwill did, however, improve significantly in the year to 15.1%, compared to 13.5% in 2004. Operating profit before impairment of goodwill rose 19% to £20.1 million, reflecting the major improvements in Countermeasures production efficiency. Profit before tax and impairment of goodwill increased

substantially by 30% to £17.3 million (2004: £13.3 million), producing 27% growth in earnings per share before impairment of goodwill to 42.22p (2004: 33.32p).

The focus on operational cash flow remained strong with £21.1 million of cash inflow, a cash conversion rate of 105%. Investment in research and development and capital expenditure amounted to £10.7 million. A major investment of £22.0 million (before costs) was made through the acquisition of Nobel Energetics in Scotland. The Group net debt therefore increased to £52.8 million, but remains at a comfortable level.

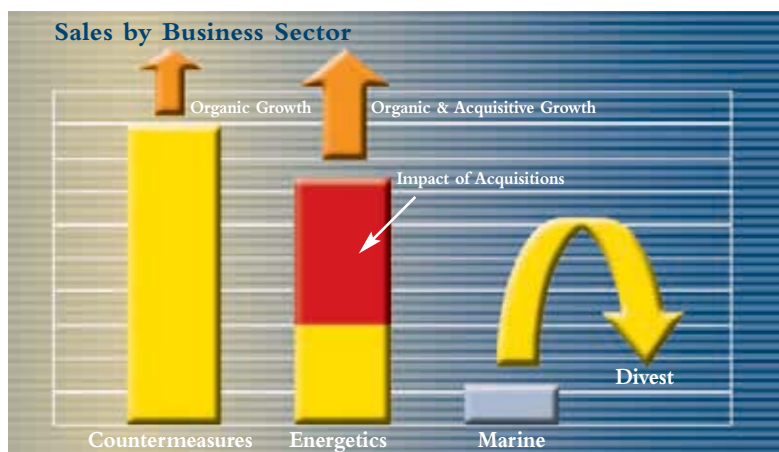
Strategy

During the year, the Board undertook a review of the long-term strategy for the business and made the decision to clearly focus the Group on our core competencies of energetic materials, high reliability and safety, high volume production and access to global defence markets.

Our strategy focuses on three key strands:

- We intend to grow our Countermeasures business organically, with particular emphasis on the US, where global peacekeeping operations continue to drive demand for our decoy products from the US Air Force, the US Army and export customers.
- We will expand our newly formed Energetics division through organic growth and acquisitions in both the US and Europe. Our recent acquisitions maintain this balance. This second sector has some counter-cyclical characteristics to those of the Countermeasures business. This will provide a more robust long-term business model.
- Finally, we have decided that the Marine businesses of lights, electronics and coast radio stations are no longer core and will be divested, provided a satisfactory commercial offer emerges.

Our new strategy for the Energetics division and the recent acquisitions in both the US and Europe have created a centre-of-excellence for the design, development and production of energetic materials, which should make us an attractive long-term partner for many defence prime contractors. We believe that the Group can become a major focus for industrial consolidation in both Europe and the US, and we are actively promoting this opportunity with both industry and Government.



Business Activities

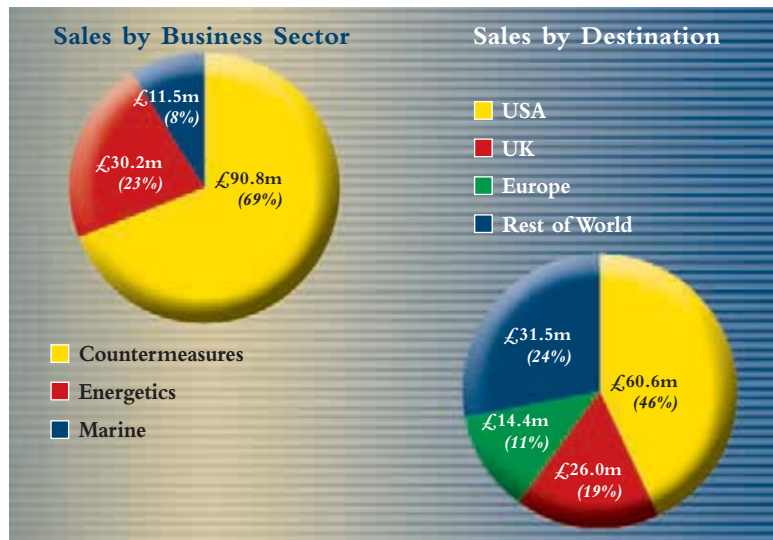
The Group's activities are reported under three main headings:

Countermeasures: Alloy Surfaces, Kilgore, Chemring Countermeasures and Pains Wessex Australia

Energetics: PW Defence, Kilgore, Nobel Energetics, Pains Wessex Safety Systems, Pains Wessex Australia, Oroquieta, Comet, Technical Ordnance, Leaffield Engineering and Leaffield Marine

Marine: McMurdo and ICS Electronics

In 2005, the Group results were dominated by continued strong growth in our Countermeasures division to 69% of the Group turnover. Our Energetics division, with £30.2 million of sales, currently represents only 23% of the Group. However, the recent acquisitions of Nobel Energetics, Comet in Germany, Technical Ordnance in the US and



Leaffield Engineering in the UK will significantly increase the size of this division in future years.

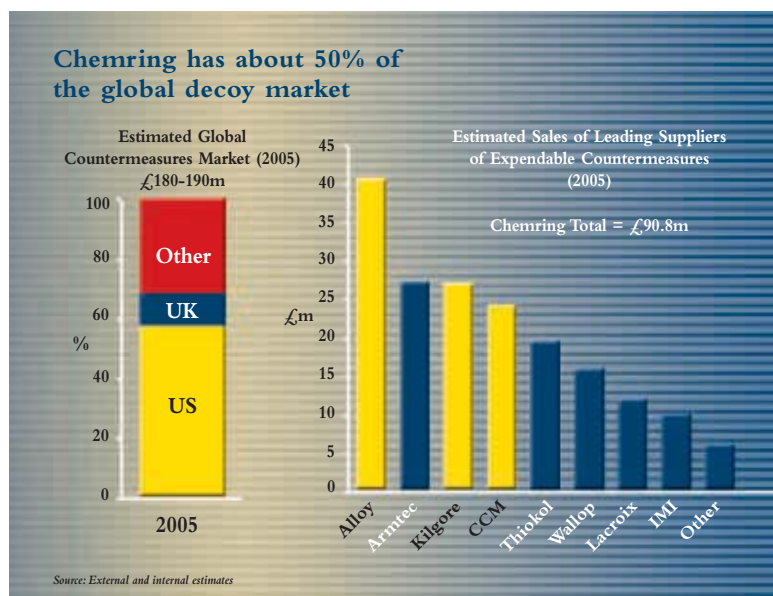
The UK remains a solid market, with strong demand for Alloy Surfaces' special material decoys, particularly for deployment in Afghanistan. The US

continues to be our largest market, contributing 46% of Group turnover, and the US Department of Defense (DoD) is our largest customer, providing over 40% of our business. The vast majority (94%) of our US sales are manufactured within our US-based subsidiaries.

Countermeasures

The global expendable countermeasures market continued to grow in 2005, and is now estimated to stand at about £180 million per annum. The demand for decoys, particularly our special material products, has grown very strongly, driven by the MANPADS threat to the numerous peacekeeping operations currently being undertaken in the Middle East, Eastern Europe, Southern Asia and Africa. The Group is the world leader in decoy technology, and we have three of the four largest suppliers. Alloy Surfaces' strong growth has continued and it is now the largest supplier of expendable decoys in the world.

Alloy Surfaces had an excellent year, generating in excess of \$75 million of sales. A second production facility was commissioned and completed on schedule during the first half of the year, and production has ramped-up steadily to full capacity. This was



primarily to meet increased demand for decoys from the US Air Force. The build-up of BOL-IR decoys to production rates in excess of 50,000 per month to support the UK Ministry of Defence (MoD) operations in Afghanistan and Iraq was

also successfully completed. Overall, Alloy Surfaces manufactured in excess of one million decoys during the year.

Export sales of special material decoys also started to increase, with sizable volumes (\$15 million) delivered to the UK.

Review by the Chief Executive

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Japan and Australia. The US Government has indicated its willingness to allow exports to other NATO countries, offering the potential for growth in our export sales.

Early in the year, the award of a multi-year contract to Kilgore for the production of M206 and MJU-7A/B decoys for the US Air Force was delayed by three months because of an appeal from one of our competitors, which was duly rejected. Production was then successfully ramped-up and consistent manufacture of over one million decoys was achieved in the remaining nine months of the year. The second half performance of the business was ahead of the same period last year.

Kilgore finalised the technology transfer from Chemring Countermeasures for the TALOS naval decoy. The first production contract for an export customer has now been completed and final qualification

testing at a US DoD facility is underway. Follow-on export orders are expected in early 2006.

However, production levels in the year for the F/A-22 Raptor programme were well below expectations as a result of delays in order placement. These orders are expected in early 2006.

Our UK business, Chemring Countermeasures, also had a successful year, making considerable progress on the development of new products for the air, sea and land environments.

Good progress was made on the development of new dual-spectral flares for fixed-wing and helicopter applications, and recent flight tests have demonstrated that these meet the stringent MoD requirements. We have also completed flight testing of a new kinematic decoy that will cope with rate-biased seekers. Orders for these new

products have already been secured in the first months of the current financial year.

We have secured our first export development and production contract for key sub-systems in the underwater countermeasure system, LOKI. This will open up a new export market, which is just starting to grow.

We successfully completed initial development of a rapid burst multi-spectral smoke grenade. This is expected to provide one element of the Defensive Aids System for the new MoD Future Rapid Effects System (FRES) land-warfare capability.

Finally, a five year framework agreement, worth £11.9 million, was signed with the MoD for the supply of decoys, and work is now underway to convert this into a full partnering agreement.

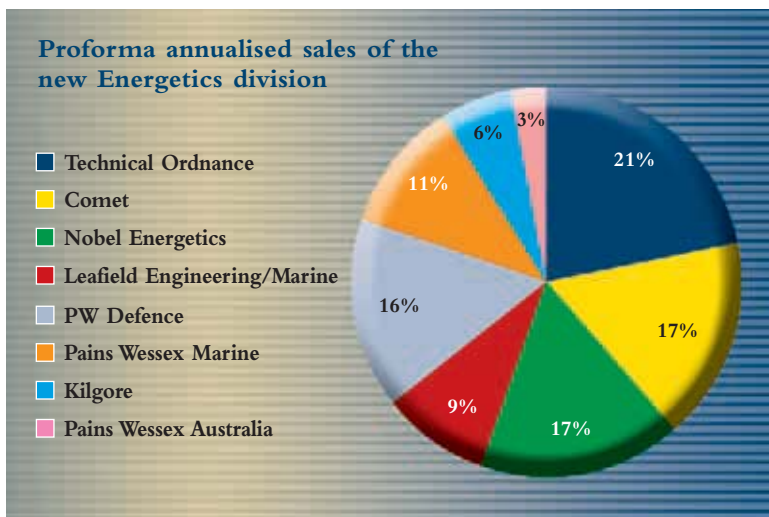
Energetics

There was a reduction in sales volumes in the year at PW Defence and Kilgore, although Pains Wessex Marine increased its turnover by 6%.

PW Defence was affected by strong competitive pressures in the UK market from other European companies. Following a restructuring of the cost base and investment in various new products, a recovery is expected in 2006. We also signed a partnership agreement with Martin Electronics Inc. in the US. This should secure better access to the lucrative US military market for our pyrotechnic products, and provides us with a family of 40mm products for the European market.

The ordnance activities at Kilgore also had a disappointing year, down 17%, with delays in new orders for both ordnance primers and marine location markers. One type of marine location marker, in particular, suffered delay due to the introduction of new design enhancements.

Shortly after the year end, we completed the acquisition of Comet,



located in Bremerhaven, Germany. The company has a turnover of approximately £14 million and employs 110 people. Comet extends our product portfolio significantly in training/simulation products, and mine breaching systems. It also enhances our access to German and Eastern European markets. It has a strong marine pyrotechnics brand, which combined with Pains Wessex Marine, makes us the world leader in this market.

During the year, the marine pyrotechnics business was transferred out of our Marine division to a new stand alone operation, Pains Wessex Safety Systems. It is now part of the Energetics division and, with Oroquieta, forms the Pains Wessex Marine business. Comet's marine pyrotechnic products complement the Pains Wessex Safety Systems range, and plans for a significant manufacturing rationalisation of all our marine energetic products were generated this

year and will be implemented during 2006.

In September 2005, we completed the acquisition of Nobel Energetics, located on the Ardeer peninsula on the west coast of Scotland. The company has a turnover of approximately £13 million and employs 130 people.

Nobel Energetics has a wide range of products that significantly enhance our product range, including initiators, actuators, gas generators, munition release cartridges, demolition stores, propellants and rocket motors. The company provides twenty devices for Martin Baker ejector seats. It is in the process of completing the development of the rocket motors for the Saab NLAW missile that has been ordered by the MoD as its short-range anti-tank weapon. A total of 14,000 units have been ordered.

Finally, we have separately announced today the acquisitions of three other companies that will further enhance the growth of our Energetics division.



We have reached agreement on the acquisition of Technical Ordnance in South Dakota, USA. It manufactures initiators, impulse cartridges, safety and arming components, and cutting charges, and has a complementary range to Nobel Energetics. Technical Ordnance supplies all of the US armed forces, although its largest customer is the US Air Force. It has a turnover of approximately £18 million and employs 120 staff.

We have also acquired Leaffield Engineering and Leaffield Marine, both located in the UK.

Leaffield Engineering provides a comprehensive range of pyro-mechanical devices, safety and arming mechanisms, and weapon break-up systems, as well as protractors, cutters and explosive release bolts. It greatly extends our presence in the missile and weapon segment of the defence market. It has a turnover of over £5.8 million and employs just over 70 staff.

Leaffield Marine manufactures valves and inflation systems for the marine and defence markets, utilising technology similar to that which exists at Nobel Energetics. It has sales of £1.4 million and employs 20 people.

Marine

It was a disappointing year for the Marine division. In the lights business, reduced demand from the MoD led to a 22% fall in sales volumes, whilst beacons sales, particularly in the US, continued to be affected by doubts regarding the performance of GPS beacons. An upgrade programme took place over the first seven months of the year and sales only started to recover towards the very end of the year, after a second independent trial had verified the improved performance.

Sales of automatic identification system (AIS) transponders were also down to 40% of last year's levels, as the expected legislation for the US and Russian work boats failed to materialise; this now looks to be delayed until 2006 or 2007.

A major restructuring of the business to reduce costs was undertaken during the year. A number of new products,

including a lower cost beacon, are nearing completion, and we expect McMurdo to return to profitability during 2006.

A new International Maritime Organisation (IMO) requirement for a float-free Simplified Voyage Data Recorder (S-VDR) came into force in 2005 for all cargo vessels above 3,000 gross tonnage. We have developed a float-free capsule, using our 406MHz beacon technology, and this has been incorporated into the VDR systems of a number of leading marine electronics companies, such as Furuno.

In September, McMurdo also signed a strategic partnership with the RNLI to develop a confidential Position Reporting System to monitor and protect fishing boats whilst at sea. The UK and Spanish Governments have indicated their wish to have the system fitted on all fishing boats, and

other European Governments are considering whether to legislate as well.

These new products will be launched in 2006, and should provide enhanced earnings during the second half of the year.



Review by the Chief Executive

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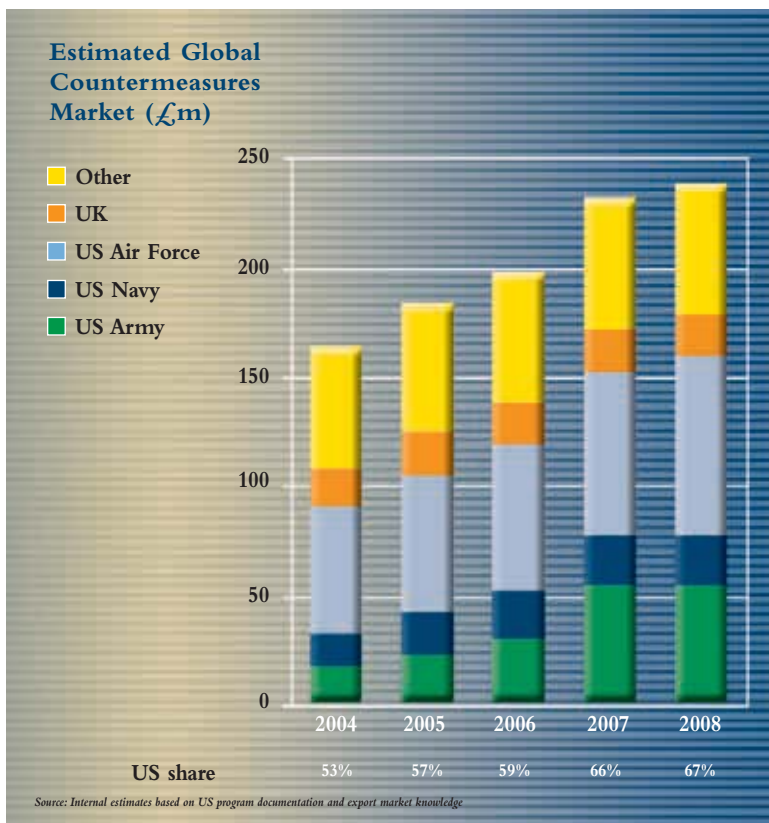
Future Prospects

The market outlook for our Countermeasures business continues to be very positive. In 2005, the global market increased by 12%, driven by the increased requirements of the US. Over the next three years, the global market is expected to grow, with significant growth in demand from both the US Army and the US Air Force, particularly for our special material decoys.

We recently announced the signing of a Memorandum of Understanding with the DoD for the expansion of Alloy Surfaces' production capacity in Philadelphia to increase the manufacture of one of its special material decoys for US Army helicopters. To meet the growth from 20,000 to 80,000 units per month, we shall be expanding one of the two existing plants and building a third manufacturing facility. We expect to have the extension to the second plant operational by May 2006, and to have commissioned the third plant by September 2006. Maximum manufacturing rates will be achieved in January 2007 and will continue until at least the end of 2008. If the ramp-up in production is achieved to the US Army's schedule, then, at full capacity, the new requirement should generate more than \$50 million per annum of additional revenues.

The US Air Force's decoy requirements are also expected to grow significantly over the next three years, driven by the acquisition of decoys for new aircraft and applications. At Kilgore, we are just completing development of a new decoy suite for the B52 bomber, which is expected to remain in service for another twenty years. This is a physically large flare, and a new manufacturing plant will be commissioned during 2006 to accommodate this procurement and all other large-sized flare programmes.

Kilgore is also in production of the decoy for the F-22 Raptor aircraft and is developing a decoy suite for the F-35 Joint Strike Fighter (JSF). We are therefore well-positioned to exploit the expected growth in the US decoy market.



In the UK, enhanced military operations in both Afghanistan and Iraq have increased the consumption of decoys, and further orders for a broad range of decoys are expected. Chemring Countermeasures is the sole developer of the decoy suite for the Typhoon aircraft and the recent announcement of the sale of up to seventy two aircraft to Saudi Arabia should offer substantial opportunities from 2007 onwards.

The five new acquisitions in the Energetics division have created an enormous opportunity for growth, bringing together key expertise and technology from both the US and Europe. The Group now has a very broad range of products and we expect to achieve strong export growth when these are coupled with our global market access.

In Germany and Spain, we are just starting to exploit our local presence and, during 2006, we expect to increase the transfer of technology and enhance our market penetration.

Our acquisition of Technical Ordnance, coupled with our ordnance activities at Kilgore and the strategic partnership with Martin Electronics Inc., is expected to generate major opportunities within the enormous US defence market. The transfer of technology from Nobel Energetics, Comet and Leafield Engineering should allow us to address a much broader market and to bring to bear highly competitive technologies.

We continue to look for new acquisition targets that will generate good shareholder value. However, 2006 will see a strong emphasis on the integration of our recent acquisitions and the establishment of strong organic growth in both of our core sectors.

Dr David Price
Chief Executive
1 February 2006

Review by the Finance Director

Operating Results

Turnover from continuing operations was £130.2 million (2004: £125.6 million), an increase of 4%. Net operating margin from continuing operations before impairment of goodwill was 14.8% (2004: 13.5%). Net operating profit from continuing operations before impairment of goodwill was £19.3 million (2004: £16.9 million), an increase of 14%.

The acquired business turnover of £2.3 million and operating profit of £0.8 million represents two months' contribution from Nobel Energetics, which was acquired on 1 September 2005.

Following the Board's annual impairment test on the Group's total goodwill, it was decided to take a goodwill impairment charge of £3 million against operating profit in relation to the non-core Marine division. Total operating profit was £17.1 million (2004: £16.9 million).

An analysis of the core and non-core business turnover and operating profit is shown below.

Analysis of the core and non-core businesses		2005 £m	2004 £m	
	Turnover	Operating profit/(loss)	Turnover	Operating profit/(loss)
Core	118.7	21.8	110.1	17.4
Non-core	11.5	(2.5)	15.5	(0.5)
	<u>130.2</u>	<u>19.3</u>	<u>125.6</u>	<u>16.9</u>
Core – acquired	<u>2.3</u>	<u>0.8</u>	<u>-</u>	<u>-</u>
	132.5	20.1	125.6	16.9
Impairment of goodwill	<u>-</u>	<u>(3.0)</u>	<u>-</u>	<u>-</u>
	<u>132.5</u>	<u>17.1</u>	<u>125.6</u>	<u>16.9</u>

The non-core Marine losses of £2.5 million include restructuring costs of £1.0 million in relation to accelerated amortisation of development costs, additional stock provisions and redundancy costs.

"Profit before tax and impairment of goodwill was £17.3 million, an increase of 30%..."



Profit before tax and impairment of goodwill was £17.3 million (2004: £13.3 million), an increase of 30%. Profit before tax was £14.3 million (2004: £13.3 million) an increase of 8%.

Acquisition of Business

On 1 September 2005, the entire issued share capital of Nobel Energetics Limited (formerly Troon

The total consideration was paid in cash and financed with a new medium term bank loan.

A summary of the fair value of assets acquired and the goodwill arising on acquisition is shown in the table below.

Summary of the fair value of assets acquired and goodwill

	£m
Fixed assets	6.5
Working capital	1.9
Taxation	(1.8)
Cash	<u>1.4</u>
Fair value of assets acquired	<u>8.0</u>
Cash consideration including costs	<u>23.0</u>
Goodwill arising on acquisition	<u>15.0</u>

Research and Development

Research and development expenditure totalled £6.3 million (2004: £6.0 million), an analysis of which is set out below.

Research and development expenditure	2005 £m	2004 £m
Customer funded research and development	2.6	2.4
Internally funded research and development	2.6	2.2
Capitalised development costs	<u>1.1</u>	<u>1.4</u>
Total research and development expenditure	<u>6.3</u>	<u>6.0</u>

The Group's policy is to write-off capitalised development costs over a three year period. Amortisation of development costs was £1.6 million (2004: £1.6 million).

Review by the Finance Director

- continued

Loss on Disposal

No loss on disposal arose in the year. In 2004, the disposal of Kembrey Wiring Systems Limited resulted in a loss of £690,000.

Interest

The interest charge for the year was £3.0 million (2004: 3.1 million). Interest was covered 6.8 times (2004: 5.5 times) by operating profits before impairment of goodwill.

Taxation

The tax charge of £5.0 million (2004: £3.8 million) represents a rate of 29% (2004: 29%) on profits before impairment of goodwill. The goodwill impairment charge does not attract tax relief.

Pensions

In accordance with *FRS17 Accounting for pension costs*, the Group has disclosed the additional information required in Note 8 of the Financial Statements. Under FRS17, the calculated deficit on the Group's two defined benefit pension schemes after tax was £13.6 million (2004: £12.3 million). The increased deficit arose principally as a result of the reduction in the discount rate on future liabilities.

Shareholder Returns

Basic earnings per ordinary share before impairment of goodwill were 42.22p (2004: 33.32p), an increase of 27%. Basic earnings per ordinary share were 31.90p (2004: 33.32p), a decrease of 4%.

The dividend per ordinary share of 10.50p (2004: 9.00p) is covered 3.0 times (2004: 3.5 times).

The total shareholder return for the Group over the five years to 31 October 2005 has outperformed the FTSE Small Cap Index for the same period by 144%.

Shareholders' funds at the year end were £70.2 million (2004: £63.4 million).

Cash Flow and Net Debt

Operating cash flow was £21.1 million (2004: £14.5 million), with £23.6 million of operating cash flow generated in the second half of the year, compared to an outflow in the first half of £2.5 million.

Working capital balances reduced in the second half.

Fixed asset expenditure in the year was £8.0 million (2004: £5.6 million). The increase in expenditure was in support of Alloy Surfaces' second facility. Following the year end, Alloy Surfaces signed a lease on a third plant to provide additional capacity to satisfy increased demand for its decoys. The costs associated with the fit-out of the new plant and an extension to the existing facilities will be in the region of \$8 million, and will be incurred in 2006.

The Group generated positive cash flow before the acquisition of Nobel Energetics. However, as this acquisition was funded with a medium term loan, the Group's overall net debt increased to £52.8 million (2004: £30.0 million). Gearing is 75% (2004: 47%).

Share Capital

During the year 189,000 5p ordinary shares were issued upon the exercise of previously awarded share options. Proceeds of these options were £0.6 million.

Foreign Exchange

The Group's principal foreign exchange exposure is to the US dollar.

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.

Post Balance Sheet Events

On 30 November 2005, the entire issued share capital of Comet GmbH was acquired for a cash consideration of €9.6million (approximately £6.6 million before costs). The consideration, which is subject to a working capital adjustment, has been funded by a Euro medium term loan.

The acquisitions of Technical Ordnance, Inc., Leaffield Engineering Limited and Leaffield Marine Limited have been announced today. A summary of the transactions is set out below.

Agreement has been reached on the acquisition of the entire capital stock of Technical Ordnance for \$70 million (approximately £39.3 million), subject to a working capital adjustment.

The acquisition is dependent upon regulatory approvals and is anticipated to complete in March 2006. The acquisition of Technical Ordnance has been funded via a vendor placing of the Company's shares which is expected to raise approximately £27.7 million (before costs), with the balance funded from a new medium term loan.

The entire issued share capital of Leaffield Engineering and Leaffield Marine has been acquired for a cash consideration of £4.4 million, subject to a working capital adjustment, and the assumption of £0.6 million of bank overdrafts. The Leaffield acquisitions have been financed utilising an existing term loan facility.

International Financial Reporting Standards

International Financial Reporting Standards (IFRS) came into effect on 1 January 2005. The Group's first set of audited 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

The deficit arising from actuarial valuations will be recorded on the balance sheet.



P A Rayner
Finance Director
1 February 2006

Directors and Professional Advisers

Non-Executive Chairman

Kenneth C Scobie⁺⁺

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 67.

Executive Directors

Dr David J Price

Chief Executive

Joined the Group in April 2005 as Chief Executive. Formerly Managing Director, Naval Marine at Rolls-Royce plc. Previous appointments in the aerospace sector include Managing Director of Thomson (UK) Holdings Ltd and Chief Executive of Thomson-Thorn Missile Electronics Ltd (both now part of the Thales Group). Fellow of the Institute of Electrical Engineers and the Institute of Marine Engineering, Science & Technology.
Aged 50.

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 44.

Non-Executive Directors

David R Evans⁺

Deputy Chairman

Joined the Group in 1987 as Managing Director of the Countermeasures business and appointed to the Board in 1988. He took up his current position as Non-Executive Deputy Chairman in April 2005, after stepping down as Chief Executive, a position he had held since January 1999. Managing Director of the Marconi torpedo business prior to joining the Group. Currently a non-executive director of Whatman PLC.
Aged 59.

Ian F R Much⁺⁺

Joined the Group as a non-executive director in December 2004. Chairman of the Remuneration Committee. Previous appointments include Chief Executive of De La Rue plc and T&N plc, and non-executive director of Admiral plc, Camelot plc and Manchester United plc. Currently a non-executive director of Senior plc and Simplyhealth Group Ltd.
Aged 61.

Air Marshal Sir Peter Norriss

KBE CB AFC MA FRAeS⁺⁺

Joined the Group as a non-executive director in May 2004. Currently Chairman of Microturbo Limited, Senior Military Adviser of VEGA Group PLC and consultant within the aerospace and defence sectors. Formerly Deputy Chief of Defence Procurement (Operations) and Controller Aircraft. Past President of the Royal Aeronautical Society.
Aged 61.

Secretary

Sarah Ellard FCIS

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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Hampshire PO15 7AH, England
Tel: +44 1489 881880
Fax: +44 1489 881123
Website: 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

Directors' Report

for the year ended 31 October 2005

Your directors present the financial statements of the Group for the year ended 31 October 2005.

Principal Activities

The principal activities of the Group are the design, manufacture and sale of countermeasures, energetics and marine safety 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 12.

Dividends

The directors recommend a final dividend of 7.30p per ordinary share, which together with the interim dividend of 3.20p per ordinary share paid in September 2005, gives a total for the year of 10.50p (2004: 9.00p).

Directors and their Interests

The present directors are shown on page 13.

Dr D J Price was appointed as a director on 4 April 2005. He will be seeking re-appointment under Article 87.1 of the Company's Articles of Association at the forthcoming Annual General Meeting on 23 March 2006. Details of Dr Price's service contract with the Company are set out in the Directors' Remuneration Report on page 19.

Mr D R Evans and Mr P A Rayner will be retiring by rotation at the Annual General Meeting and will be offering themselves for re-election. Details of Mr Evans' and Mr Rayner's service contracts with the Company are set out in the Directors' Remuneration Report on page 19.

Mr I F R Much was appointed as a non-executive director on 1 December 2004.

Mr T W Hayter resigned as a director on 10 March 2005. General Sir John Stibbon, having attained the age of seventy, retired as a non-executive director at the Annual General Meeting on

24 March 2005, and Mr P J Molony retired as a non-executive director on 28 July 2005.

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 2005.

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

Substantial Shareholdings

At 31 January 2006 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>
Standard Life Group	5.90
UBS AG	4.05
Legal & General Investment Management	4.01
Prudential Corporation PLC	3.93
Barclays PLC	3.06

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, in line with the Group's philosophy of equal opportunities for all

employees, irrespective of race, nationality, gender, disability or age.

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;
- re-using 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 £9,620 (2004: £3,750) were made during the year. No political donations were made during the year (2004: £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 2005 amounted to 66 days (2004: 59 days).

The Chemring 1998 Executive Share Option Scheme

On 7 April 2005, options were granted over 52,798 ordinary shares to Dr D J Price, further details of which are set out in the Directors' Remuneration Report. During the year options over 189,000 ordinary shares were exercised. Additional information is set out in Note 22.

The Chemring Group PLC Share Based Incentive Scheme

No options were granted during the year and there were no options outstanding under this scheme at 31 October 2005.

Share Capital

Your Board has decided to seek shareholders' approval to increase the Company's authorised share capital by the creation of 10,000,000 new ordinary shares of 5p each. The purpose of this proposal is to ensure that the Board will have sufficient share capital available, if the need should arise, to issue shares as part of the consideration for any future acquisitions and to issue shares on the exercise of options under the share option scheme. The proposal is set out as resolution 8 in the Notice of the Annual General Meeting.

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 10 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 11 in the Notice of the 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 2005.

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 23 March 2006, together with explanatory notes, appear in the separate Notice of the Annual General Meeting sent to all shareholders.

Approved by the Board of Directors on 1 February 2006.

Signed on behalf of the Board

S L Ellard - Secretary

Directors' Remuneration Report

for the year ended 31 October 2005

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 23 March 2006.

Unaudited Information

Remuneration Committee

During the year under review the Remuneration Committee comprised:

- Mr I F R Much
(Committee Chairman)
- Mr P J Molony
(resigned 28 July 2005)
- Air Marshal Sir Peter Norriss

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.

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 seven times during the year. The Chairman and the Chief Executive attend meetings by invitation but are not present during any discussions relating to their own remuneration.

The terms of reference of the Committee are 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 Chairman, 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-based incentives 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, share options and share-based incentives.

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 the arrangement in place during the year, bonuses were paid based upon the achievement of pre-determined targets for earnings per share and reductions in the Group's net indebtedness (excluding acquisitions). The on-target bonus which could be earned for the year under review was 30% of basic salary, and the maximum bonus which could be earned was 45%. Bonuses are non-pensionable.

During the year the Committee undertook a review, with the assistance of New Bridge Street Consultants LLP, of all aspects of the Group's remuneration policy, including the bonus arrangements for executive directors and senior executives in the Group. As a consequence of this review, a new bonus plan has been introduced for the current financial year, with key characteristics as follows:

- the payment of any bonus will remain ultimately at the discretion of the Committee;

- the maximum bonus potential for the executive directors will be a bonus equating to 60% of basic salary, with an on-target bonus (unchanged from the current arrangements) of 30% of basic salary;
- three quarters of the bonus potential will be linked to two separate financial conditions, namely earnings per share and cash flow (with equal weighting). The conditions, which are set by the Committee, take into account a number of factors including budget, market expectations, long term growth prospects and the previous year's out-turn. No bonus will be payable for achievement of less than 90% of target, with bonuses being earned thereafter on a straight-line basis up to the maximum for 110% or better achievement of target;
- one quarter of the bonus potential may be achieved in connection with the satisfaction of personal objective criteria set at the beginning of the financial year. No part of this element of bonus will be payable unless threshold performance of both the financial conditions described above is achieved; and
- one quarter of any bonus payable will be deferred as a conditional award of the Company's shares, with vesting subject to continued employment (save in good leaver scenarios) three years from the award of bonus.

Long Term Incentive Schemes

Share Option Scheme

Since 1998, the Company has operated an executive share option scheme (The Chemring 1998 Executive Share Option Scheme), under which both Inland Revenue approved and unapproved marked priced options may be granted. Following the review of the Group's remuneration policy which was undertaken during the year, the Committee has concluded that this executive share option scheme no longer provides a suitable alignment of interests between the senior executives and the

long term success of the Group, and is in many respects dated. Accordingly, shareholder approval for a new long term incentive plan, which will replace the executive share option scheme, will be sought at the Annual General Meeting on 23 March 2006. Further details of the new plan are set out below. Following adoption of the new plan, no further grants will be made under the executive share option scheme save in exceptional circumstances such as on recruitment. The conditions applying to such grants would accord with current corporate governance best practice.

As part of the remuneration package offered to Dr Price in order to secure his appointment, options over £250,000 worth of the Company's shares were granted to Dr Price under the scheme during the year, subject to a performance condition linked to growth in earnings per share, whereby 50% of the options granted will vest after three years if the growth in the Company's earnings per share over the period exceeds RPI+3% per annum, increasing (on a straight line basis) to 100% of the options vesting if earnings per share growth over the period exceeds RPI+6% per annum. If the applicable performance condition for options granted during the year is not met after three years, no re-testing will be permitted and the options will lapse.

In order to align the interests of participants in the executive share option 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.

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

Proposed Performance Share Plan

As referred to above, the Committee proposes that shareholder approval for a new long term incentive plan (The Chemring Group Performance Share Plan) be sought at the Annual General Meeting on 23 March 2006. Full details of the new plan are set out in the separate Notice of the Annual General Meeting which is being sent to all shareholders. The Committee consulted with major institutional shareholders and their representative bodies on the structure of this plan and the revised bonus plan, details of which are set out above, prior to finalising their proposals.

The new plan will have the following key features:

- conditional awards will be made of the Company's shares worth no more than 100% of basic salary each year;
- awards will vest three years after grant subject to the extent to which a demanding performance condition has been achieved over a single three year period (with no ability to re-test the performance condition). The performance condition will be based on the growth of the Company's earnings per share in excess of RPI over three consecutive financial years;
- the following vesting schedule will apply:

<i>Total earnings per share growth per annum (not compounded) over three financial years</i>	<i>Percentage of the total number of shares under an award that vest</i>
Less than RPI + 5%	Nil
RPI + 5%	33%
RPI + 15% or more	100%
Between RPI + 5% and RPI + 15%	Between 33%-100% on a straight-line basis

Directors' Remuneration Report

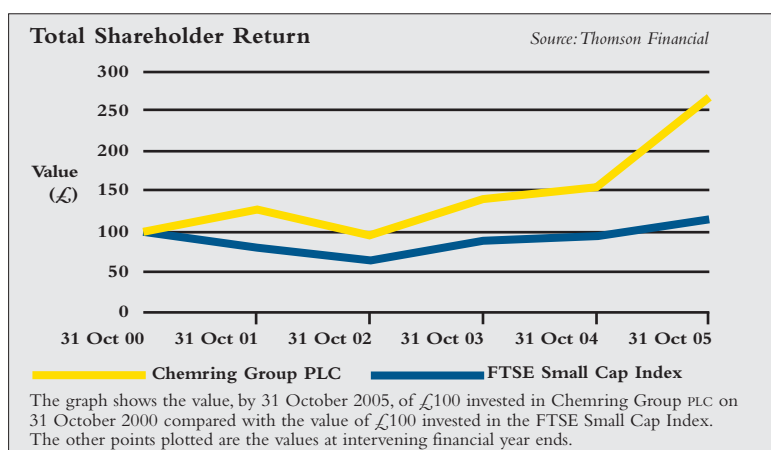
- continued

- by way of illustration, for the awards that are proposed to be made to participants this year, assuming growth in the RPI of 7.5% over the period, earnings per share will need to increase from 42p to 64p for shares to vest in full;
- earnings per share will be calculated on a fully diluted and normalised basis, as specified by the Committee prior to grant; and
- market purchase shares or new issue shares (including treasury shares) may be used to satisfy awards. To the extent that new issue shares or treasury shares are used, these will

made a one-time award of 125,000 restricted ordinary shares to Dr Price shortly after he took 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 are no other performance conditions. This award was necessary in order to secure the appointment of Dr Price, and compensates him for the loss of the options and performance shares he held in his previous employment.

Performance Graph

The graph below shows a comparison of the Company's total shareholder return (TSR) over the last five financial years



count towards the usual share usage dilution limits (10% in ten years for all schemes and 5% in ten years for discretionary (executive) schemes).

Participation in the new plan will be extended at the discretion of the Committee to the executive directors and senior management of the Group, both in the UK and overseas.

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 at present.

Restricted Share Award

As referred to in last year's Directors' Remuneration Report, the Company

against a "broad equity market index", as required by the 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 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 are required to

make monthly contributions to the scheme at the rate of 8% of pensionable salary.

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 spouses' pension. For service accrued from 1 February 2004 the spouses' 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 spouses' 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 spouses 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 spouses' pension would be payable, as calculated above. Mr Rayner is subject to the earnings cap in respect of his membership of the Executive Scheme.

Dr Price 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 are required to make monthly contributions to the scheme at the rate

of 8% of pensionable salary. Dr Price'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. Dr Price is also subject to the earnings cap.

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

The Committee will be reviewing the impact of changes in pension legislation during this year but has set a policy that any changes in benefits should be broadly cost neutral from the Company's perspective.

Service Contracts

Dr Price has a rolling service contract dated 4 April 2005. This provides 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 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.

Mr Rayner has a rolling service contract dated 27 August 1999. This provides 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' salary plus 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. Neither of the executive directors currently hold any external appointments.

Non-Executive Directors

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, has been increased from £80,000 per annum to £88,000 per annum with effect from 1 November 2005. 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.

Mr Evans' existing service contract with the Company remained in place when he retired as Chief Executive and took up his appointment as Non-Executive Deputy Chairman in April 2005. The contract, which is dated 10 December 1991, will expire on Mr Evans' 60th birthday on 27 October 2006. The contract was terminable on two years' notice by the Company and on twelve months' notice by Mr Evans but the notice periods are now reducing as Mr Evans approaches his retirement date. Mr Evans continues to receive remuneration of £200,000 per annum and contractual benefits under the contract.

Mr Much and Air Marshal Sir Peter Norriss 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. The basic fees payable to Mr Much and Air Marshal Sir Peter Norriss have been increased from £25,000 per annum to £30,000 per annum with effect from 1 November 2005. Mr Much also receives an additional fee of £4,500 per annum with effect from this date, in respect of his Chairmanship of the Remuneration Committee.

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.

The Company provides private medical insurance for Mr Scobie and Air Marshal Sir Peter Norriss, and their respective spouses.

With the exception of Mr Evans, whose pension arrangements are set out above, the non-executive directors do not participate in the Company's pension, bonus or share based incentive 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 is 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. No further awards will be made under this scheme.

Directors' Remuneration Report

- continued

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	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Executives								
D J Price (appointed 4 Apr 2005)	144	-	54	-	18	-	216	-
T W Hayter (resigned 10 Mar 2005)	247	151	-	40	9	17	256	208
P A Rayner	156	144	70	37	16	15	242	196
Non-executives								
D R Evans	200	201	41	51	30	27	271	279
P J Molony (retired 28 Jul 2005)	19	41	-	-	-	-	19	41
I F R Much (appointed 1 Dec 2004)	21	-	-	-	-	-	21	-
P C Norriss	25	13	-	-	1	1	26	14
K C Scobie	80	82	-	-	2	1	82	83
J Stibbon (retired 24 Mar 2005)	13	30	-	-	1	2	14	32
Total remuneration	905	662	165	128	77	63	1,147	853

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 Hayter's remuneration includes a payment of £184,588 which was made to him on termination of his employment with the Company, comprising twelve months' pay in lieu of notice, compensation for loss of contractual benefits and compensation for loss of office.

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 19, in respect of which the Group had accrued £810,000 (2004: £441,000) as at 31 October 2005. £369,000 (2004: £21,000) 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.

The bonuses paid to Dr Price, Mr Evans and Mr Rayner for the year were linked to the achievement of pre-agreed targets for earnings per share and reduction in net debt (excluding acquisitions).

Directors' Share Interests

The interests of the directors in the ordinary shares of the Company at 1 November 2004 (or date of appointment if later) and 31 October 2005 are shown below. All are beneficial holdings.

	2005 Number	2004 Number
D R Evans	87,497	100,497
I F R Much	-	-
P C Norriss	-	-
D J Price	1,000	-
P A Rayner	20,000	12,000
K C Scobie	144,864	134,864

No movements have taken place between 31 October 2005 and 1 February 2006.

In addition to the interests detailed above, by the virtue of section 324 of the Companies Act 1985, 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 2005.

Share Options

The holdings by the directors of share options granted under The Chemring 1998 Executive Share Option Scheme at 1 November 2004 (or date of appointment if later) and 31 October 2005 (or date of leaving if earlier) are shown below.

	At 1 Nov 2004 or date of appointment if later	Number of share options			At 31 Oct 2005 or date of leaving if earlier	Exercise price (p)	Market price at date of exercise (p)	Date from which exercisable	Expiry date
		Granted during the year	Lapsed during the year	Exercised during the year					
T W Hayter	54,000	-	-	54,000 ¹	54,000	380.5	500	23 Jan 2005	22 Jan 2012
	25,000	-	-	25,000 ¹	25,000	436.5	500	8 July 2007	7 July 2014
D J Price	-	52,798	-	-	52,798	473.5	-	7 Apr 2008	6 Apr 2015
P A Rayner	50,000	-	-	50,000	-	236	479	3 Feb 2003	2 Feb 2010
	25,000	-	-	-	25,000	436.5	-	8 Jul 2007	7 Jul 2014

¹ Mr Hayter exercised his options following the termination of his employment with the Company.

Mr Hayter made a gain of £80,405 on the exercise of his options during the year and Mr Rayner made a gain of £121,500 on the exercise of his options.

Dr Price also received a one-time award of 125,000 restricted ordinary shares shortly after he took 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 are no other performance conditions.

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.
- For options first exercisable in 2008, 50% of the options granted will vest after three years if the growth in the Company's earnings per share over the period exceeds RPI+3% per annum, increasing (on a straight line basis) to 100% of the options vesting if earnings per share growth over the period exceeds RPI+6% per annum. No re-testing is permitted.

The market price of the ordinary shares at 31 October 2005 was 652p. During the year, the ordinary shares traded within the range 411.5p to 680p.

Pensions

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

	Total benefit accrued at 31 Oct 2004		Transfer value of accrued benefit at 31 Oct 2004	Increase in accrued benefit during year before inflation		Total benefit accrued at 31 Oct 2005		Transfer value of accrued benefit at 31 Oct 2005	Increase in accrued benefit during year after inflation		Transfer value of increase in accrued benefit after inflation (less members' contributions)	Increase in transfer value during year (less members' contributions)
	Pension (£p.a.)	Cash (£)		Pension (£p.a.)	Cash (£)	Pension (£p.a.)	Cash (£)		Pension (£p.a.)	Cash (£)		
D R Evans	104,122	123,152	1,832,159	5,315	14,472	109,437	137,624	2,092,271	2,712	11,393	45,469	244,112
T W Hayter	3,825	11,475	32,868	425	1,275	4,250	12,750	44,921	329	988	650	9,305
D J Price	-	-	-	660	1,980	660	1,980	-	660	1,980	-	-
P A Rayner	13,281	39,843	162,120	1,789	5,367	15,070	45,210	201,844	1,457	4,371	4,709	31,420

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

ii) Mr Hayter left service on 10 March 2005.

iii) As Dr Price joined the Pension Scheme less than two years ago his benefits have not yet vested, and therefore he is not entitled to a transfer value.

iv) 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 1 February 2006.

Signed on behalf of the Board

I F R Much - Chairman of the Remuneration Committee

Statement on Corporate Governance

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 on Corporate Governance, 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, the Chief Executive, the Finance Director and three non-executive directors, one of whom is the Deputy Chairman. 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. A search is currently underway for a third independent non-executive director to replace Mr Molony, who retired during the year. The directors' biographical details are set out on page 13.

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; pensions; 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 fulfilment 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. The division of responsibilities between the Chairman and the Chief Executive, and their respective job descriptions, are 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 two independent 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. As referred to above, a search is currently underway for a third independent non-executive director. The Board considers that once this appointment is made, the balance of executive and non-executive influence which exists will be 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.

Mr Much and Air Marshal Sir Peter Norriss 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.

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 the 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.

Due to the significant changes in the composition of the Board during the year, the Board considered that it would be prudent to defer the implementation of a formal process for annual evaluation of the performance of the Board, its committees and individual directors until the current financial year.

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

Board Committees

The terms of reference of the Audit Committee, the Nomination Committee and the Remuneration Committee are posted on the Company's website and are available on request from the Company Secretary.

Meetings Attendance

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

	<i>Board (13 meetings)</i>	<i>Audit Committee (2 meetings)</i>	<i>Nomination Committee (2 meetings)</i>	<i>Remuneration Committee (7 meetings)</i>
K C Scobie	13 (13)	1 (1)	2 (2)	2 (2)
D R Evans	13 (13)	-	2 (2)	-
T W Hayter ¹	4 (5)	-	-	-
P J Molony ²	9 (10)	2 (2)	2 (2)	5 (6)
I F R Much ³	10 (11)	1 (1)	-	5 (5)
Air Marshal Sir Peter C Norriss	12 (13)	1 (1)	-	4 (5)
Dr D J Price ⁴	7 (7)	-	-	-
P A Rayner	13 (13)	-	-	-
General Sir John Stibbon ⁵	6 (6)	1 (1)	-	2 (2)

The maximum number of meetings which each director could have attended is shown in brackets.

¹ Resigned 10 March 2005

² Retired 28 July 2005

³ Appointed 1 December 2004

⁴ Appointed 4 April 2005

⁵ Retired 24 March 2005

Statement on Corporate Governance

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Audit Committee

During the year Mr Scobie, Mr Molony, General Sir John Stibbon, Mr Much and Air Marshal Sir Peter Norriss all served as members of the Audit Committee.

Mr Scobie initially acted as Chairman of the Committee but resigned as a member, together with General Sir John Stibbon, in January 2005, when Mr Much and Air Marshal Sir Peter Norriss were appointed as members. Mr Molony took over the Chairmanship of the Committee with effect from 9 February 2005 until his retirement, unexpectedly, on 28 July 2005. Following this, Mr Scobie was reappointed as Chairman of the Committee on an interim basis, pending the appointment of a new independent non-executive director with appropriate financial experience. Mr Scobie will resign as Chairman of the Audit Committee when this appointment is made.

The Committee meets not less than twice a year and operates within formal written terms of reference. As referred to above, the terms of reference are available on the Company's website.

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 Committee meets with the auditors on a regular basis without executive directors present. 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.

The Committee reviews annually its terms of reference and its effectiveness, and recommends to the Board any changes required as the result of such review.

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

- reviewing the Group's draft 2004 financial statements and 2005 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 Accounting Standards;
- reviewing the external auditors' plan for the 2004 financial statements and 2005 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.

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

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 proposed for re-appointment 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 40.

Nomination Committee

Mr Scobie, Mr Evans, Mr Much and Air Marshal Sir Peter Norriss all served

on the Nomination Committee during the year. Mr Evans and Mr Molony resigned as members of the Committee in January 2005, when Mr Much and Air Marshal Sir Peter Norriss were appointed. Mr Scobie is Chairman of the Committee but, in accordance with the Committee's terms of reference, is not permitted to chair meetings when the Committee is dealing with the appointment of his successor. As referred to above, the Committee's terms of reference are available on the Company's website.

With regards to the recruitment and appointment of new directors to the Board, the Committee considers the specific knowledge and expertise which would be of benefit to the Group's current operations and future strategy, and provides 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 interviews preferred candidates prior to making any formal offers of appointment. These procedures were adopted for the appointment during the year of both Mr Much and Dr Price.

Remuneration Committee

Mr Scobie, Mr Molony, General Sir John Stibbon, Mr Much and Air Marshal Sir Peter Norriss all served on the Remuneration Committee during the year. Mr Scobie initially acted as Chairman of the Committee but resigned as a member, together with General Sir John Stibbon, in January 2005, when Mr Much and Air Marshal Sir Peter Norriss were appointed as members. The Committee has been chaired by Mr Much since January 2005.

The Committee met seven 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, Dr Price, chairs the Executive Committee, which meets monthly. The other members are 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. No such requests were received during the year. 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) 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 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 15.

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

Statement on Corporate Governance

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establishes a five 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 Health, Safety 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. The Chief Executive is the Board member nominated with specific responsibility for health and safety, and 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.

The Group's Risk Management Committee has been reconstituted since the year end, and new terms of reference agreed. The Chief Executive, the Finance Director and the Company Secretary now serve on the Committee, and will report to the Board on a biannual basis on the key risks and 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 2005, 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 2005, 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 was deemed to be inappropriate due to the changes in the non-executive directors in the year but will be addressed this year as part of the formal process for annual evaluation of the performance of the Board, its committees and individual directors (A.1.3).

■ 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).

■ The membership of the Nomination Committee was revised in January 2005 to include a majority of independent non-executive directors and new terms of reference were adopted. During the initial part of the year however, the Nomination Committee did not comply with the requirements of the revised Combined Code (A.4.1).

■ A formal evaluation of the performance of the Board, its committees and individual directors has been deferred until the current financial year. It was deemed that this was appropriate given the significant changes in the composition of the Board during the year (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).
- The membership of the Remuneration Committee was revised in January 2005. The Committee now consists entirely of independent non-executive directors and new terms of reference have been adopted. During the initial part of the year however, the Remuneration Committee did not comply with the requirements of the revised Combined Code (B.2.1).
- The membership of the Audit Committee was revised in January 2005 and new terms of reference approved by the Board to satisfy the requirements of the revised Combined Code. However, following the unexpected retirement of Mr Molony in July 2005, it was necessary for Mr Scobie to be reappointed as Chairman of the Committee on an interim basis, pending the appointment of a new independent non-executive director with appropriate financial experience. Mr Scobie will resign as Chairman of the Committee when this appointment is made (C.3.1).

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
1 February 2006.

Signed on behalf of the Board

S L Ellard - Secretary

Independent Auditors' Report on the Financial Statements

for the year ended 31 October 2005

Independent Auditor's Report to the Members of Chemring Group PLC

We have audited the financial statements of Chemring Group PLC for the year ended 31 October 2005 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 27, 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 5 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 2005. 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 2005 are disclosed in Note 5. 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 2005 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

1 February 2006

Consolidated Profit and Loss Account

for the year ended 31 October 2005

Note				2005	2004
		<i>Before impairment of goodwill</i>	<i>Impairment of goodwill</i>	<i>Total operations</i>	<i>Total operations</i>
		£000	£000	£000	£000
2	Turnover				
	- continuing	130,186	-	130,186	125,580
	- acquired	2,272	-	2,272	-
		<u>132,458</u>	<u>-</u>	<u>132,458</u>	<u>125,580</u>
4	Operating profit				
	- continuing	19,324	(3,000)	16,324	16,927
	- acquired	742	-	742	-
		<u>20,066</u>	<u>(3,000)</u>	<u>17,066</u>	<u>16,927</u>
	Associated undertaking	197	-	197	151
	Loss on disposal of subsidiary undertaking	-	-	-	(690)
	Profit/(loss) on ordinary activities before interest	<u>20,263</u>	<u>(3,000)</u>	<u>17,263</u>	<u>16,388</u>
9	Interest payable	<u>(2,960)</u>	<u>-</u>	<u>(2,960)</u>	<u>(3,073)</u>
	Profit/(loss) on ordinary activities before taxation	<u>17,303</u>	<u>(3,000)</u>	<u>14,303</u>	<u>13,315</u>
10	Tax on profit/(loss) on ordinary activities	<u>(5,011)</u>	<u>-</u>	<u>(5,011)</u>	<u>(3,822)</u>
	Profit/(loss) on ordinary activities after taxation	<u>12,292</u>	<u>(3,000)</u>	<u>9,292</u>	<u>9,493</u>
	Equity minority interest			<u>(13)</u>	<u>15</u>
	Profit for the year			<u>9,279</u>	<u>9,508</u>
11	Dividends			<u>(3,073)</u>	<u>(2,690)</u>
23	Retained profit for the year			<u>6,206</u>	<u>6,818</u>
12	Basic earnings per ordinary share	<u>42.22p</u>	<u>(10.32p)</u>	<u>31.90p</u>	<u>33.32p</u>
12	Diluted earnings per ordinary share			<u>31.76p</u>	<u>33.14p</u>
11	Dividend per ordinary share			<u>10.50p</u>	<u>9.00p</u>

Additional Financial Performance Statements

for the year ended 31 October 2005

	<i>2005</i>	<i>2004</i>
	<i>£000</i>	<i>£000</i>
Statement of total recognised gains and losses		
Profit for the financial year	9,279	9,508
Currency translation differences on foreign currency net investments	67	(1,945)
Total recognised gains and losses since last annual report and financial statements	9,346	7,563
Reconciliation of movements in shareholders' funds		
Profit on ordinary activities after taxation	9,292	9,493
Equity minority interest	(13)	15
Dividends	(3,073)	(2,690)
Retained profit for the year	6,206	6,818
Other recognised gains/(losses)	67	(1,945)
Ordinary shares issued	10	77
Share premium arising	564	5,984
Net addition to shareholders' funds	6,847	10,934
Opening shareholders' funds	63,357	52,423
Closing shareholders' funds	70,204	63,357

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

Consolidated Balance Sheet

as at 31 October 2005

	Note	£000	2005 £000	2004 £000
Fixed assets				
Intangible assets:				
Development costs	13	2,297		2,841
Goodwill	13	39,948		27,984
			42,245	30,825
Tangible assets	14		51,747	41,810
Investments	15		1,068	1,073
			95,060	73,708
Current assets				
Stock	16	32,274		25,090
Debtors	17	29,948		27,036
Cash at bank and in hand		7,774		9,933
		69,996		62,059
Creditors due within one year	18	(43,026)		(49,915)
Net current assets			26,970	12,144
Total assets less current liabilities			122,030	85,852
Creditors due after more than one year	19		(46,922)	(18,174)
Provisions for liabilities and charges	21		(4,627)	(4,057)
Equity minority interest			(277)	(264)
			70,204	63,357
Capital and reserves				
Called-up share capital	22		1,521	1,511
Reserves				
Share premium account	23	27,274		26,710
Special capital reserve	23	12,939		12,939
Revaluation reserve	23	2,374		2,410
Revenue reserves	23	26,096		19,787
			68,683	61,846
Shareholders' funds			70,204	63,357
Attributable to equity shareholders			70,142	63,295
Attributable to non-equity shareholders			62	62
			70,204	63,357

These financial statements were approved by the Board of Directors on 1 February 2006.

Signed on behalf of the Board

D J Price

P A Rayner

Parent Balance Sheet

as at 31 October 2005

			2005		2004
	Note	£000	£000	£000	£000
Fixed assets					
Tangible assets	14		456		895
Investments	15		62,636		34,660
			63,092		35,555
Current assets					
Debtors	17	55,776		48,289	
Cash at bank and in hand		-		341	
		55,776		48,630	
Creditors due within one year	18	(31,600)		(27,376)	
Net current assets			24,176		21,254
Total assets less current liabilities			87,268		56,809
Creditors due after more than one year	19		(44,027)		(12,951)
Provisions for liabilities and charges	21		(170)		(340)
			43,071		43,518
Capital and reserves					
Called-up share capital	22		1,521		1,511
Reserves					
Share premium account	23	27,274		26,710	
Special capital reserve	23	12,939		12,939	
Revenue reserves	23	1,337		2,358	
			41,550		42,007
Shareholders' funds			43,071		43,518
Attributable to equity shareholders			43,009		43,456
Attributable to non-equity shareholders			62		62
			43,071		43,518

These financial statements were approved by the Board of Directors on 1 February 2006.

Signed on behalf of the Board

D J Price

P A Rayner

Consolidated Cash Flow Statement

for the year ended 31 October 2005

	Note	£000	2005 £000	2004 £000
Net cash inflow from operating activities	A		21,141	14,462
Returns on investments and servicing of finance	B		(3,131)	(3,045)
Taxation			(7,612)	(2,291)
Capital expenditure	B		(7,953)	(5,580)
Acquisitions and disposals	B		(21,767)	482
Equity dividends paid			(2,736)	(2,219)
Net cash (outflow)/inflow before financing			(22,058)	1,809
Financing – issue of shares	B	574		6,061
– increase/(decrease) in debt	B	25,967		(4,478)
			26,541	1,583
Increase in cash	C		4,483	3,392
Reconciliation of net cash flow to movement in net debt				
Increase in cash			4,483	3,392
Cash (inflow)/outflow from the (increase)/decrease in debt			(25,967)	4,478
Change in net debt resulting from cash flows			(21,484)	7,870
New finance leases			(103)	(354)
Translation difference			(1,109)	1,157
Amortisation of debt finance costs			(70)	–
Movement in net debt			(22,766)	8,673
Opening net debt			(30,008)	(38,681)
Closing net debt			(52,774)	(30,008)

Notes to the Consolidated Cash Flow Statement

for the year ended 31 October 2005

A. RECONCILIATION OF OPERATING PROFIT TO NET CASH FLOW FROM OPERATING ACTIVITIES

	<i>Continuing operations</i>	<i>Acquired operations</i>	<i>2005 Total operations</i>	<i>2004 Total operations</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Operating profit	16,324	742	17,066	16,927
Impairment of goodwill	3,000	-	3,000	-
Amortisation charge	1,607	-	1,607	1,555
Depreciation charge	4,087	16	4,103	3,229
Loss on sale of tangible fixed assets	8	-	8	128
Increase in stock	(5,549)	(147)	(5,696)	(1,169)
(Increase)/decrease in debtors	(854)	(251)	(1,105)	1,116
Increase/(decrease) in creditors	1,901	257	2,158	(7,324)
	<u>20,524</u>	<u>617</u>	<u>21,141</u>	<u>14,462</u>

B. ANALYSIS OF CASH FLOWS

	<i>£000</i>	<i>2005 £000</i>	<i>£000</i>	<i>2004 £000</i>
Returns on investments and servicing of finance				
Interest paid		(3,235)		(3,148)
Preference dividend paid		(4)		(4)
Dividend from associate		108		107
		<u>(3,131)</u>		<u>(3,045)</u>
Net cash outflow from returns on investments and servicing of finance				
		<u>(3,131)</u>		<u>(3,045)</u>
Capital expenditure				
Purchase of intangible fixed assets		(1,063)		(1,404)
Purchase of tangible fixed assets		(6,898)		(4,176)
Receipt from sale of tangible fixed assets		8		-
		<u>(7,953)</u>		<u>(5,580)</u>
Net cash outflow from capital expenditure				
		<u>(7,953)</u>		<u>(5,580)</u>
Acquisitions and disposals				
Acquisitions of subsidiary undertakings (see Note 25)		(23,448)		(580)
Net cash balance acquired with subsidiary undertaking		1,439		-
Receipts from sale of subsidiary undertaking/division		242		1,062
		<u>(21,767)</u>		<u>482</u>
Net cash (outflow)/inflow from acquisitions and disposals				
		<u>(21,767)</u>		<u>482</u>
Financing				
Issue of ordinary share capital		574		6,061
Capital elements of finance lease payments	(965)		(1,313)	
Debt due within one year:				
- bank loans	(3,165)		(5,057)	
Debt due within one year:				
- bank loans	30,097		1,892	
		<u>25,967</u>		<u>(4,478)</u>
Net cash inflow from financing		<u>26,541</u>		<u>1,583</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 2004</i>	<i>Cash flow</i>	<i>non-cash</i>	<i>movement</i>	<i>31 Oct 2005</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	9,933	(2,464)	-	305	7,774
Overdrafts	(17,463)	6,947	-	(228)	(10,744)
	<u>(7,530)</u>	<u>4,483</u>	<u>-</u>	<u>77</u>	<u>(2,970)</u>
Debt due within one year	(3,070)	3,165	(2,004)	(48)	(1,957)
Debt due after one year	(17,055)	(30,097)	1,934	(1,102)	(46,320)
Finance leases	(2,353)	965	(103)	(36)	(1,527)
	<u>(30,008)</u>	<u>(21,484)</u>	<u>(173)</u>	<u>(1,109)</u>	<u>(52,774)</u>

Other non-cash changes represent the movement of debt due after one year to within one year, and the amortisation of debt finance costs.

Notes to the Financial Statements

for the year ended 31 October 2005

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, energetics 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, except for the marine business, these demonstrate that no impairment has occurred. Accordingly no charge for impairment is required, other than for the marine business, for which a £3,000,000 impairment charge has been made.

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 from the date that commercial production commences.

Tangible fixed assets

Other than revalued land and buildings, tangible fixed assets are held at cost less accumulated depreciation. 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.

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

	<i>Continuing operations</i>	<i>Acquisitions</i>	<i>2005 Total operations</i>	<i>2004 Total operations</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Turnover by destination				
UK	24,362	1,605	25,967	20,774
USA	60,532	57	60,589	53,016
Australia	8,288	132	8,420	14,259
Europe	13,900	471	14,371	14,661
Rest of world	23,104	7	23,111	22,870
Total	130,186	2,272	132,458	125,580

	<i>Continuing operations</i>	<i>Acquisitions</i>	<i>2005 Total operations</i>	<i>2004 Total operations</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Turnover by origin				
UK	52,171	2,272	54,443	58,952
USA	72,097	-	72,097	59,555
Australia	4,288	-	4,288	5,609
Europe	1,630	-	1,630	1,464
Total	130,186	2,272	132,458	125,580

An analysis of turnover by business area is given in the summary financial information on page 1 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.

3. ANALYSIS OF OPERATING PROFIT

	<i>Continuing operations</i>	<i>Acquisitions</i>	<i>2005 Total operations</i>	<i>2004 Total operations</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Sales	130,186	2,272	132,458	125,580
Cost of sales	(93,101)	(1,009)	(94,110)	(92,178)
Gross profit	37,085	1,263	38,348	33,402
Operating expenses:				
Distribution costs	3,431	62	3,493	3,678
Administrative expenses	14,330	459	14,789	12,797
Impairment of goodwill	3,000	-	3,000	-
Total operating expenses	20,761	521	21,282	16,475
Operating profit	16,324	742	17,066	16,927

Notes to the Financial Statements

- continued

4. OPERATING PROFIT

	2005	2004
	£000	£000
Operating profit is stated after charging:		
Depreciation		
- owned assets	3,278	2,592
- leased assets	825	637
Impairment charge		
- goodwill	3,000	-
Amortisation		
- other intangible assets	1,607	1,555
Operating lease rentals		
- other	428	362
- plant and machinery	882	1,002
Loss on disposal of tangible fixed assets	8	128
Parent company audit fee	30	30

During the year £6,350,000 (2004: £6,030,000) of research and development costs were incurred by the Group, of which £1,063,000 (2004: £1,404,000) was capitalised (see Note 13).

	2005	2004
	£000	£000
Auditors' remuneration		
Services as auditors:		
Statutory audit	174	130
Audit-related regulatory reporting	27	27
Further assurance services:		
Tax compliance	93	86
Tax services:		
Tax advisory	100	88
Other non-audit services:		
Corporate finance	242	100
	<u>636</u>	<u>431</u>

Included within the above are £249,000 (2004: £118,000) of tax advisory and corporate finance fees relating to acquisitions and disposals.

5. 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 2004, payments totalling £10,756,000 had been received from the Group's insurers.

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. During the year the Group incurred costs of £147,000 in relation to the claim, which were written-off.

The balance of the claim that had not been recovered from the Group's insurance brokers at the year end was £2,796,000 (2004: £2,689,000), which has been included within other debtors. Foreign exchange movements of £107,000 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.

6. EMPLOYEES

The average number employed by the Group within each category of persons (including directors) was:

	2005 <i>Number</i>	2004 <i>Number</i>
Production	1,436	1,426
Sales and administration	218	207
	<u>1,654</u>	<u>1,633</u>

The costs incurred in respect of these employees were:

	£000	£000
Wages and salaries	36,454	35,723
Social Security costs	4,647	3,845
Other pension costs	3,073	2,969
	<u>44,174</u>	<u>42,537</u>

7. 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 16 to 21, and that information which is described as having been audited forms part of these audited financial statements.

8. 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.

Notes to the Financial Statements

- continued

8. PENSIONS – continued

Regular pension costs – SSAP 24

The total pension costs for the Group for the year ended 31 October 2005 were £3,073,000 (2004: £2,969,000).

Disclosures given relate to the Group as the pension assets and liabilities of the Parent cannot be separately identified. These costs include £1,004,000 (2004: £729,000) 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.

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 17) is £234,000 (2004: £252,000) 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 had 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 2005 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 2005 in accordance with FRS17, along with the expected rates of return on assets were as follows:

8. PENSIONS – *continued*

		2005		2004		2003
	<i>Long term rate of return expected</i>	<i>Value £000</i>	<i>Long term rate of return expected</i>	<i>Value £000</i>	<i>Long term rate of return expected</i>	<i>Value £000</i>
Equities	6.4%	16,007	6.8%	12,858	7.1%	12,395
Bonds	5.0%	11,440	5.4%	9,248	5.1%	7,195
Other assets	4.4%	478	4.8%	638	5.1%	731
Total market value of assets		27,925		22,744		20,321
Present value of scheme liabilities		(45,728)		(38,821)		(34,450)
Deficit in schemes		(17,803)		(16,077)		(14,129)
Related deferred tax		4,184		3,790		3,331
Net pension liability		(13,619)		(12,287)		(10,798)

If the FRS17 net deficit in respect of the two schemes of £13,619,000 at 31 October 2005 (2004: £12,287,000) 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 £26,096,000 to £12,477,000 (2004: £19,787,000 to £7,500,000).

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

	2005	2004	2003
Discount rate	5.5%	5.9%	6.1%
Rate of increase in salaries	3.9-4.9%	3.9-4.9%	3.9-4.9%
Rate of increase in deferred pensions	2.9%	2.9%	2.9%
Rate of increase in pensions in payment (where applicable)	2.9%	2.9%	2.9%
Inflation assumption	2.9%	2.9%	2.9%

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

	2005	2004	2003
	<i>£000</i>	<i>£000</i>	<i>£000</i>
Opening deficit in the schemes	(16,077)	(14,129)	(13,467)
Current service cost	(823)	(680)	(802)
Contributions	1,582	1,780	1,030
Other finance costs	(862)	(782)	(851)
Actuarial losses	(1,623)	(2,266)	(39)
Closing deficit in the schemes	(17,803)	(16,077)	(14,129)

Notes to the Financial Statements

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8. PENSIONS – continued

Amounts that would have been included within the financial statements for the year ended 31 October 2005 had FRS17 been applied are as follows:

Amounts included within operating profit:	2005	2004
	£000	£000
Current service cost	<u>(823)</u>	<u>(680)</u>
Amounts included as other finance costs:	2005	2004
	£000	£000
Expected return on scheme assets	1,438	1,331
Discount on scheme liabilities	<u>(2,300)</u>	<u>(2,113)</u>
Net charge	<u>(862)</u>	<u>(782)</u>

Amounts that would have been included within the statement of total recognised gains and losses for the year ended 31 October 2005 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.

	2005		2004	
	£000	%	£000	%
Difference between actual and expected return on scheme assets (i)	2,659	9.5	(372)	(1.6)
Experience gains and losses arising on scheme liabilities (ii)	(321)	(0.7)	(902)	(2.3)
Effects of changes in assumptions underlying the present value of the scheme liabilities (ii)	<u>(3,961)</u>	<u>(8.7)</u>	<u>(992)</u>	<u>(2.6)</u>
Total actuarial losses	<u>(1,623)</u>	<u>(3.5)</u>	<u>(2,266)</u>	<u>(5.8)</u>

9. INTEREST PAYABLE

	2005	2004
	Total	Total
	operations	operations
	£000	£000
Interest payable:		
Bank overdraft interest	1,282	1,466
Loan stock interest (see Note 18)	1	2
Medium term loan interest	1,487	1,333
Finance lease interest	120	272
Amortisation of debt finance costs	<u>70</u>	<u>-</u>
	<u>2,960</u>	<u>3,073</u>

10. TAX ON PROFIT ON ORDINARY ACTIVITIES

	2005 £000	2004 £000
Corporation tax:		
Corporation tax charge for the year	(65)	1,019
Overseas taxation	5,400	3,449
(Over)/under provision in prior years	(554)	383
Total current tax	4,781	4,851
Deferred tax:		
Timing differences – current year	(21)	(59)
Changes in discount	(61)	(225)
Under/(over) provision in prior years	245	(796)
Total deferred tax	163	(1,080)
Associate's tax	67	51
Tax on profit on ordinary activities	5,011	3,822

The standard rate of current tax for the year is 30%. The current tax charge for the year is higher (2004: higher) than 30% for the reasons set out in the following reconciliation:

	2005 £000	2004 £000
Profit on ordinary activities before taxation	14,303	13,315
Tax on profit on ordinary activities at standard rate	4,291	3,995
Factors affecting charge:		
Expenses not deductible for tax purposes net of tax credits	336	(162)
Capital allowances in excess of depreciation	11	(220)
Prior year adjustments	(554)	383
Overseas profits taxed at rates higher than the standard rate	697	576
Deferred tax movements	-	279
Total current year tax charge	4,781	4,851

11. DIVIDENDS

	2005 £000	2004 £000
Dividends on cumulative preference shares of £1 each		
Paid 30 April 2005 3.50p (2004: 3.50p)	2	2
Paid 31 October 2005 3.50p (2004: 3.50p)	2	2
	4	4
Dividends on ordinary shares of 5p each		
Interim paid 23 September 2005 3.20p (2004: 2.80p)	933	809
Final proposed 7.30p (2004: 6.20p)	2,130	1,797
Under provided in previous year	6	80
	3,069	2,686
Total dividends	3,073	2,690

Notes to the Financial Statements

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12. EARNINGS PER ORDINARY SHARE

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

	2005			2004		
	<i>Earnings</i>	<i>Ordinary shares</i>	<i>EPS</i>	<i>Earnings</i>	<i>Ordinary shares</i>	<i>EPS</i>
	<i>£000</i>	<i>Number</i>	<i>Pence</i>	<i>£000</i>	<i>Number</i>	<i>Pence</i>
	<i>000s</i>	<i>000s</i>		<i>000s</i>	<i>000s</i>	
Basic	9,275	29,075	31.90	9,504	28,521	33.32
Additional shares issuable other than at fair value in respect of options outstanding	-	125	(0.14)	-	160	(0.18)
Diluted	<u>9,275</u>	<u>29,200</u>	<u>31.76</u>	<u>9,504</u>	<u>28,681</u>	<u>33.14</u>

Earnings comprise profit for the financial year after deducting preference dividends of £4,000 (2004: £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 before impairment of goodwill:

	2005			2004		
	<i>Earnings</i>	<i>Ordinary shares</i>	<i>EPS</i>	<i>Earnings</i>	<i>Ordinary shares</i>	<i>EPS</i>
	<i>£000</i>	<i>Number</i>	<i>Pence</i>	<i>£000</i>	<i>Number</i>	<i>Pence</i>
	<i>000s</i>	<i>000s</i>		<i>000s</i>	<i>000s</i>	
Basic	9,275	29,075	31.90	9,504	28,521	33.32
Impairment of goodwill (see Note 13)	3,000	-	10.32	-	-	-
Basic - before impairment of goodwill	<u>12,275</u>	<u>29,075</u>	<u>42.22</u>	<u>9,504</u>	<u>28,521</u>	<u>33.32</u>

13. INTANGIBLE FIXED ASSETS

GROUP

	<i>Development costs</i>	<i>Goodwill</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>
Cost			
At 1 November 2004	5,842	27,984	33,826
Additions	1,063	14,964	16,027
Foreign exchange movements	17	-	17
At 31 October 2005	<u>6,922</u>	<u>42,948</u>	<u>49,870</u>
Amortisation			
At 1 November 2004	3,001	-	3,001
Charge for the year	1,607	-	1,607
Impairment charge	-	3,000	3,000
Foreign exchange movements	17	-	17
At 31 October 2005	<u>4,625</u>	<u>3,000</u>	<u>7,625</u>
Net book value			
At 31 October 2005	<u>2,297</u>	<u>39,948</u>	<u>42,245</u>
At 31 October 2004	<u>2,841</u>	<u>27,984</u>	<u>30,825</u>

The addition to goodwill arose on the acquisition of Nobel Energetics Limited (formerly Troon Investments Limited) (see Note 25). The impairment charge relates to a write-down of goodwill in respect of the non-core Marine division.

14. TANGIBLE FIXED ASSETS

(A) GROUP

	<i>Land and buildings £000</i>	<i>Plant and equipment £000</i>	<i>Total £000</i>
Cost or valuation			
At 1 November 2004	19,888	39,301	59,189
Additions	1,164	5,837	7,001
Acquisition of subsidiary undertaking	5,740	976	6,716
Transfer to assets for resale (see Note 17)	(633)	-	(633)
Disposals	-	(32)	(32)
Foreign exchange movements	441	958	1,399
At 31 October 2005	<u>26,600</u>	<u>47,040</u>	<u>73,640</u>
Depreciation			
At 1 November 2004	1,994	15,385	17,379
Charge for the year	408	3,695	4,103
Acquisition of subsidiary undertaking	-	219	219
Transfer to assets for resale (see Note 17)	(219)	-	(219)
Disposals	-	(16)	(16)
Foreign exchange movements	35	392	427
At 31 October 2005	<u>2,218</u>	<u>19,675</u>	<u>21,893</u>
Net book value			
At 31 October 2005	<u>24,382</u>	<u>27,365</u>	<u>51,747</u>
At 31 October 2004	<u>17,894</u>	<u>23,916</u>	<u>41,810</u>

(B) PARENT

	<i>Land and buildings £000</i>	<i>Plant and equipment £000</i>	<i>Total £000</i>
At 1 November 2004	1,168	541	1,709
Additions	-	20	20
Transfer to current assets (see Note 17)	(633)	-	(633)
At 31 October 2005	<u>535</u>	<u>561</u>	<u>1,096</u>
Depreciation			
At 1 November 2004	299	515	814
Charge for the year	31	14	45
Transfer to current assets (see Note 17)	(219)	-	(219)
At 31 October 2005	<u>111</u>	<u>529</u>	<u>640</u>
Net book value			
At 31 October 2005	<u>424</u>	<u>32</u>	<u>456</u>
At 31 October 2004	<u>869</u>	<u>26</u>	<u>895</u>

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14. TANGIBLE FIXED ASSETS – continued

(C) LAND AND BUILDINGS

	Group		Parent	
	2005	2004	2005	2004
	£000	£000	£000	£000
Land and buildings comprise:				
Freehold	25,432	18,720	-	-
Long leasehold	1,168	1,168	1,168	1,168
	<u>26,600</u>	<u>19,888</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	20,780	14,068	1,168	1,168
	<u>26,600</u>	<u>19,888</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:

	Group		Parent	
	2005	2004	2005	2004
	£000	£000	£000	£000
Cost	24,503	17,791	535	1,168
Accumulated depreciation	(2,495)	(2,307)	(111)	(302)
Historical cost value	<u>22,008</u>	<u>15,484</u>	<u>424</u>	<u>866</u>

All other tangible fixed assets are stated at historical cost. Included in plant and equipment are assets of net book value £3,165,000 (2004: £3,887,000) held under finance leases.

(D) FUTURE CAPITAL EXPENDITURE

	Group		Parent	
	2005	2004	2005	2004
	£000	£000	£000	£000
Contracted for but not provided for	<u>634</u>	<u>627</u>	<u>-</u>	<u>-</u>

15. FIXED ASSET INVESTMENTS

(A) GROUP

	<i>Trade investments £000</i>	<i>Associated undertaking share of net assets £000</i>	<i>Total £000</i>
At 1 November 2004	10	1,063	1,073
Retained profit of associated undertaking	-	130	130
Dividend received	-	(108)	(108)
Foreign exchange movements	-	(27)	(27)
At 31 October 2005	10	1,058	1,068

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

(B) PARENT

	<i>Shares in subsidiary undertakings £000</i>	<i>Shares in associated undertaking £000</i>	<i>Loans to subsidiary undertakings £000</i>	<i>Trade investments £000</i>	<i>Total £000</i>
Cost					
At 1 November 2004	32,323	13	6,250	10	38,596
Additions	8,000	-	-	-	8,000
Acquisitions (see Note 25)	22,976	-	-	-	22,976
At 31 October 2005	63,299	13	6,250	10	69,572
Provision for impairment					
At 1 November 2004	3,936	-	-	-	3,936
Charge for the year	3,000	-	-	-	3,000
At 31 October 2005	6,936	-	-	-	6,936
Net book value					
At 31 October 2005	56,363	13	6,250	10	62,636
At 31 October 2004	28,387	13	6,250	10	34,660

The Company subscribed for 5,000,000 new ordinary £1 shares in McMurdo Ltd for a consideration of £5,000,000 in cash on 25 October 2005 and 3,000,000 new ordinary £1 shares in Pains Wessex Safety Systems Ltd for a consideration of £3,000,000 in cash on 26 October 2005.

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15. 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
PW Defence Ltd	England	100	Energetics
McMurdo Ltd	England	100	Marine electronics
I.C.S. Electronics Ltd	England	100	Marine electronics
Nobel Energetics Ltd	Scotland	100	Energetics
Alloy Surfaces Company, Inc.	Delaware, USA	100	Countermeasures
Kilgore Flares Company LLC	Delaware, USA	100	Countermeasures and energetics
Pains Wessex Australia Pty Ltd	Australia	100	Countermeasures and energetics
Pirotécnia Oroquieta S.L.	Spain	51	Energetics
Associated undertaking			
CIRRA S.A.	France	49	Countermeasures

16. STOCK

	<i>Group</i>	
	2005	2004
	£000	£000
Raw materials	15,501	10,048
Work in progress	7,764	7,184
Finished goods	9,009	7,858
	32,274	25,090

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

17. DEBTORS

	<i>Group</i>		<i>Parent</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Trade debtors	23,204	20,511	12	53
Amounts owed by subsidiary undertakings	-	-	51,342	43,068
Group relief recoverable	-	-	2,112	3,210
Advance corporation tax recoverable	170	170	-	-
Deferred tax asset (see Note 21(B))	-	-	172	102
Assets for resale	414	-	414	-
Other debtors	5,416	4,752	1,670	1,151
Prepayments and accrued income	744	1,603	54	705
	<u>29,948</u>	<u>27,036</u>	<u>55,776</u>	<u>48,289</u>

Included within other debtors are amounts recoverable under an insurance claim relating to an incident at Kilgore Flares Company LLC (see Note 5).

Assets for resale represent buildings formerly classified as tangible fixed assets which are now classified as assets for resale, due within one year.

All amounts shown above are due within one year.

18. CREDITORS DUE WITHIN ONE YEAR

	<i>Group</i>		<i>Parent</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Bank overdrafts (see Note 19)	10,744	17,463	15,408	14,304
Bank loans (see Note 19)	1,957	3,030	1,957	2,367
Unsecured loan stock (see Note 19)	-	40	-	40
Trade creditors	17,079	14,957	507	244
Amounts owed to subsidiary undertakings	-	-	9,787	7,191
Other creditors	2,279	3,022	270	738
Obligations under finance leases (see Note 19)	925	1,234	-	-
Corporation tax payable	56	297	-	-
Overseas tax payable	1,094	2,643	-	-
Other taxation and Social Security	1,560	1,059	43	39
Accruals and deferred income	5,202	4,373	1,498	656
Proposed dividends	2,130	1,797	2,130	1,797
	<u>43,026</u>	<u>49,915</u>	<u>31,600</u>	<u>27,376</u>

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.

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19. CREDITORS DUE AFTER MORE THAN ONE YEAR

	<i>Group</i>		<i>Parent</i>	
	2005	2004	2005	2004
	£000	£000	£000	£000
Medium term loan - UK	44,027	12,951	44,027	12,951
- overseas	2,293	4,104	-	-
Obligations under finance leases	602	1,119	-	-
	46,922	18,174	44,027	12,951

The average interest rate applicable to the UK medium term loan is 6.1% (2004: 5.0%) and the average rate for the overseas medium term loan is 2.8% (2004: 4.1%) 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 in the above, total £398,000, with the remaining £204,000 falling due within two to five years.

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

	<i>Group</i>	
	2005	2004
	£000	£000
Bank loans and overdrafts	12,701	20,493
UK medium term loans		
- sterling denominated	29,282	5,783
- US dollar denominated	14,745	7,168
Overseas medium term loans		
- US dollar denominated	2,293	4,104
Obligations under finance leases		
- sterling denominated	629	1,195
- US dollar denominated	898	1,158
Unsecured loan stock	-	40
	60,548	39,941
Borrowings falling due within:		
One year	13,626	21,767
One to two years	6,236	6,709
Two to five years	27,766	11,006
After five years	12,920	459
	60,548	39,941

20. 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 19.

The total undrawn committed borrowing facilities at the financial year end amounted to £39,438,000 (2004: £20,381,000).

The Group had open forward foreign exchange contracts with a value of US\$9,172,000 at a weighted average exchange rate of US\$1.7399 and €1,900,000 at a weighted average exchange rate of €1.4062 as at 31 October 2005. A loss of £283,000 was recognised during the year as a result of marking to market these contracts.

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20. 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

	2005			2004		
	<i>Floating rate</i>	<i>Fixed rate</i>	<i>Total</i>	<i>Floating rate</i>	<i>Fixed rate</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Sterling	4,518	-	4,518	3,300	-	3,300
US dollar	10,979	-	10,979	10,384	-	10,384
Australian dollar	1,158	-	1,158	468	-	468
Euro	985	-	985	-	-	-
Other currencies	8	-	8	112	-	112
	<u>17,648</u>	<u>-</u>	<u>17,648</u>	<u>14,264</u>	<u>-</u>	<u>14,264</u>
Offset in the UK			<u>(9,874)</u>			<u>(4,331)</u>
			<u>7,774</u>			<u>9,933</u>
Disclosed as:						
Cash at bank and in hand			<u>7,774</u>			<u>9,933</u>

Financial assets held in the UK enjoy a right of interest off set against overdraft balances. Overseas financial assets have a weighted average interest rate of 1% (2004: 1%).

II) FINANCIAL LIABILITIES

	2005			2004		
	<i>Floating rate</i>	<i>Fixed rate</i>	<i>Total</i>	<i>Floating rate</i>	<i>Fixed rate</i>	<i>Total</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
Sterling	(34,398)	(10,191)	(44,589)	(13,201)	(9,385)	(22,586)
US dollar	(15,009)	(10,824)	(25,833)	(7,853)	(13,093)	(20,946)
Australian dollar	-	-	-	(740)	-	(740)
	<u>(49,407)</u>	<u>(21,015)</u>	<u>(70,422)</u>	<u>(21,794)</u>	<u>(22,478)</u>	<u>(44,272)</u>
Offset in the UK			<u>9,874</u>			<u>4,331</u>
			<u>(60,548)</u>			<u>(39,941)</u>
Disclosed as:						
Bank loans and overdrafts			<u>(12,701)</u>			<u>(20,493)</u>
Medium term loan	- UK		<u>(44,027)</u>			<u>(12,951)</u>
	- overseas		<u>(2,293)</u>			<u>(4,104)</u>
Obligations under finance leases	- UK		<u>(629)</u>			<u>(1,195)</u>
	- overseas		<u>(898)</u>			<u>(1,158)</u>
Loan stock			<u>-</u>			<u>(40)</u>
			<u>(60,548)</u>			<u>(39,941)</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 1.25% 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 2005 was 5.2% (2004: 5.5%) and the weighted average period of funding was three years (2004: 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 2005. 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 £12,000 lower (2004: £462,000 higher) than the book value. The Board has no intention of realising this asset/liability. The fair value of the financial assets is their book value.

21. 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 2004	3,431	626	4,057	340	340
Provided in the year	163	-	163	-	-
Transfer from current tax	663	-	663	-	-
Utilised in the year	-	(456)	(456)	(170)	(170)
Acquired with subsidiary undertaking	200	-	200	-	-
At 31 October 2005	<u>4,457</u>	<u>170</u>	<u>4,627</u>	<u>170</u>	<u>170</u>

In the Group and Parent 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.

(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>2005 £000</i>	<i>2004 £000</i>	<i>2005 £000</i>	<i>2004 £000</i>
Capital allowances in excess of depreciation	3,434	2,261	41	35
Other timing differences	1,908	1,994	37	135
Discount	(885)	(824)	(250)	(272)
Deferred tax provision/(asset)	<u>4,457</u>	<u>3,431</u>	<u>(172)</u>	<u>(102)</u>

22. CALLED-UP SHARE CAPITAL

	<i>2005 £000</i>	<i>2004 £000</i>
Authorised		
62,500 7% cumulative preference shares of £1 each	62	62
33,000,000 ordinary shares of 5p each	<u>1,650</u>	<u>1,650</u>
	<u>1,712</u>	<u>1,712</u>
Issued, allotted and fully paid		
62,500 7% cumulative preference shares of £1 each	62	62
29,177,576 (2004: 28,988,576) ordinary shares of 5p each	<u>1,459</u>	<u>1,449</u>
	<u>1,521</u>	<u>1,511</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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22. CALLED-UP SHARE CAPITAL - continued

Share options

The following options to subscribe for ordinary shares granted under the Company's share option scheme were outstanding at 31 October 2005.

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>
5 Feb 2003	100,000	2.285	5 Feb 2006 - 4 Feb 2013
8 Jul 2004	90,000	4.365	8 Jul 2007 - 7 July 2014
7 Apr 2005	52,798	4.735	7 Apr 2008 - 6 Apr 2015

23. RESERVES

(A) GROUP

	<i>Share premium account £000</i>	<i>Special capital reserve £000</i>	<i>Revaluation reserve £000</i>	<i>Revenue reserves £000</i>	<i>Total £000</i>
As at 1 November 2004	26,710	12,939	2,410	19,787	61,846
Ordinary shares issued	564	-	-	-	564
Retained profit for the year	-	-	-	6,206	6,206
Gains arising from foreign exchange translations	-	-	-	67	67
Transfer between reserves	-	-	(36)	36	-
At 31 October 2005	<u>27,274</u>	<u>12,939</u>	<u>2,374</u>	<u>26,096</u>	<u>68,683</u>

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

Included within revenue reserves is £1,045,000 of retained profits (2004: £1,050,000) relating to the associated undertaking.

(B) PARENT

	<i>Share premium account £000</i>	<i>Special capital reserve £000</i>	<i>Revenue reserves £000</i>	<i>Total £000</i>
At 1 November 2004	26,710	12,939	2,358	42,007
Ordinary shares issued	564	-	-	564
Loss for the year	-	-	(281)	(281)
Foreign exchange differences	-	-	(740)	(740)
At 31 October 2005	<u>27,274</u>	<u>12,939</u>	<u>1,337</u>	<u>41,550</u>

The share premium account and special capital reserve are not distributable. A loss after taxation of £281,000 (2004: £3,715,000) was recognised in the year by the parent company. Dividends of £7,361,000 were received in the year and dividends of £3,073,000 were payable.

24. OBLIGATIONS UNDER NON-CANCELLABLE OPERATING LEASES

	2005 Group		2004 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	205	207	352	695
Two to five years	672	771	425	1,374
More than five years	263	-	263	-
	<u>1,140</u>	<u>978</u>	<u>1,040</u>	<u>2,069</u>

25. ACQUISITIONS

Nobel Energetics Limited

The Group acquired all of the issued share capital of Nobel Energetics Ltd (formerly Troon Investments Ltd) on 1 September 2005. An analysis of the assets acquired is shown below:

	<i>Book value</i>	<i>Fair value adjustments</i>	<i>Fair value</i>
	£000	£000	£000
Tangible fixed assets	757	5,740	6,497
Stock	1,488	-	1,488
Debtors	1,637	-	1,637
Cash	1,439	-	1,439
Corporation tax liabilities	(1,637)	-	(1,637)
Other creditors	(1,212)	-	(1,212)
Deferred tax	(200)	-	(200)
Total net assets	<u>2,272</u>	<u>5,740</u>	<u>8,012</u>
Goodwill			<u>14,964</u>
			<u>22,976</u>
Consideration:			
Cash			22,703
Cash payable in future years			<u>273</u>
			<u>22,976</u>

The £273,000 cash payable in future years was paid on 25 November 2005.

The fair value adjustment is in respect of land and buildings which were valued by Jones Lang Lasalle, Chartered Surveyors, on 9 December 2005 on an existing use basis.

At the year end the goodwill is provisional and, in accordance with FRS10, will be updated if necessary in the twelve month period following acquisition.

Notes to the Financial Statements

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25. ACQUISITIONS - continued

I.C.S. Electronics Limited

Deferred consideration of £745,000 (2004: £580,000) was paid in the year.

Total cash payments in respect of acquisitions in the year were £23,448,000 (2004: £580,000).

26. SELF INSURANCE

During the year, the Group was 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.

Following the year end, insurance for public and products liability was placed entirely with external insurers. Insurance cover in respect of risks at levels over those disclosed above is also placed with external insurers.

27. POST BALANCE SHEET EVENT

The Group acquired the entire share capital of Comet GmbH on 30 November 2005 for a cash consideration of €9,600,000 (£6,600,000), subject to a working capital adjustment.

The Group reached agreement on 1 February 2006, subject to regulatory approval, for the acquisition of the entire capital stock of Technical Ordnance, Inc. for a cash consideration of \$70,000,000 (approximately £39,300,000), subject to a working capital adjustment.

The Group acquired the entire share capital of Leaffield Engineering Limited and Leaffield Marine Limited on 1 February 2006 for a cash consideration of £4,370,000, subject to a working capital adjustment and the assumption of £570,000 of bank overdrafts.

The above acquisitions were funded by additional medium term loans and by the issue of 2,900,000 new ordinary shares.



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