



CHEMRING GROUP PLC  
Financial Statements 2007



## Contents

Summary Financial Information	1
Financial Highlights	1
Results	2
Statement by the Chairman	3
Review by the Chief Executive	6
Review by the Finance Director	13
Business Review	16
Corporate Responsibility Report	23
Directors	26
Professional Advisers	28
Directors' Report	29
Directors' Remuneration Report	32
Statement on Corporate Governance	40
Independent Auditors' Report to the Members of Chemring Group PLC	45
Consolidated Income Statement	47
Consolidated Statement of Recognised Income and Expense	48
Consolidated Balance Sheet	49
Consolidated Cash Flow Statement	50
Notes to the Consolidated Cash Flow Statement	51
Notes to the Group Financial Statements	52
Independent Auditors' Report on the Parent Company Financial Statements	82
Parent Company Balance Sheet	84
Parent Company Statement of Total Recognised Gains and Losses	85
Notes to the Parent Company Financial Statements	86



## Summary Financial Information

Continuing operations	2007 £m	2006 £m	2005 £m
<b>Revenue</b>			
Countermeasures total	<u>126.5</u>	<u>118.4</u>	<u>90.8</u>
Energetics - continuing operations	107.8	69.3	30.2
- acquired	20.4	-	-
Energetics total	<u>128.2</u>	<u>69.3</u>	<u>30.2</u>
<b>Total revenue</b>	<u>254.7</u>	<u>187.7</u>	<u>121.0</u>
<b>Underlying operating profit*</b>			
- continuing operations	57.2	38.5	22.9
- acquired	4.0	-	-
<b>Total underlying operating profit*</b>	<u>61.2</u>	<u>38.5</u>	<u>22.9</u>
<b>Underlying profit before tax*</b>	53.2	32.5	19.2
<b>Operating profit</b>	57.8	37.8	22.9
<b>Profit before tax</b>	49.8	31.8	19.2
<b>Underlying basic earnings per ordinary share*</b>	112p	72p	47p
<b>Basic earnings per ordinary share</b>	105p	70p	47p
<b>Diluted earnings per ordinary share</b>	104p	70p	46p
<b>Dividend per ordinary share</b>	25.0p	16.0p	10.5p
<b>Net debt (£m)</b>	99.6	70.6	52.9
<b>Shareholders' funds (£m)</b>	124.0	94.1	56.9

\*Excludes intangible amortisation arising from business combinations of £3.4 million (2006: £0.7 million)

## Financial Highlights





## Results

### Continuing operations

Revenue

2007	2006
£m	£m

254.7	187.7
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Underlying operating profit\*

61.2	38.5
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Underlying profit before tax\*

53.2	32.5
------	------

Operating profit

57.8	37.8
------	------

Profit before tax

49.8	31.8
------	------

Underlying earnings per share\*

112p	72p
------	-----

Basic earnings per share

105p	70p
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\* Excludes intangible amortisation arising from business combinations of £3.4 million (2006: £0.7 million)



## Statement by the Chairman

I am delighted to report another year of outstanding performance following the excellent profits generated in 2006. Underlying profit before tax\* increased 64% and earnings per share increased 56% to £53.2 million (2006: £32.5 million) and 112p (2006: 72p) respectively. Profit before tax and earnings per share on continuing operations increased by 57% and 50% respectively. The Board is recommending a final dividend of 17.8p, giving a total for the year of 25.0p, an increase of 56% over last year.

Both our operating divisions, Countermeasures and Energetics, performed strongly and achieved record years.

The Group maintained its position as the world's leading manufacturer of countermeasure decoys, with over 50% market share, including a commanding presence in the vital US market. Our competitors, inevitably, challenge us at every opportunity but our recognition of their activities, the strength of our research and development and new products, and our investment in the latest manufacturing technologies continues to strengthen our order book for future years.

Our Energetics activities expanded rapidly through a combination of organic and acquisitive growth. This division now manufactures a broad portfolio of explosive and pyrotechnic ordnance, with twelve factories in seven countries. It has also become a vital supplier to the major prime contractors in a widely fragmented industry, whilst becoming a prime contractor in its own right. During the year the Group completed the acquisitions of Simmel Difesa in Italy, Dyno Nobel's High Energy Materials business in Norway (now trading as Chemring Nobel), and the remaining 49% shareholding in Pirotécnia Oroquieta in Spain. The total value of these acquisitions was £57 million, of which £50.2 million was satisfied in cash and £6.8 million by the issue of new shares in the Company.

Since the year end, the Group has acquired Richmond Electronics & Engineering Limited in the UK for £11 million. The acquisition was funded utilising existing bank facilities.

### BALANCE SHEET AND CASH FLOW

Our operating companies continued to deliver a very strong cash flow of £60.6 million (2006: £45.6 million), which has enabled us to fund the majority of acquisitions for debt, whilst maintaining a debt/equity ratio of 80% (2006: 75%) and interest cover on underlying operating profit\* of 8 times (2006: 6 times).

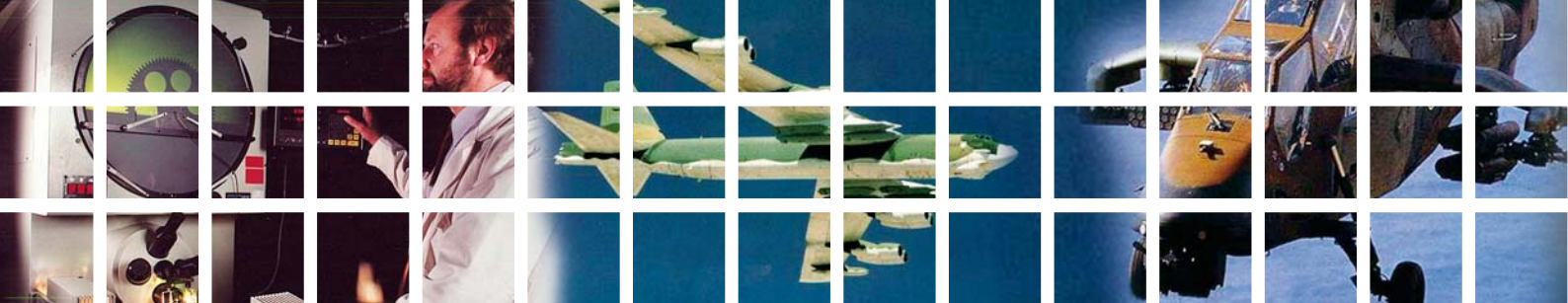


The Board has been cognisant for some time of the continuing development of our activities in the US, and the probability that the US would be a major source of both our organic and acquisitive growth in the future. Accordingly, in November 2007 the Company completed a \$150 million private placement in the US of ten year fixed interest loan notes, with an interest rate of approximately 6.30%.

### COUNTERMEASURES

During the year, Alloy Surfaces completed the commissioning of its third plant in the US. In the UK, Chemring Countermeasures, which has enjoyed considerable success with its new spectral flares and is the sole source supplier of countermeasure flares for the Typhoon, has commissioned a major new production plant at its base in Salisbury.

Kilgore's performance during the year was affected by composition difficulties in two products - not an unknown problem in our industry, and delays on product lot acceptances due to external factors in the final month of the year which affected revenue recognition. However, Kilgore has significantly increased its order book, particularly as it is the supplier of flares for the new Raptor and Joint Strike Fighter. This business is expected to have the greatest growth in the Countermeasures division over the next five years.



## Statement by the Chairman

(CONTINUED)

### ENERGETICS

At the half year, I stated that the Energetics division faced challenges in developing an effective organisational structure, rationalising production plants and strengthening its international sales capability. These objectives are ongoing. With regards to the organisational structure, the management has concentrated on finding appropriately qualified personnel, both at divisional level and in the individual subsidiaries, to promote our substantial product offering. The benefits of these appointments will start to come through in 2008. I am delighted to say that the production rationalisation programme is also progressing very well.

Our strategy to grow this division is proving successful, with revenue for the year now exceeding that of the Countermeasures division.

### GROUP STRATEGY

Our Group strategy remains unchanged. We will continue to concentrate on our two divisions - Countermeasures, where we are the world leader, and Energetics, where, in a sector with many fragmented businesses, we are becoming a major force. It is possible that, as this latter division expands, one of the individual product categories within it might justify its establishment as a separate third division.

Our intentions are to continue to grow organically and, where possible, by acquisition. We are committed to expansion in both divisions, and are currently planning to establish additional manufacturing facilities in certain chosen countries, including India and the Far East. I expect this latter development to take three to five years to achieve.

### HEALTH AND SAFETY

As previously reported, an explosion occurred at our Simmel Difesa site in Italy on 9 October 2007. Very regrettably, this resulted in one fatality and injuries to several other employees. The Board is committed to ensuring that incidents such as this do not recur in the future, and the provision of a safe working environment for all our employees remains a critical feature of the Group's development.

### THE BOARD OF DIRECTORS AND OTHER NON-EXECUTIVE APPOINTMENTS

There have been no changes to the composition of the Board since I last reported. I believe its current membership is appropriate for the size of the Group and the skills required for proper corporate governance. As we continue to grow, the directors will reflect on future requirements.

A number of our overseas subsidiaries are, of course, supported by non-executive directors appointed specifically for their contributions in individual countries. In the US, for example, our Group has the support of five prominent US citizens, three of whom are retired Generals or Admirals who contribute fully to the success of the US operations. The same philosophy is currently adopted in Australia, and is planned for Italy.

### PENSIONS

In previous reports I have stated my confidence that we would address future funding requirements for the Group's UK defined benefit pension plans without any material change to the financial contributions currently made by the Group, as we believe that the existing funds are adequate to meet their obligations. I am happy to report that the 2006 valuation for the Executive Pension Scheme has been successfully completed and submitted to the Pension Regulator. We hope to conclude our discussions with the trustees of the Staff Pension Scheme in the next few weeks.

The Group introduced a new defined contribution scheme for UK employees during the year, and take-up of membership has been very encouraging to date.



## DIVIDENDS

The Board is recommending a final dividend of 17.8p per ordinary share, a 59% increase on the final dividend for 2006. This, together with the interim dividend of 7.2p paid in July 2007, gives a total dividend for the year of 25.0p, a 56% increase over 2006. The dividend is over four times covered on net profits of the continuing operations. The shares will be marked "ex dividend" on 26 March 2008 and the dividend is payable on 18 April 2008 to shareholders on the register at the close of business on 28 March 2008.

## PROSPECTS

The Board remains committed to delivering total shareholder value, through the generation of strong after tax profits and a progressive dividend policy. Our strategy has already proved very successful, with over 50% earnings and dividend growth in both of the last two years. The Board believes it can continue with this strategy and produce further above average growth. Next year we expect to see continuing growth in our Countermeasures business, and the ongoing development of Energetics, as this division starts to realise its full potential. We believe the Group is ideally placed to participate in the consolidation of this fragmented energetics industry.

Inevitably, questions are often raised concerning the longevity of both the Iraq and Afghanistan conflicts. Adjustments in procurement will eventually take place but our healthy order book and knowledge of military requirements gives us confidence in our long term future. We look forward to the 2008 financial year and are confident that it will be another year of strong performance.

K C SCOBIE  
CHAIRMAN  
22 JANUARY 2008

\* Excludes intangible amortisation arising from business combinations of £3.4 million (2006: £0.7million)



## Review by the Chief Executive

### GROUP RESULTS

The Group performed strongly throughout the year and revenue from continuing operations increased 36% to £254.7 million. 16% of this growth was achieved from our existing businesses, 9% from the full year trading of acquisitions made in 2006 and 11% from the two acquisitions completed in 2007. The Countermeasures division increased its sales to record levels, in spite of a frustrating performance from Kilgore and the adverse impact of the continuing weakness of the dollar. The Energetics division had another excellent year, achieving an 85% increase in revenue, and for the first time generating revenue in excess of the Countermeasures division.

Underlying operating margins\* for the Group continued to improve and by the year end reached 24%. Enhanced automation, process improvements and the rationalisation of both products and manufacturing locations, particularly within the Energetics division, continued to improve our performance. Consequently, underlying operating profit\* rose strongly by 59% to £61.2 million.

The operating cash inflow during the year was excellent at £60.6 million, equivalent to a cash conversion rate from underlying operating profit\* of 99%. Capital expenditure increased 43% to £14.6 million as the Group continued to invest significantly in improved automation and additional manufacturing facilities. Investment in company funded research and development (R&D) also increased 69% to £5.4 million but still represented only 2.1% of Group revenue. This will be augmented in 2008 by a new five year research partnership with the Defence Academy and Cranfield University, which will focus on our longer term technology and product requirements.

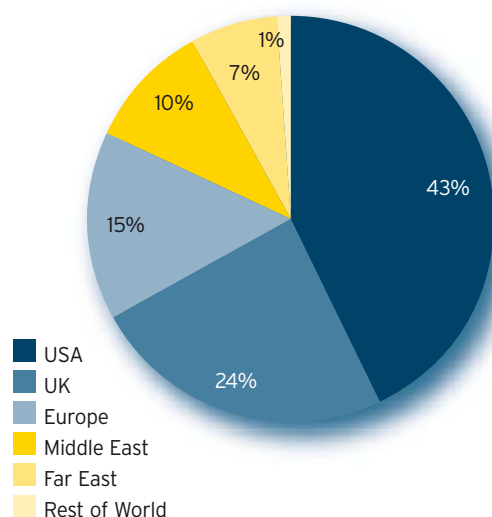
At the year end, the Group had an excellent order book of £297 million, some 39% higher than the previous year. This record level of order cover continues to underpin the prospects for 2008. I am also delighted to report that the order book for the Energetics division was £177.8 million, 111% higher than the previous year, creating a solid foundation for continued strong growth in the future.

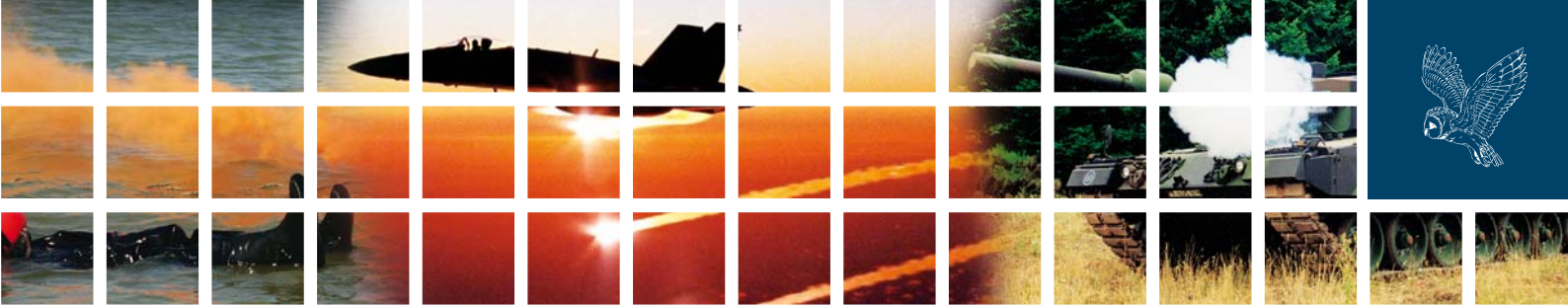


### HEALTH AND SAFETY

On 9 October 2007, an explosion occurred when a white light composition ignited whilst being mixed in a remote operation in a manufacturing building at the Simmel Difesa site in Colleferro, Italy. The product which was being made is used for the illumination of battlefields, and had been manufactured in the facility for more than ten years without incident. Tragically, there was one fatality, two non-life threatening injuries and nine people were taken to hospital suffering from shock and distress. A detailed investigation into the incident has been undertaken in full co-operation with the authorities, and we await the final conclusions from the authorities before access to the affected building is granted.

### Revenue by destination (2007)





As referred to last year, the Group is committed to achieving the highest levels of safety in both its products and its manufacturing facilities. Significant investment in automated manufacturing with remote operation continues, in line with our commitment to reduce operator risk, and all levels of management have been tasked with continuously improving our levels of safety. The Board remains focused on reducing the risks to as low a level as reasonably practicable, and will continue to invest in improved processes and the new capital facilities that can achieve this.

## COUNTERMEASURES

- Orders: £123.0 million
- Revenue: £126.5 million
- Operating profit: £38.6 million
- Operating margin: 30%

The global expendable countermeasures market continued to grow in 2007 and is now estimated at £237 million, an increase over the previous year of just over 10%, in spite of the adverse impact of the dollar depreciation against sterling of approximately 10%. Revenue from our Countermeasures division, however, grew by only 7% year-on-year, reflecting the slightly lower than expected sales volumes achieved by Kilgore in the second half of the year. The record demand for our decoys continues to be driven principally by the threat from shoulder-launched missiles to the helicopters and



transport aircraft used by the US, UK and other coalition forces in Iraq and Afghanistan.

Chemring Countermeasures, our UK business, had another excellent year, generating £31.1 million of revenue, which was 40% higher than the previous year. This growth was driven by the successful qualification and production of our new spectral flare for use by the UK and coalition partners. Construction and qualification of a new special purpose facility was achieved over a five month period, and full production output of in excess of 20,000 spectral flares per month was consistently delivered throughout the second half of the year - a tremendous achievement. During the year, further spectral flare variants were developed and flight-tested for combat and transport aircraft applications. We expect production of a number of these new flares to begin shortly.

Production of conventional flare types also reached record levels. The first batches of flares for Typhoon were delivered to all of the participating nations and a number of significant export contracts are expected shortly. We also continued to deliver chaff and flares to India as part of a multi-year contract for protecting the Indian Air Force Mirage 2000 aircraft. This contract follows on from our previous programme to supply the Indian Air Force with flares for its Mig-29 combat aircraft.

During the year, there was increased interest shown in naval countermeasures, particularly from NATO countries looking to operate in littoral waters. Chaff rounds were delivered to Spain and Australia, and advanced CHIMERA rounds were supplied to Norway. Furthermore, four new contracts for Spain, Norway, Romania and Chile were won against fierce competition. These successes have broadened our customer base and reflect our increasing market position for 130mm naval munitions.

Alloy Surfaces also had an excellent year, generating record levels of production and \$132.1 million of revenue, which was over 14% higher than in the previous year. Production of the M211 decoy for the US Army continued at a high rate and over 800,000 units were delivered to schedule throughout the year. Alloy Surfaces also secured a



## Review by the Chief Executive

(CONTINUED)

\$20 million contract from the UK Ministry of Defence for the supply of BOL/IR special material decoys for use on Harrier and Tornado aircraft, with a further \$20 million option to cover any surge requirement. Negotiations with the US Air Force, US Navy and US Army on multi-year contracts, covering seven of the eight most important special material decoys, have all started. The US Navy awarded an initial two year contract for the supply of MJU-49 decoys and has continued discussions to create a five year contract for all of its major products. The US Air Force and US Army negotiations for five year contracts have progressed but have been delayed by the protracted discussions on budgets that have taken place between the Department of Defense and Congress. These new contracts are all expected to be finalised during 2008.

Kilgore had a rather frustrating year, even though it generated a record level of revenue at \$67.4 million. This was 1% higher than last year but about \$15 million lower than expected.

Revenue growth was impacted as a result of two factors: Kilgore's high volume conventional flare programs encountered several minor manufacturing problems that took time to resolve, and the production of three new products encountered a number of technical problems associated with the start of volume manufacturing, including the lack of timely availability of test aircraft to complete the flight qualification.

In spite of these set backs Kilgore managed to capture a record \$98 million of orders, of which \$72 million related to its countermeasures business and \$26 million to its energetics business. This resulted in a year end order book of \$99 million, 44% higher than in 2006. This will provide a solid foundation for improvement in 2008. Kilgore was also hugely successful in securing, against fierce competition, a contract from the US Navy, for the manufacture of 100% of the advanced flares for the F-18 aircraft. A review of the design and technical data has now been completed and first article testing is scheduled during the first half of 2008.

Kilgore also successfully completed the first article test activities on the flares for the F-22 aircraft, as a direct contractor to the US Air Force. The first production deliveries have commenced on schedule, and construction of a high volume production facility is well underway, which should be completed by the end of the first half of 2008. A contract worth \$12 million for the second year of production was awarded in September 2007.

## ENERGETICS

- Orders: £172.0 million
- Revenue: £128.2 million
- Operating profit: £27.9 million
- Operating margin: 22%

During the year, the operational management of PW Defence in the UK, Comet in Germany and Pirotecnia Oroquieta in Spain was combined to create a pan-European pyrotechnic business, Chemring Defence, with a coherent sales network and new centres-of-excellence for manufacturing that are delivering benefits of scale on distinct families of products.

Chemring Defence UK had an excellent year, with record levels of production and revenue of £23.9 million, almost 100% higher than in 2006. Strong export growth was achieved in the Middle East with sales to Saudi Arabia, Kuwait, Bahrain and Qatar. The successful management of our first prime contract was a notable milestone during the year and has resulted in the placement of follow-on contracts. A major success was also achieved in the US towards the end of the year, when a five year IDIQ (indefinite delivery/indefinite quantity) contract, worth up to \$78 million, was placed by the US Army for 66mm non-lethal Vehicle-launched Discharge Grenades.

Chemring Defence Germany (formerly Comet) secured major contracts for both its ordnance-clearance and battlefield training products. The UK, Australia and several Eastern European countries all placed contracts for substantial numbers of the PEMBS ordnance-clearance system, which has now established itself as the leading portable ordnance-clearance system in the world. Our MECS (multiple effect cartridge system) battlefield simulation ammunition is now in-service with the US, UK, and a number of other countries. Our performance under the US Army contract is delighting the customer and deliveries are now running at about 700,000 units per year. Furthermore, the US Army has ordered 1,400 more launchers to increase training, and has recently qualified black and yellow smoke variants to broaden their weapon effects options. We have also recently completed development of an IED-simulator kit and a number of systems have been bought by the US Army for qualification purposes. This simulator is intended to be used at squad, platoon and company level for realistic training in urban operations, such as check point and convoy training.

The operational management of Nobel Energetics and Leaffield Engineering were also combined during the year to



form a new business, Chemring Energetics, which becomes the UK centre-of-excellence for demolition stores, ceremonial ammunition, detonators, actuators and pyro-mechanisms. The new business generated record revenue of £22.7 million, 22% higher than in 2006. Sales of metron actuators increased 36% and sales of demolition stores 35%, whilst sales of NLAW flight and launch motors increased 65% as full production was finally started. A rocket motor grain for 70mm air-launched rockets was also developed and is expected to complete qualification by April 2008.

Technical Ordnance also performed well in the first full year of ownership, with record revenue of \$45.6 million, compared with the \$34 million generated in the twelve months prior to acquisition. Good progress was made in the development of strategic partnering with the three US ammunition prime contractors, ATK, General Dynamics and L3. ATK, in particular, has significantly increased the volume of explosive pellet and fuze components ordered from Technical Ordnance. During the year, Technical Ordnance was awarded production contracts, from two prime contractors, for the supply of M55 detonators for use in 40mm rifle-launched grenades used by the US Army. Three new production stations are currently being qualified and are expected to achieve 900,000 units per month by the end of April 2008.

Kilgore increased its sales of pyrotechnics and munitions by 68% compared with 2006. During the year, Kilgore successfully completed factory acceptance test activities on the MK4 practice bomb cartridge, and produced and delivered over 450,000 units. Kilgore was also awarded a \$30 million, five year IDIQ contract for both the MK58 and the MK25 marine location markers directly from the US Navy.

BDL Systems also had a good year, completing its fourth contract to supply a Far Eastern customer with equipment and facilities for handling unexploded ordnance and roadside bombs. BDL Systems also completed development of its next generation initiation system (BREACH), which is primarily designed for the "explosive means-of-entry" market and makes use of the latest securely coded data transmission techniques. The system has attracted great interest in the US and NATO countries, and is expected to generate significant sales over the next few years.

Chemring Marine completed the consolidation of the manufacturing of marine distress signals in Germany during 2007. The increased volumes and the use of automated manufacturing has significantly improved efficiency and substantially improved the profitability of the business. During the year, two major worldwide agreements were signed with the major liferaft suppliers, Viking and RFD Beaufort, for the supply of our commercial distress signals.

In March, we announced the acquisition of Simmel Difesa, based in Colleferro, Italy. Simmel Difesa is a key supplier of energetics sub-systems, such as fuzes, safety and arming systems, warheads and modular charge systems, for major ammunition prime contractors around the world. The company is also a specialist manufacturer of medium and large calibre ammunition, rockets and illumination mortar rounds for a substantial number of NATO and non-NATO armed forces. It also has a second site in Anagni, Italy, where it has a specialist facility for the disposal of ordnance at the end of its operational life.

In spite of the accident in October, Simmel Difesa achieved all of its 2007 objectives and delivered all of the 81mm white light and black light illuminating mortar rounds





## Review by the Chief Executive

(CONTINUED)

required for use in Afghanistan. Production of the illumination canister will restart by the end of February 2008. A new multi-year contract for the continued supply of both types of illuminating ammunition is currently under negotiation. Simmel Difesa has also recently secured a major contract, worth €26 million, to supply high explosive anti-tank ammunition to a NATO country.

## FUTURE PROSPECTS

### Countermeasures

The market outlook for our expendable countermeasures business continues to be positive. Over the next three years, we believe that the global market is likely to expand at just over 20% per annum, driven by the continued demand from the US Army and the US Air Force's requirements for the protection of helicopters, transport aircraft and advanced flares for air-superiority combat aircraft.

In Iraq, the US "surge" operation appears to have enhanced security and allowed the Iraqi army to take over the majority of peacekeeping activities. The US Department of Defense has indicated that significant combat troop withdrawals may take place towards the end of 2008. However, the US still expects to support the Iraqi army with

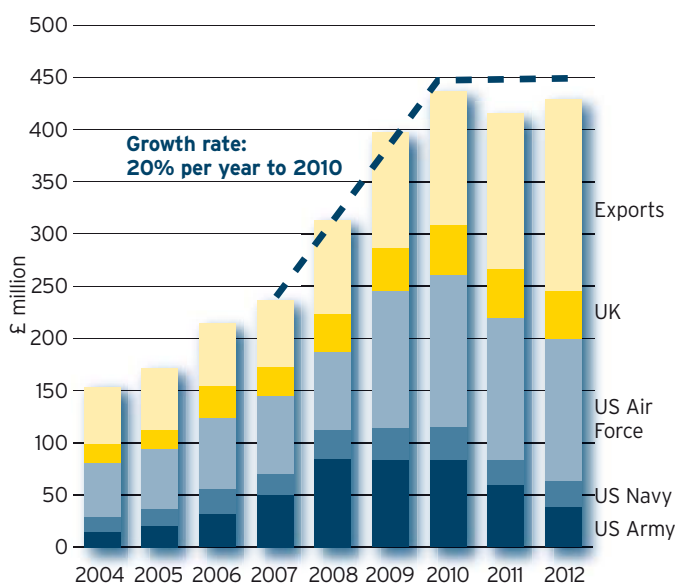


helicopters and transport aircraft for the movement of troops across the country, and to provide rapid reaction combat troops to support the Iraqis when required.

In Afghanistan, the number of NATO troops increased to 43,000 during the last six months, and are reported to be conducting extensive operations against the insurgents across the south of the country at the border with Pakistan. NATO commanders are also expected to bolster the force with additional troops currently allocated to Iraq. Both the

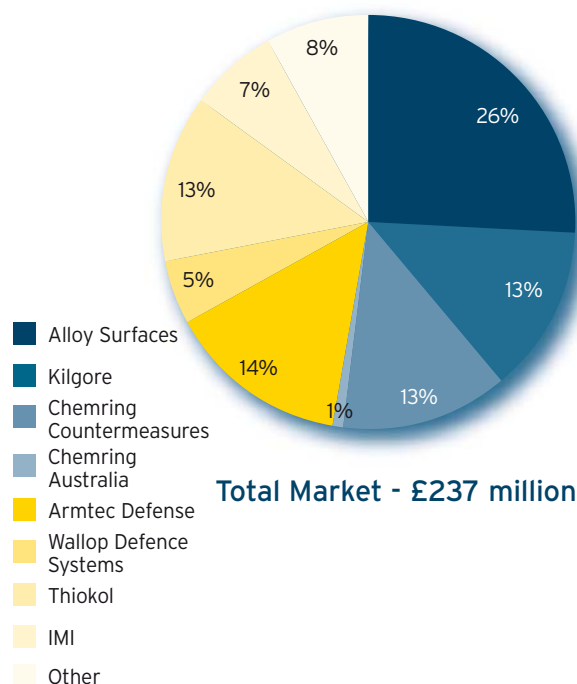
## OUTLOOK FOR COUNTERMEASURES

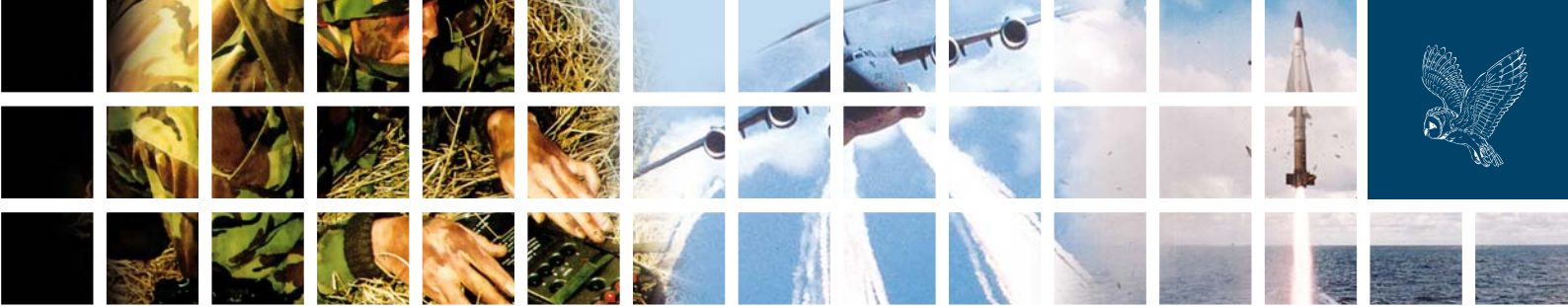
### Global Market



\*All figures based on program funding plans and estimates of key export markets

### Market Shares (2007)





UK Ministry of Defence and the US Department of Defense continue to stress the long term nature of these operations in Afghanistan.

Current UN operations, excluding Iraq and Afghanistan, now involve more than 140,000 troops. The deployment of helicopters and transport aircraft to support these operations will be needed to provide greater operational flexibility and effectiveness. Demand for decoys is, therefore, expected to continue.

A number of important aircraft will enter service over the next ten years. In Europe, the introduction of Typhoon will have a major impact on demand for decoys, particularly for advanced technologies against sophisticated surface-to-air or air-to-air threats. However, the biggest growth is expected to be in the US market where procurement of advanced flares for all its major combat aircraft, namely the F-18, F-22 and the F-35, is planned. The Group is the lead contractor for the manufacture of flares for all of these platforms and is, therefore, extremely well placed to exploit these opportunities as the requirements grow.

### **Energetics - Pyrotechnics and explosive ordnance disposal (EOD)**

The global market for pyrotechnics and EOD is estimated to be approximately £3 billion per annum. In 2007, the Group's revenue in this sector was £74.8 million, which represents a 2.5% market share. The market remains fragmented with a large number of small players, many of whom are nationally focused and with limited product ranges. There are, therefore, many opportunities for growth.



In battlefield training, the Group is building on its strong position with the MECS technology and is developing a low weight, modular battlefield effects simulator which is adaptable to combat vehicles for force-on-force training, as well as for simulating hits in force-on-target live fire training. Saab Training Systems have adopted the technology as standard and we are in discussion with the US Army on qualification for the US market.

The development of new initiator technology will also help BDL Systems to penetrate both the US and NATO EOD markets. BDL Systems is currently completing development of a new timer answer back system (TABS) that provides long-range two-way radio-frequency initiation with remote programmable time delay and reliable sterilisation capabilities. TABS and BREACH are expected to have a major impact on the global market over the next few years.



In November 2007, we announced the acquisition of Richmond Electronics & Engineering Limited. Richmond, which is based in the UK, is a supplier of EOD equipment which complements that provided by BDL Systems. It produces disrupters which fire a water jet or projectile into the firing circuit of an explosive device to neutralise it without detonation. Its patented recoilless disrupters and its proprietary laser-aimed weapons carriers are fitted to most of the leading US and UK bomb disposal robots.



## Review by the Chief Executive

(CONTINUED)



### Energetics - Munitions

The global market for munitions is approximately £10 billion per annum. In 2007, the Group's revenue in this segment was £53.4 million, representing only 0.5%. However, our acquisition of Simmel Difesa significantly enhances our position in the market, and we believe that there are major opportunities for growth at both the prime contract and component supplier level.

Simmel Difesa is a world leader in naval ammunition and is currently well placed to expand its position in the 76mm market over the next few years. Qualification of the 76/62mm naval round for the Franco-Italian FREMM programme is scheduled for early 2008 and production is expected to quickly follow. The Group is also working with Oto Melara and Alliant Techsystems to introduce an Insensitive Munition (IM) variant into the US market.

Simmel Difesa expects to complete qualification of its 155mm modular charge system in the first half of 2008. The Group expects there to be significant opportunities for this technology and is exploring a number of strategic partnerships to access key non-NATO markets.

Overall, the future outlook remains encouraging and many opportunities exist for growth. The Group has a strong order book, which today stands at a record level of £401 million, up 35% since the year end and up 63% since January 2007. The Board remains confident that the prospects for the Group in 2008 continue to be excellent.



*David Price*

DR D J PRICE  
CHIEF EXECUTIVE  
22 JANUARY 2008

\* Excludes intangible amortisation arising from business combinations of £3.4 million (2006: £0.7 million)



## Review by the Finance Director

### RESULTS

Revenue from continuing operations increased 25% to £234.3 million (2006: £187.7 million). Underlying operating profit\* from continuing operations increased 49% to £57.2 million (2006: £38.5 million). Net underlying operating margins\* from continuing operations were 24% (2006: 21%).

Revenue from acquired businesses was £20.4 million and £4.0 million of underlying operating profit\* was generated at a margin of 20%.

Total revenue was £254.7 million (2006: £187.7 million), an increase of 36%. Total underlying operating profit\* was £61.2 million (2006: £38.5 million), an increase of 59%.

The revenue of the Countermeasures division grew 7% and the operating profit grew 14%. The revenue of the Energetics division grew 85%, and the operating profit grew 168%.

The interest charge for the year was £8.1 million (2006: £6.1 million). Interest was covered 7.6 times (2006: 6.3 times) by underlying operating profit\*. Included with interest is £0.6 million (2006: £0.8 million) for retirement benefit obligations.



Underlying profit before tax\* was £53.2 million (2006: £32.5 million), an increase of 64%.

Tax on the underlying profit before tax\* was £17.1 million (2006: £10.1 million), representing a rate of 32% (2006: 31%).

Underlying profit after tax\* on continuing operations was £36.1 million (2006: £22.4 million), an increase of 61%.

An analysis of total revenue and operating profit by business segment is set out below:

Segment	Revenue £m	Operating profit £m	2007		Operating profit £m	2006
			Margin	Revenue £m		Margin
Countermeasures	126.5	38.6	30%	118.4	33.9	29%
Energetics	128.2	27.9	22%	69.3	10.4	15%
Share-based payments	-	(2.4)		-	(2.2)	
Unallocated head office costs	-	(2.9)		-	(3.6)	
	254.7	61.2	24%	187.7	38.5	21%
Amortisation of acquired intangibles	-	(3.4)		-	(0.7)	
<b>Total</b>	<b>254.7</b>	<b>57.8</b>	<b>23%</b>	<b>187.7</b>	<b>37.8</b>	<b>20%</b>

## Review by the Finance Director

(CONTINUED)

### DISCONTINUED OPERATIONS

The results of the discontinued operations represent those of the Marine division. In April 2007, the McMurdo Electronics business was sold to Signature Industries Limited for a consideration of £2.8 million. Further deferred contingent consideration of £1.0 million has been agreed, payable by the end of February 2008.

In December 2006, Leaffield Marine Limited was sold to its management for £0.4 million. In May 2007, I.C.S. Electronics Limited was sold to its management for £1.

A summary of discontinued results is set out below:

	2007 £m	2006 £m
<b>Revenue</b>	<b>3.8</b>	<b>11.3</b>
Pre-tax loss	(1.7)	(9.0)
Tax	(0.2)	0.9
<b>Post-tax loss</b>	<b>(1.9)</b>	<b>(8.1)</b>

The pre-tax loss includes £0.2 million of trading losses (2006: £1.0 million), and £1.5 million of impairment and loss on disposal charges (2006: £8.0 million).

### SHAREHOLDER RETURNS

Underlying basic earnings per ordinary share\* from continuing operations were 112p (2006: 72p), an increase of 56%. Basic earnings per share from continuing operations were 105p (2006: 70p), an increase of 50%. Total basic earnings per ordinary share for continuing and discontinued operations were 99p (2006: 44p), an increase of 125%.

The dividend per ordinary share of 25.0p (2006: 16.0p) is covered 4.2 times (2006: 4.3 times) by the post-tax profits of the continuing operations.

The total shareholder return for the Group over the five years to 31 October 2007 has exceeded the FTSE 250 Index return for the same period by 335%.

Shareholders' funds at the year end were £124.0 million (2006: £94.1 million).

### PENSIONS

The Group's pension deficit before associated tax credits, as defined by IAS19 *Accounting for pension costs*, was £13.3 million (2006: £16.3 million), a decrease of 18%.

The triennial valuation of the Executive Pension Scheme as at 6 April 2006 has been agreed with the trustees of the scheme.

The triennial valuation of the Staff Pension Scheme as at 6 April 2006 is in the process of being finalised.

### RESEARCH AND DEVELOPMENT

Research and development expenditure totalled £6.7 million (2006: £5.3 million), an analysis of which is set out below:

	2007 £m	2006 £m
Customer funded research and development	1.3	2.1
Internally funded research and development	4.1	2.5
Capitalised development costs	1.3	0.7
<b>Total research and development expenditure</b>	<b>6.7</b>	<b>5.3</b>

The Group's policy is to write-off capitalised development costs over a three year period. Amortisation of development costs was £0.6 million (2006: £0.4 million).

### ACQUISITIONS

During the year the Group acquired the following businesses:

	Date acquired	% of share capital acquired	Consideration (including costs) £m
Simmel Difesa S.p.A.	30 March 2007	100	53.3
Chemring Nobel AS - business and assets	29 June 2007		3.4
Pirotécnia Oroquieta S.L.	20 July 2007	49	0.3
<b>Total consideration</b>			<b>57.0</b>

The Group now owns 100% of Pirotécnia Oroquieta S.L.

Of the total consideration, £50.2 million was funded by the draw down of medium term local currency loans, and the balance of £6.8 million by the issue of 373,551 5p ordinary shares to the vendor of Simmel Difesa S.p.A.



A summary of the fair value of assets acquired and the goodwill arising on the acquisition of Simmel Difesa S.p.A. is as follows:

	2007 £m
Intangible assets	16.1
Fixed assets	3.9
Working capital	2.7
Tax and provisions	(6.7)
Cash (net of finance leases)	3.2
<b>Fair value of assets acquired</b>	<b>19.2</b>
Consideration (including costs)	53.3
<b>Goodwill arising</b>	<b>34.1</b>

## CASH FLOW

Operating cash flow was £60.6 million (2006: £45.6 million), which represents a conversion rate of underlying operating profit\* to operating cash of 99% (2006: 118%). Working capital balances were well controlled in the year and were kept below increases in Group revenues.

Group fixed asset expenditure was £16.0 million (2006: £12.0 million). The principal expenditure was in support of Alloy Surfaces' third facility, a large flare facility at Kilgore, and the purchase of freehold land and buildings at Technical Ordnance for £2.6 million.

Free cash flow was £32.6 million (2006: £23.0 million), which represents a conversion rate of underlying operating profit\* to free cash of 53% (2006: 60%).

A summary of Group cash flow is set out below:

	2007 £m	2006 £m
<b>Operating cash flow</b>	<b>60.6</b>	<b>45.6</b>
Capital expenditure	(16.0)	(12.0)
Tax	(12.0)	(10.6)
<b>Free cash flow</b>	<b>32.6</b>	<b>23.0</b>
Interest	(7.4)	(5.2)
Dividends	(6.0)	(3.7)
<b>Net cash inflow before acquisitions and disposals</b>	<b>19.2</b>	<b>14.1</b>

## NET DEBT

Net debt at the year end was £99.6 million (2006: £70.6 million), an increase of 41%.

Gearing at the year end was 80% (2006: 75%).

## SHARE CAPITAL

During the year 373,551 5p ordinary shares were issued to the vendor of Simmel Difesa S.p.A. to fund the acquisition.

82,500 5p ordinary shares were issued during the year on the exercise of employee share awards. The proceeds of these share issues were £0.1 million.

## FOREIGN EXCHANGE

During the year the US\$ depreciated against sterling quite significantly. The rates used in translating the results of the Group's US businesses are set out below.

	First half	Second half	Full year
2007 \$ to £1	1.98	2.00	1.99
2006 \$ to £1	1.76	1.86	1.81
Depreciation	13%	8%	10%

If 2006 rates had prevailed, the Group's revenue and operating profit would have been higher by approximately £11.8 million and £3.5 million respectively.

## POST BALANCE SHEET EVENTS

### Acquisition of Richmond Electronics & Engineering Limited ("Richmond")

On 5 November 2007, the Group purchased the entire ordinary share capital of Richmond for a consideration of £11 million. The consideration was satisfied by the issue of 50,107 new 5p ordinary shares and a balancing cash payment of £10 million. The cash payment was funded using existing bank facilities.

### US Private Placement

On 14 November 2007, the Group completed a \$150 million private placement of ten year fixed interest loan notes in the US with a number of institutional investors.

The loan notes, which mature in 2017, carry an interest rate of approximately 6.30%. The proceeds were used to repay existing dollar debt and provide additional working capital facilities for the Group.

P A RAYNER  
FINANCE DIRECTOR  
22 JANUARY 2008

\* Excludes intangible amortisation arising from business combinations of £3.4 million (2006: £0.7 million)

## Business Review

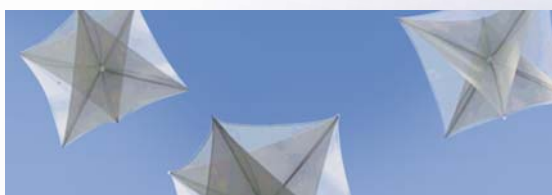
This Business Review, together with the Chairman's Statement, the Review by the Chief Executive and the Review by the Finance Director set out on pages 3 to 15, and the Corporate Responsibility Report set out on pages 23 to 25, provides a fair review of the Group's business development, performance and position at the end of the financial year; its strategy and likely future developments; key performance indicators; and a description of the principal risks and uncertainties facing the business.

### GROUP OPERATIONS

Chemring Group PLC is an international leader in expendable countermeasures and energetics, with manufacturing operations in the UK, the US, Europe and Australia.

#### Countermeasures

The Group is the world's leading producer of expendable decoy countermeasures for protecting air, sea and land platforms against guided missile threats. Our countermeasures products can be categorised as follows:



#### Air Countermeasures

- Conventional MTV Flares
- Special Material Decoys
- Chaff

#### Naval Countermeasures

- RF Decoys
- IR Decoys





## Energetics

The Group is a centre of excellence for the design, development and production of energetic materials and sub-systems for military, OEM and safety customers. Our energetics products can be categorised as follows:



## Pyrotechnics and Explosive Ordnance Disposal (EOD)

### Military Pyrotechnics

- Smoke and Flares
- Distraction and Screening Grenades
- Markers
- Smoke Payloads
- Battlefield Simulation Products
- Impulse Cartridges and Cartridge Activated Devices

### Demolition Stores

- RF and Hard-wired Electrical Initiators
- Percussion Initiators
- Detonators and Charges
- Minefield Clearance Systems
- Recoilless De-armers/Disrupters
- ROV Weapon Carriers

### Marine Pyrotechnics

- Smokes and Flares
- Rockets
- Line Throwers

### Aircrew Egress

- Rocket Propellant
- Canopy Cutting Charges
- Linear Explosives
- Cartridge Actuated Devices

## Munitions

### Energetics Sub-Systems

- Propellants and Rockets
- Fuze and Safe/Arm Units
- Flight Termination Systems
- Pyro-mechanisms and Actuators
- Warheads and Charges
- Primers

### Ammunition and Components

- Medium and Large Calibre Ammunition
- Fuzes
- Propellants
- Manufacture of Base High Explosives
- Insensitive HE Material

## Business Review

(CONTINUED)

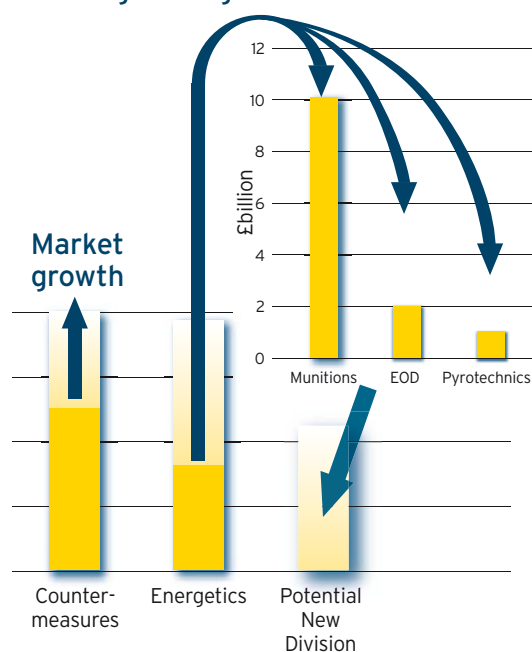
### STRATEGY

#### Group strategy

The Group strategy remains focused on our two core sectors of operations - Countermeasures and Energetics.

**"OUR VISION IS TO BE THE LEADING PRODUCER OF COUNTERMEASURES AND ENERGETIC MATERIALS FOR THE GLOBAL DEFENCE MARKET."**

#### Organic and acquisitive growth in three large Energetics markets



#### Countermeasures strategy

The core strategy for the Countermeasures business is to maintain our market share and to exploit the continuing market growth expected over the next five years. We intend to increase our investment in new products and technologies, and to build on our current leadership in special material, spectral and kinematic flare technologies. We will continue to invest in new fully automated production facilities that will improve operator safety, significantly enhance our operational efficiency, and maintain our lead role in the development of new products for the next generation of fixed wing and rotary aircraft.

#### Energetics strategy

We intend to expand our Energetics division, with new acquisitions in both the US and Europe. We will become the clear world leader in pyrotechnics by focused investment in new products and by consolidation of the market through carefully selected bolt-on acquisitions. We will build on our expertise in explosive ordnance disposal and will become the world leader in demolition stores, particularly targeting the US market. We will also focus on becoming the preferred supplier of energetic materials to the key prime contractors in both the US and Europe for ammunition and missiles. This will be achieved by investment in new products, by targeted competition against single source suppliers and by further acquisitions. We will also maintain our position as the world leader in naval ammunition, and our focus as a prime contractor in special niche markets that are complementary to those of our principal customers.

Our geographic strategy remains unchanged. We intend to manufacture in the US for the US market and in Europe for the European market. We will then use our excellent worldwide sales network to export from both the US and Europe. We will also develop our capabilities to bundle third party products and offer a broader supply chain management service to our export customers.

### STRENGTHS AND RESOURCES

The Group has core competencies in the design and manufacture of energetic materials; the development of highly reliable and safe products; and volume manufacturing.

#### Market position and reputation

The Group is the world's leading manufacturer of countermeasure decoys, with over 50% market share. The special material decoys manufactured by our US countermeasures business are unique to the Group, and we are currently leading the field in the development and manufacture of other advanced technology products, such as spectral or kinematic decoys.

In our growing Energetics division, we are developing a prominent position in several niche market areas, and building on the Group's reputation as an expert manufacturer of products containing energetic materials.

#### Customer relationships

The Group has an extensive customer base, comprising governments, armed forces, prime contractors and OEMs across the globe. The US Department of Defense is our



largest single customer. We have an extensive distribution network and, with worldwide market access, our businesses currently supply to over eighty countries.

### Manufacturing operations

The Group continues to benefit from significant efficiency improvements achieved through enhanced automation and rationalisation of manufacturing capabilities across the Group, and we have an ongoing investment plan for new plants and technologies. Our operational structure is now geared to leverage strongly from future sales growth.

### Solid financial base

The Group enjoys healthy operating margins across its businesses. Our focus on working capital management in recent years has manifested itself in excellent cash conversion and produced a sound balance sheet for the Group.

### Management

Management resource and expertise have been strengthened at all levels across the Group during the last three years, and we continue to develop our operational skills to ensure that we remain a world class manufacturer. We have an experienced team working on business development and acquisitions, and we are focusing heavily on our post-acquisition plans to ensure that new acquisitions are effectively integrated within the Group and we achieve maximum value from our growth strategy.

## OPERATING PERFORMANCE

Continuing operations	2007 £m	2006 £m
<b>Revenue</b>		
Countermeasures	126.5	118.4
Energetics	107.8	69.3
- continuing	20.4	-
- acquired	128.2	69.3
<b>Total revenue</b>	<b>254.7</b>	<b>187.7</b>
<b>Underlying operating profit*</b>		
- continuing	57.2	38.5
- acquired	4.0	-
<b>Total underlying operating profit</b>	<b>61.2</b>	<b>38.5</b>
<b>Operating profit</b>	<b>57.8</b>	<b>37.8</b>
<b>Underlying profit before tax*</b>	<b>53.2</b>	<b>32.5</b>
<b>Profit before tax</b>	<b>49.8</b>	<b>31.8</b>
<b>Underlying basic earnings per ordinary share*</b>	<b>112p</b>	<b>72p</b>
<b>Basic earnings per ordinary share</b>	<b>105p</b>	<b>70p</b>

\* Excludes intangible amortisation arising from business combinations of £3.4 million (2006: £0.7 million)

## Business Review

(CONTINUED)

### KEY PERFORMANCE INDICATORS

The Group's strategy is underpinned by focusing on a number of key financial performance indicators. The key indicators that the Board utilises to assess Group performance are set out below. Similar indicators are used to

review performance in the two divisions.

The Board considers the measurement of underlying and divisional operating profit provides additional useful information to users.

#### Orders received and order book

Continuing operations	Orders received		Order book	
	2007 £m	2006 £m	2007 £m	2006 £m
Countermeasures	123.0	173.7	119.5	130.4
Energetics	172.0	95.1	177.8	84.2
<b>Total</b>	<b>295.0</b>	<b>268.8</b>	<b>297.3</b>	<b>214.6</b>

The closing order book at the year end of £297.3 million represents a 39% increase on the previous year end. This reflects the significant increase in demand for the Group's products during the year, and provides a solid base for performance in the current financial year.

#### Interest cover

	2007	2006
<b>Total</b>	<b>7.6 times</b>	<b>6.3 times</b>

Interest was covered 7.6 times by underlying operating profit\* at the year end. The Board aims to keep interest cover at a prudent level.

#### Operating profit\*\*

Continuing operations	2007 £m	2006 £m
Countermeasures	38.6	33.9
Energetics	27.9	10.4
<b>Total</b>	<b>66.5</b>	<b>44.3</b>

\*\* Operating profits of the divisions are stated before charges for share-based payments, unallocated head office costs and intangible amortisation arising from business combinations

The operating profit on continuing operations increased by 50% during the year, reflecting the strong operating performance of both divisions.

#### Operating cash flow

	2007 £m	2006 £m
<b>Total</b>	<b>60.6</b>	<b>45.6</b>

Group operating cash flow increased by 33% to £60.6 million during the year. This represents a conversion rate of underlying operating profit\* to operating cash of 99%.

#### Return on sales

Continuing operations	2007 %	2006 %
Countermeasures	30	29
Energetics	22	15
<b>Total</b>	<b>26</b>	<b>24</b>

The return on sales percentage increased by 8% during the year. This growth is driven by improved automation, increased process efficiencies, and rationalisation of manufacturing facilities.

### PRINCIPAL RISKS AND UNCERTAINTIES

As described on pages 43 and 44, the Board is responsible for the Group's systems of internal control and its risk management systems. The Board has constituted a Risk Management Committee, which meets quarterly, to review the key risks associated with the achievement of the annual budget and the five year plan for each business, and the risk control procedures implemented. The Committee reports biannually to the Board and, through this process, the Board has identified the following principal risks currently facing the Group. The Group mitigates its risk exposure through an insurance programme that covers property and liability risks, where it is appropriate and cost effective to do so.



## Health and safety risks

The nature of the Group's operations, involving energetic materials, is such that the Board considers health and safety to be a key area of focus in managing risk. Accordingly, health and safety is included on the agenda at every Board meeting and is also discussed at the monthly Group Executive Committee meeting. The Board believes that responsibility for the delivery of world class safety standards is an integral part of the operational management accountability, and managers are therefore expected to embrace a positive safety culture and to demonstrate leadership and commitment in the workplace. All employees are encouraged to report potential hazards, and to raise any health and safety concerns through the appropriate channels.

Quarterly health and safety meetings are held in Europe and the US, chaired by the Managing Director of the Energetics division and the President of our US operations respectively. These supplement the regular health and safety meetings held at each operational site, which are chaired by the President or Managing Director of the site.

Our stated aim is to achieve zero injuries and to reduce health and safety risks, where they cannot be eliminated altogether, to a level which is "as low as reasonably practicable". All businesses are expected to proactively manage their own risks but in addition, the top five site risks at each business and their associated mitigation programmes are reviewed on a monthly basis by the Group Executive Committee. Technology and automation roadmaps were developed during the year to support the Group's strategy for risk reduction through increased automation and remote operations included within its five year plan.

On 9 October 2007, an explosion occurred at Simmel Difesa in Colleferro, Italy, that tragically led to the death of one employee and injuries to several others. Simmel Difesa has worked very closely with the relevant authorities, its workforce and the unions on the investigation into the incident. Interim findings have been issued periodically, and circulated to all other businesses in the Group who use energetic materials to ensure a consistent approach to the issues highlighted. A controlled, phased restart of production in the undamaged areas of the Colleferro site is underway.

Further details on the Group's approach to health and safety are set out below.

## Introduction of new products

The Group's innovative approach and continued research and development activity ensure that we are continually adding new products to the range. During the year, our position was further strengthened in this area by the demand for our countermeasures on a range of new platforms.

In order to satisfy these requirements, we need to ensure that new product development is completed in a timely manner to a standard which allows us to undertake volume manufacturing, and to produce products against high reliability and safety criteria to meet our customers' requirements. New manufacturing facilities have been established in the year to accommodate the production of these new products, and in other areas, there has been a requirement to significantly increase capacity on our existing production lines. This necessitates careful management of contractors - where construction work is being undertaken, suppliers - where new components have to be qualified for use in our products, and employees - where training in new skills is required. We continue to introduce Six Sigma techniques as appropriate within the organisation to improve our manufacturing capabilities. This investment in new facilities is ongoing.

## Competitors

The nature of the threat from missiles and other weapons is continually changing, particularly as new platforms are introduced in different countries, and countermeasures solutions need to develop on an ongoing basis to meet the enhanced requirements. The number of countermeasures manufacturers is currently small but as technologies change, existing manufacturers compete for new products and new businesses can enter into the market. The Group is currently the world leader in the supply and manufacture of expendable countermeasures, with a number of proprietary products, and we intend to maintain this position through our continued investment in research and development, and world class manufacturing facilities.

## Product design changes

Many of the Group's products are required to be modified and updated on a regular basis to meet our customers' changing requirements. There is inevitably risk associated with the implementation of product design changes, and whilst a review of the design change and product modification process in operation at each site was undertaken last year, further process improvements continue to be driven by the Group management.



## Business Review

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### Technology transfers

The formation by the Group of centres-of-excellence for the production of energetic materials has generated considerable interest from major prime contractors in both the US and Europe, who are looking for strategic partners. Progressing the development of these relationships and securing the transfer of technologies from these large prime contractors is a key objective for the Group over the next five years. Accordingly, the Group has been recruiting new personnel to manage these activities, and reviewing manufacturing capabilities and investing capital where necessary, to ensure that we mitigate the risk associated with the technology transfers and maximise the opportunities that are presented.

### Management of prime contracts

The Energetics division now has substantial prime contracts with a number of countries, and is planning to secure more. The contracts provide for the supply of an extensive range of our own and third party products over the next three years, and require a particular type of programme management expertise. Dedicated programme

managers have been appointed, with a reporting chain through to the Group Executive Committee, which undertakes a regular high level review of programme status and supply chain issues. We are also in the process of appointing additional personnel with specialist knowledge of the management of offset requirements and complex export compliance issues for this growing area of business.

### Political risks

It is anticipated that the nature of the military activities in Iraq and Afghanistan may change over the next three to five years. We do not believe that the Group's countermeasures business will be significantly impacted by this, as our products will still be required to provide defensive protection. Growth in the countermeasures business will be delivered as our proprietary products are fitted to a range of new platforms in the US and Europe.

Our energetics activities are less dependent on the current military activity in Iraq and Afghanistan, particularly as our product portfolio continues to grow in areas such as training and explosive ordnance disposal.



# Corporate Responsibility Report

## CORPORATE RESPONSIBILITY MANAGEMENT AND ACCOUNTABILITY

The Board fully acknowledges its obligation to ensure the responsible operation of the Group's businesses at all times with due regard to the interests of shareholders, employees, customers, suppliers and the wider community. The Board has overall responsibility for establishing and maintaining the Group's policies in this area, and the Chief Executive is accountable to the Board for ensuring that the Group's businesses adhere to these policies.

## BUSINESS CONDUCT

The Group has adopted a Code of Business Conduct, which requires our employees and our businesses to comply with applicable laws and regulations in all of the countries in which we operate. The managing directors of each business are required to report to the Chief Executive on compliance with the Code of Business Conduct on an annual basis.

Our US businesses are currently in the process of implementing an ethical compliance programme to satisfy new US Government requirements for ethical training for employees, compliance audits, an employees' "hotline", and related investigation procedures.

Arrangements exist by which all employees may, in confidence, raise concerns about possible improprieties.

## POLICY ON THE SALE OF GOODS AND SERVICES

The Group's strategy is to become the world leader in the manufacture of energetic material products for the global defence market, and we are presently delivering significant growth in this area through a combination of organic development and acquisitions. The scope of the Group's activities has significantly widened over the last few years, particularly with regards to the supply of components and sub-systems for various types of munitions, and there is increasing demand for the supply to our customers of third party products. Consequently, the Board introduced a Policy on the Sale of Goods and Services during the year, which provides guidance to all stakeholders on the products and services that the Group will supply and to which customers, and sets out a clear definition of what we will not supply.

## HEALTH AND SAFETY

The Board recognises that the highest levels of safety are required in order to protect our employees, whilst achieving

growth and maintaining leadership in the Group's chosen markets. The Board believes that all injuries are preventable, and management systems and a long term strategy have been adopted to ensure that we continually improve our performance and reduce risk within the constraints of what is reasonably achievable.

The Board requires that all businesses systematically manage their health, safety and environment hazards, set objectives, monitor progress by regular measurement, audit and review, and take additional action where necessary. Each Managing Director is responsible for the management of health, safety and environmental issues within their business and for providing adequate resources to satisfy the Board's requirements. The Group management and business heads have regular meetings to ensure that all these objectives are being met. We also ensure that all sites handling energetic materials are subjected to annual audits. The audits of the US businesses were strengthened in the year by the addition of OSHA "type" inspections and process safety management audits.

We recognise that a key element in the continual improvement of health, safety, and environmental management is sharing best practice and lessons learnt from incidents across all of the Group companies. A common incident reporting and investigation procedure is in place, as well as an alert system that formally ensures key findings from incidents are quickly communicated to all operational sites and actions taken as appropriate. All accidents and near misses are investigated. An annual Group HS&E Conference is attended by representatives from all businesses.

In addition to the introduction of ISO14001, the development of automated production and other plans to address principal risk areas during the year, all operational sites reported a number of improvements to health, safety and environmental management and performance. In particular:

- Kilgore achieved more than 2.7 million hours worked without a lost time accident
- Technical Ordnance were given the "South Dakota Governor's Safety Meritorious Award"
- Chemring Defence UK, Derby, and Chemring Countermeasures, Salisbury, both halved their number of lost time accidents compared to the previous year

The Board monitors health and safety performance through the quarterly reporting of Key Performance Indicators, which include lost time accidents, "near misses" and action management. These were reviewed during the

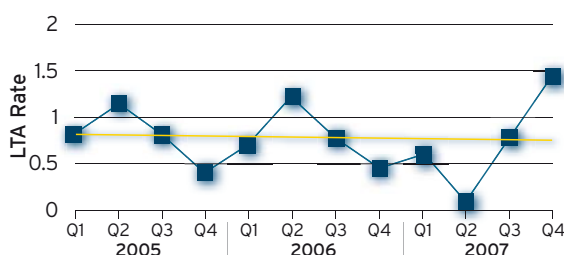
## Corporate Responsibility Report

(CONTINUED)

year and have been expanded this year to include data on employees placed on restricted duties due to work-related injuries. In addition, the Chief Executive reports monthly to the Board on all key health and safety issues.

During the year under review, the overall Group lost time accident rate remained unchanged from last year at 0.76 per 100,000 hours. However, this figure includes the eleven lost time accidents which occurred as a result of the explosion at Simmel Difesa in October 2007. The lost time accident rate excluding this incident was 0.54 per 100,000 hours, a reduction of 29% compared to last year across the rest of the Group, and a 44% reduction from 2005.

### Lost time accident rate per 100,000 hours



In October 2007, in order to drive further improvements in the management of health and safety within the Group, the Board set the goal of generating an overarching corporate framework and implementing a common safety culture across the Group. A project team has been established with the initial remit to review effectiveness and efficiency of Group and divisional health and safety management arrangements, and to review the current health and safety culture. These reviews will result in a series of actions aimed at the development of a common culture initially in the UK, then Europe, and then in the US.

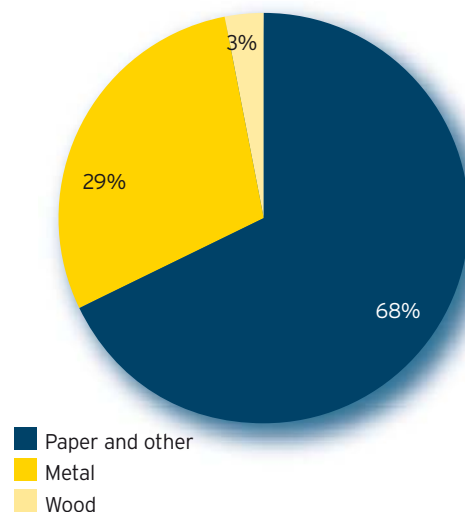
We are aiming for all operational sites to achieve certification to the OHSAS 18001 safety and health management system by the end of 2008.

## ENVIRONMENT

The Board believes that environmental protection will help to secure the long term future of our businesses. The Group's Health, Safety and Environment Policy states that we will control pollution, minimise the quantity of material burnt at each site, consume resources efficiently, and use materials that minimise the environmental impact of our operations where practicable.

We are continually improving our waste management and percentage of waste recycled. During the year, the Group recycled approximately 83% of its general waste and 78% of hazardous waste, compared to 76% of a combination of both last year. All businesses are tasked with achieving further improvements to their recycling proportion.

### Recycled general waste proportions



The Board monitors environmental performance through the quarterly reporting of Key Performance Indicators, which include energy use, waste management and recycling. For the current year, the Group will put in place formal mechanisms for calculating CO<sub>2</sub> contributions from direct and key indirect sources, such as international travel. The table below provides an estimate of our direct CO<sub>2</sub> contributions from the usage of electricity and gas and the burning of oil at our sites during the year under review.

### Tonnes CO<sub>2</sub> Equivalent

Electricity	21,556
Gas	11,931
Oil	2,878
<b>Total</b>	<b>36,365</b>

Last year we reported that we were aiming for the majority of sites to be certified to the environmental management system ISO14001 by the end of 2007. Seven of the ten operational sites achieved this goal, and we are planning



for the remainder, plus the three newly acquired businesses, to complete their certification by the end of this year. Certification provides the businesses with a strong foundation for continual improvement.

## EMPLOYEES

The Board recognises the valuable contribution that the Group's employees make to its success, and aims to provide a working environment that reflects and rewards this. During the year under review, the Group employed an average of 2,592 employees in seven countries.

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. We plan to introduce a Group magazine over the forthcoming year.

We continue to address training and development requirements for employees at all levels within the organisation. We are in the process of implementing a tailored management development programme for senior managers in the Group. Succession planning and the future organisational structure of the Group as it continues to grow are reviewed on a regular basis by the Board.

The Board is seeking shareholder approval for the establishment of an SAYE share option scheme at the forthcoming Annual General Meeting. Employees across the Group will be encouraged to join this scheme, in order that they can share in the future success of the Group.

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. The Group is committed to meeting, at a minimum, the labour rights and legislation requirements in each country in which it operates, and in practice, often exceeds these.

## COMMUNITY

The Board recognises that each of the Group's businesses has an important role to play in its local community.

The Board adopted a charitable policy during the year, which confirmed its commitment to support selected

charitable causes with a focus on the military and armed services, and those linked to the local communities in which the Group's businesses operate. At a Group level, charitable donations are considered on a monthly basis by the Group Executive Committee, and each business has its own locally held charity budget. Examples of support provided during the year include:

- Donations to charities including the Queen Alexandra Hospital Home and other local hospitals, the Mary Rose Appeal, and funds assisting the families of those serving in current military activities
- Sponsorship of Irvine Rugby Football Club in Scotland
- Sponsorship and promotion of marine safety initiatives in the UK and Australia

In addition to making cash donations, the Group also encourages and supports employees who undertake voluntary work in the local community, where appropriate. During the year, our employees donated their time and services on a wide range of projects, several of which had an educational bias. At Chemring Countermeasures in the UK, a work experience programme was established for local students, and HR personnel assisted with training in interview techniques at nearby schools. Employees from Chemring Australia provided assistance to the Lions Club for special needs children and were involved with a Victoria Police "Streetsmart" handbook initiative for local teenagers.

The Group is involved with a number of educational initiatives, notably including the sponsorship of a Schools Science Prize for secondary schools in North Ayrshire, and the provision of scholarship donations to Duel County School in South Dakota for graduating students. In addition, the Group has recently entered into a partnership agreement with Cranfield University, under which the Group will provide significant funding for research activities over the next five years.

With regards to the impact of our manufacturing activities on the local community, at locations where our operations may inconvenience neighbours through product proofing, we liaise with local residents to minimise any impact. In the UK, Chemring Marine is working with government authorities and voluntary organisations to develop a flare disposal policy for out-of-date flares, which might otherwise find their way into the wider community outside of the marine industry.

## Directors

### NON-EXECUTIVE CHAIRMAN

#### **Kenneth C Scobie~+**

Joined the Group as Non-Executive Chairman in June 1997. Former Chairman of Allied Leisure plc. Chairman, Chief Executive and non-executive director of a wide range of industrial companies since 1972.

Aged 69.

### 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. Member of the Defence Industries Council, and the Boards of the Society of British Aerospace Companies and the Defence Manufacturers' Association.

Aged 52.

#### **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 46.

### NON-EXECUTIVE DIRECTORS

#### **David R Evans**

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 a non-executive director 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 Avon Rubber plc. Previously a non-executive director of Whatman PLC.

Aged 61.





#### **The Rt Hon Lord Freeman\*~**

Joined the Group as a non-executive director in May 2006. Chairman of the Audit Committee. Currently a Consultant (formerly Partner) to PricewaterhouseCoopers and Chairman of Thales UK plc. He is also on the main Board of Thales S.A., France. Chairman of Cambridge Enterprise – the University Technology Transfer Office. Partner with Lehman Brothers Investment Bankers between 1969 and 1985. Member of Parliament from 1983 to 1997. Made a Privy Councillor in 1993. Minister from 1985 to 1997.

Aged 65.

#### **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 63.

#### **Air Marshal Sir Peter Norriss KBE CB AFC MA FRAeS\*~+**

Joined the Group as a non-executive director in May 2004. Currently Chairman of Turbomeca UK 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 63.

#### **SECRETARY**

**Sarah Ellard FCIS**

Membership of Board committees during year:

- \* Audit
- ~ Remuneration
- + Nomination





## 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**

Chemring House, 1500 Parkway, Whiteley, Fareham  
Hampshire PO15 7AF, England

Tel: +44 1489 881880

Fax: +44 1489 881123

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

### **REGISTRATION NUMBER**

86662

### **REGISTRARS**

Computershare Investor Services PLC  
The Pavilions  
Bridgwater Road  
Bristol BS13 8AE



## Directors' Report

The directors present their annual report, together with the audited financial statements of the Group and the Company for the year ended 31 October 2007.

### PRINCIPAL ACTIVITIES

The principal activities of the Group are the design, manufacture and sale of countermeasures and energetic materials.

### BUSINESS REVIEW

The Statement by the Chairman, the Review by the Chief Executive and the Review by the Finance Director on pages 3 to 15, together with the Business Review and the Corporate Responsibility Report on pages 16 to 25, provide a review of the Group's business development, performance and position during and at the end of the financial year; its strategy and likely future development; key performance indicators; and a description of the principal risks and uncertainties facing the business. Further information regarding financial risk management policies and financial instruments is given in Notes 19 and 23 of the financial statements.

### RESULTS AND DIVIDENDS

The profit attributable to the Group's shareholders for the year was £32.1 million (2006: £13.8 million). The directors recommend a final dividend of 17.8p per ordinary share, which together with the interim dividend of 7.2p per ordinary share paid in July 2007 gives a total for the year of 25.0p (2006: 16.0p). The final dividend is subject to approval by shareholders at the Annual General Meeting on 20 March 2008, and accordingly has not been included as a liability in these financial statements.

### DIRECTORS AND THEIR INTERESTS

The present directors are shown on pages 26 and 27.

Mr I F R Much and Air Marshal Sir Peter Norriss will be retiring by rotation at the Annual General Meeting and will be offering themselves for re-election. Neither director has a service contract with the Company.

None of the directors had a beneficial interest in any contract of significance to which the Group was a party during the year to 31 October 2007.

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

### SUBSTANTIAL SHAREHOLDINGS

At 22 January 2008 the following substantial holdings in the ordinary share capital of the Company had been notified to the Company:

Name	% Interest
JP Morgan Chase & Co.	7.58
Old Mutual Asset Managers	5.13
AXA S.A and its group of companies	4.95
Prudential Corporation PLC	4.83
Standard Life Investments Ltd	4.82
Legal and General Group PLC	4.11

### EMPLOYEES

Details of the Group's employment policies are set out in the Corporate Responsibility Report on page 25.

### CHARITABLE AND POLITICAL DONATIONS

Charitable donations amounting to £9,875 (2006: £18,000) were made during the year. No political donations were made during the year (2006: £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 2007 amounted to 62 days (2006: 59 days).

## Directors' Report

(CONTINUED)

### THE CHEMRING GROUP PERFORMANCE SHARE PLAN (THE "PSP")

The following conditional awards were made under the PSP during the year:

Date of award	Total number of shares awarded	Number of participants receiving awards
24 January 2007	99,420	22

### THE CHEMRING 1998 EXECUTIVE SHARE OPTION SCHEME (THE "1998 ESOS")

No options were granted during the year. Options over 20,000 ordinary shares were exercised during the year. Additional information is set out in Note 31.

### THE CHEMRING GROUP PLC SHARE BASED INCENTIVE SCHEME (THE "ESOP")

No options were granted during the year and there were no options outstanding under the ESOP at 31 October 2007.

## SHARE CAPITAL

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

Section 89 of the Act requires that an allotment of shares for cash may not be made unless the shares are first offered to existing shareholders on a pre-emptive basis in accordance with the terms of the Act. In accordance with general practice, to ensure that small issues of shares can be made without the necessity of convening a general meeting, your Board proposes that advantage be taken of the provisions of section 95 of the Act to not apply the Act's pre-emptive requirements. Accordingly, a special resolution (set out as resolution 10 in the Notice of Annual

General Meeting) will be proposed which, if passed, will have the effect of granting the directors the power to allot not more than 5% of the present issued ordinary share capital free of the requirements of section 89 of the Act. No issue of these shares will be made which would effectively alter the control of the Company without prior approval of the shareholders in general meeting.

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the annual report and the financial statements. The directors have chosen to prepare accounts for the Group in accordance with International Financial Reporting Standards (IFRSs). Company law requires the directors to prepare such financial statements in accordance with International Financial Reporting Standards, the Companies Act 1985 and Article 4 of the IAS Regulation. International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's "Framework for the Preparation and Presentation of Financial Statements". In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards. Directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in International Financial Reporting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance;
- for the Company financial statements, state whether applicable UK accounting standards have been followed; and
- prepare the accounts on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or have no realistic alternative but to do so.



The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' Report, which comply with the requirements of the Companies Act 1985.

The directors are responsible for the maintenance and integrity of the Company website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

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.

## PROVISION OF INFORMATION TO AUDITORS

Each of the directors at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s234ZA of the Companies Act 1985.

## 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 2007.

## 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 20 March 2008, together with explanatory notes, appear in the separate Notice of Annual General Meeting sent to all shareholders.

Approved by the Board of Directors on  
22 January 2008

Signed on behalf of the Board

**S L ELLARD**  
**SECRETARY**

# Directors' Remuneration Report

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 20 March 2008.

## UNAUDITED INFORMATION

### REMUNERATION COMMITTEE

During the year under review the Remuneration Committee comprised:

Mr I F R Much (Committee Chairman)

Air Marshal Sir Peter Norriss

The Rt Hon Lord Freeman

Mr K C Scobie

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; and
- 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 (other than the Chairman in respect of his own remuneration; accordingly, he is not present during any discussions relating to this matter), 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 Chief Executive attends meetings by invitation but is not present during any discussions relating to his own remuneration.

The terms of reference of the Committee 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 Mercer Limited. Mercer Limited also provided administration and actuarial services for the Group's UK pension schemes during the year.

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

### REMUNERATION POLICY FOR EXECUTIVE DIRECTORS

The Committee's policy is to provide executive remuneration packages which are competitive, but not excessive, by reference to market rates across comparator companies, 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 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 data provided by its remuneration advisers, New Bridge Street Consultants, and also reviews the remuneration information presented in the



annual reports of companies in the reference group.

Following its review this year, the Committee increased salaries for Dr Price and Mr Rayner to £350,000 per annum and £220,000 per annum respectively. The Committee considered that these increases were necessary to retain a competitive remuneration package for key executives as the Group continues to grow, although salary levels remain below mid-market levels compared to companies of a similar size following these adjustments.

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, with key characteristics as follows:

- the maximum bonus potential for the executive directors is 60% of basic salary, with an on-target bonus of 30% of basic salary;
- three quarters of the bonus potential is 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 is 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 is payable unless threshold performance of both the financial conditions described above is achieved;
- one quarter of any bonus payable is 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; and
- the payment of any bonus remains ultimately at the discretion of the Committee.

Bonuses are non-pensionable.

The table below summarises the bonuses earned by the executive directors, as a percentage of basic salary, in respect of the current and last years:

	Earnings per share target %		Cash flow target %		Achievement of personal objectives %		Total %	
	2007	2006	2007	2006	2007	2006	2007	2006
D J Price	19.0	22.5	15.1	22.5	12.0	13.5	46.1	58.5
P A Rayner	19.0	22.5	15.1	22.5	10.5	13.5	44.6	58.5

## LONG TERM INCENTIVE SCHEMES

### PERFORMANCE SHARE PLAN

The Company operates the Chemring Group Performance Share Plan for the executive directors and other key members of the senior management team who influence the performance and prospects of the Group. The key features of the plan are as follows:

- conditional awards can 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 performance period (with no ability to re-test the performance condition). The performance condition is based on the growth of the Company's earnings per share in excess of RPI over three consecutive financial years. The Committee considers an earnings per share condition to most closely align the interests of participants with those of the Company's shareholders;

## Directors' Remuneration Report

(CONTINUED)

- the following vesting schedule applies in respect of awards made prior to 23 January 2007:

Total earnings per share growth per annum (not compounded) over three financial years	Percentage of the total number of shares under an award that vest
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

- following feedback from institutional shareholders last year, the Committee adopted the following vesting schedule in respect of awards made on 24 January 2007:

Total earnings per share growth per annum (not compounded) over three financial years	Percentage of the total number of shares under an award that vest
Less than RPI + 7.5%	Nil
RPI + 7.5%	33%
RPI + 20% or more	100%
Between RPI + 7.5% and RPI + 20%	Between 33%-100% on a straight-line basis

- the Committee has approved the following vesting schedule in respect of any awards which may be made over the forthcoming year:

Total earnings per share growth per annum (not compounded) over three financial years	Percentage of the total number of shares under an award that vest
Less than RPI + 10%	Nil
RPI + 10%	25%
RPI + 30% or more	100%
Between RPI + 10% and RPI + 30%	Between 25%-100% on a straight-line basis

- earnings per share is 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 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 plan is extended at the discretion of the Committee to the executive directors and senior management of the Group, both in the UK and overseas. The following awards were made under the plan during the year:

Date of award	Total number of shares awarded	Number of participants receiving awards
24 January 2007	99,420	22

Details of the awards made to executive directors during the year are set out on page 38.

The executive directors are expected to maintain a shareholding in the Company equivalent to one year's basic salary. Other participants in the plan are expected to retain a shareholding equivalent to 25% of their basic salary following vesting of the awards.

During the year, the Company purchased 150,000 (2006: nil) treasury shares at a cost of £2.8 million for use in the plan.



## OTHER SCHEMES

Between 1998 and 2005 the Company operated the Chemring 1998 Executive Share Option Scheme. Following the introduction of the Chemring Group Performance Share Plan, no further grants will be made under the option scheme, save in exceptional circumstances such as on recruitment, and the conditions applying to any such grants will accord with current corporate governance best practice. It will no longer be permissible to grant options under this scheme after 4 March 2008.

The Company previously operated a long term incentive scheme known as the Chemring Group PLC Share Based

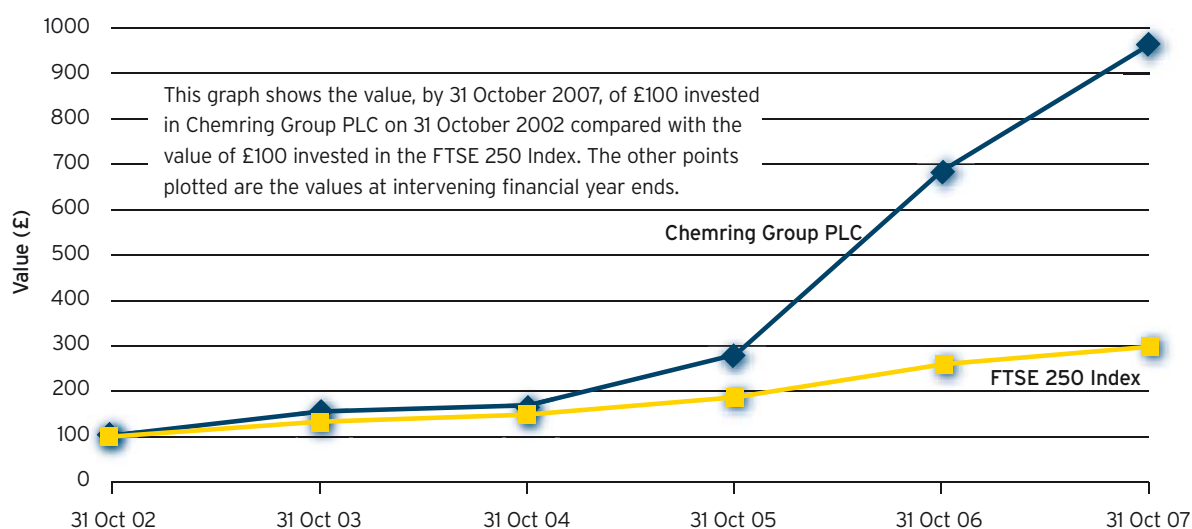
Incentive Scheme. This scheme is not being utilised at present.

## PERFORMANCE GRAPH

The following graph shows a comparison of the Company's total shareholder return (TSR) over the last five financial years against a "broad equity market index", as required by the Regulations. The FTSE 250 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.

### Total shareholder return

Source: Thomson Financial



## PENSIONS

Dr Price is a member of the Chemring Group Staff Pension Scheme (the "Staff Scheme"). This is an approved final salary scheme, which is contracted out of the State Second Pension, and which provides, at retirement, a pension of up to two-thirds of salary, subject to Inland Revenue limits. The Staff Scheme also provides life assurance cover, dependants' pensions and lump sum payments on death-in-service. 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 pension under the Staff 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, Dr Price'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. Dr Price is subject to an earnings cap (equivalent to the cap applied by HM Revenue and Customs prior to April 2006) in respect of his membership of the Staff Scheme.

Mr Rayner is a member of the Chemring Group Executive Pension Scheme (the "Executive Scheme"). The Executive Scheme is also an approved final salary scheme but is not

## Directors' Remuneration Report

(CONTINUED)

contracted out of the State Second Pension. Members of the Executive Scheme are required to make monthly contributions to the scheme at the rate of 8% of pensionable salary. Mr Rayner's benefits under the Executive Scheme accrue in an identical manner to that in which Dr Price accrues benefits under the Staff Scheme, as set out above. Mr Rayner is also subject to an earnings cap.

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

### 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. None of the executive directors currently holds any such 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, is £100,000 per annum. His time commitment under the contract is two to four days per month, not to exceed a total of fifty days per year. Additional services are paid for at the rate of £1,000 per day.

Mr Evans, The Rt Hon Lord Freeman, Mr Much and Air Marshal Sir Peter Norriss have letters of appointment covering, amongst other items, their terms of appointment and expected time commitment. These letters of appointment provide for a three year appointment, unless terminated earlier by and at the discretion of either party upon three months' written notice. In the case of The Rt Hon Lord Freeman, Mr Much and Air Marshal Sir Peter Norriss, it is anticipated that, subject to satisfactory performance and re-election by the shareholders, two three-year terms will be served by these non-executive directors. The basic fee payable to each of the four non-executive directors is £35,000 per annum. The Rt Hon Lord Freeman and Mr Much each receive an additional fee of £4,500 per annum, in respect of their Chairmanship of the Audit Committee and Remuneration Committee respectively.

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, Mr Evans and Air Marshal Sir Peter Norriss, and their respective spouses.

The non-executive directors do not participate in the Company's pension, bonus or share-based incentive schemes. However, Mr Evans does receive a pension from the Chemring Group Executive Pension Scheme, which he accrued during his former employment with the Company. In addition, 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 was the only participant in the scheme, acquired a contractual entitlement on his appointment in 1997 to the grant of phantom options over 141,025 ordinary shares in the Company at a notional exercise price of 78p per share. Mr Scobie exercised his rights under this scheme on 31 October 2007 and received a cash payment from the Company in November 2007 of £3,008,063 (gross), being equivalent to the difference between the market value of the ordinary shares on the exercise date (2,211p) less the total exercise price. No further awards will be made under this scheme.



## AUDITED INFORMATION

### DIRECTORS' EMOLUMENTS

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

	Salaries and fees		Bonuses (cash and deferred shares)		Taxable benefits		Total	
	2007	2006	2007	2006	2007	2006	2007	2006
	£000	£000	£000	£000	£000	£000	£000	£000
<b>Executives</b>								
D J Price	329	279	161	176	31	31	521	486
P A Rayner	208	177	98	111	19	17	325	305
<b>Non-executives</b>								
D R Evans	34	198	-	-	1	28	35	226
R N Freeman	38	12	-	-	-	-	38	12
I F R Much	38	34	-	-	-	-	38	34
P C Norriss	34	30	-	-	1	1	35	31
K C Scobie	102	88	-	-	2	2	104	90
<b>Total remuneration</b>	<b>783</b>	<b>818</b>	<b>259</b>	<b>287</b>	<b>54</b>	<b>79</b>	<b>1,096</b>	<b>1,184</b>

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

Mr 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 had a long term incentive scheme, details of which are given on page 36, in respect of which the Group had accrued £3,008,063 (2006: £2,122,000) as at 31 October 2007. £886,063 (2006: charge of £1,312,000) was charged to the Income Statement during the year in respect of Mr Scobie's long term incentive scheme, reflecting the increase in the Group's share price during the year and the increase in the cash amount to be paid to Mr Scobie on exercise of his phantom options.

Mr Evans' remuneration for 2006 included payments made to him under his service contract with the Company, which was terminated early on 31 March 2006.

### DIRECTORS' SHARE INTERESTS

The interests of the directors in the ordinary shares of the Company at 1 November 2006 and 31 October 2007 are shown below. All are beneficial holdings.

	2007 Number	2006 Number
D R Evans	50,348	80,348
R N Freeman	350	-
I F R Much	3,000	3,000
P C Norriss	4,600	3,600
D J Price	72,900	36,400
P A Rayner	21,100	21,000
K C Scobie	195,964	149,864

The directors' share interests at 31 October 2007 include shares held by the directors' adult children, as required by the Companies Act 2006.

## Directors' Remuneration Report

(CONTINUED)

On 16 November 2007, Mr Scobie purchased an additional 5,000 ordinary shares. No other movements have taken place between 31 October 2007 and 22 January 2008.

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. 36,712 ordinary shares were held by the Trustee at 31 October 2007.

### PERFORMANCE SHARE PLAN

Details of awards made to the executive directors under the Chemring Group Performance Share Plan during the year are shown below.

	At 1 Nov 2006	Granted during the year	Lapsed during the year	Exercised during the year	At 31 Oct 2007	Date of vesting	Share price on date of award (p)
D J Price	22,321	-	-	-	22,321	23 Mar 2009	1,136
	-	17,543	-	-	17,543	24 Jan 2010	1,730
	<u>22,321</u>	<u>17,543</u>	<u>-</u>	<u>-</u>	<u>39,864</u>		
P A Rayner	14,285	-	-	-	14,285	23 Mar 2009	1,136
	-	11,111	-	-	11,111	24 Jan 2010	1,730
	<u>14,285</u>	<u>11,111</u>	<u>-</u>	<u>-</u>	<u>25,396</u>		

Awards were granted during the year on 24 January 2007. 33% of the shares under award will vest if earnings per share growth is RPI+7.5% p.a. over the three year performance period, rising on a straight-line basis to full vesting for growth of at least RPI+20% p.a.

### SHARE OPTIONS

The holdings by the directors of share options granted under the Chemring 1998 Executive Share Option Scheme at 1 November 2006 and 31 October 2007 are shown below.

	At 1 Nov 2006	Granted during the year	Lapsed during the year	Exercised during the year	At 31 Oct 2007	Exercise price (p)	Market price at date of exercise (p)	Date from which exercisable	Expiry date
D J Price	52,798	-	-	-	52,798	473.5	-	7 Apr 2008	6 Apr 2015
P A Rayner	25,000	-	-	-	25,000	436.5	-	8 Jul 2007	7 Jul 2014

The exercise of outstanding share options is subject to the Company meeting pre-set performance targets.

- 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.

### RESTRICTED SHARES

As described in previous Remuneration Reports, Dr Price received a one-time award of 125,000 restricted ordinary shares shortly after he took up his appointment as Chief Executive in 2005 (when the Company's share price was 450p). 50% of these shares vested in March 2006 (when the Company's share price was 1,184p) and the remaining 50% vested in March 2007 (when the Company's share price was 1,857p). There were no other performance conditions. This award was necessary in order to secure the appointment of Dr Price, and compensated him for the loss of the options and performance shares he held in his previous employment.



The market price of the ordinary shares at 31 October 2007 was 2,211p. During the year, the ordinary shares traded within the range 1,490p to 2,211p.

## PENSIONS

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

	Total benefit accrued at 31 Oct 2006		Transfer value of accrued benefit at 31 Oct 2006	Increase in accrued benefit during year before inflation		Total benefit accrued at 31 Oct 2007		Transfer value of accrued benefit at 31 Oct 2007	Increase in accrued benefit during year after inflation		Transfer value of increase in accrued benefit after inflation (less members' contrib- utions)	Increase in transfer value during year (less members' contrib- utions)
	Pension (£p.a.)	Cash (£)	(£)	Pension (£p.a.)	Cash (£)	Pension (£p.a.)	Cash (£)	(£)	Pension (£p.a.)	Cash (£)	(£)	(£)
D J Price	2,036	6,109	23,905	1,489	4,466	3,525	10,575	40,592	1,403	4,207	7,296	7,831
P A Rayner	16,856	50,567	223,487	2,061	6,185	18,917	56,752	228,417	1,347	4,041	3,542	(3,926)

- i) Transfer values represent liabilities of the applicable scheme, and do not represent sums paid to the individuals.
- ii) Transfer values have been calculated on the basis of actuarial advice in accordance with actuarial professional guidance.

## APPROVAL OF THE DIRECTORS' REMUNERATION REPORT

The Directors' Remuneration Report was approved by the Board of Directors on 22 January 2008.

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 four non-executive directors. The Board considers that three of the current non-executive directors, The Rt Hon Lord Freeman, Mr Much and Air Marshal Sir Peter Norriss, are independent in character and judgment, and meet the criteria for independence set out in the revised Combined Code. The directors' biographical details are set out on pages 26 and 27.

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. During the year, the Board received specific training on the revised directors' duties introduced by the Companies Act 2006.

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 periodically with the management of the Group's operating companies. In addition to participating in Board meetings, the three 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. The Board considers that the current balance of executive and non-executive influence which exists is appropriate for the Company, taking into account its size and status.

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

During the financial year, the Chairman met regularly with the non-executive directors without the executives present.

Mr Evans, The Rt Hon Lord Freeman, Mr Much and Air Marshal Sir Peter Norriss all have letters of appointment covering, amongst other items, their terms of appointment and expected time commitment. These letters of appointment provide for a three year appointment, unless terminated earlier by and at the discretion of either party upon three months' written notice. The non-executive

directors' letters of appointment are available for inspection on request to the Company Secretary.

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

A full formal evaluation of the performance of the Board and its committees was undertaken towards the end of last year. This was updated by way of an informal review by the Chairman this year. In addition, the Chairman and the non-executive directors considered the individual performance of the Chief Executive and the Finance Director as part of the annual remuneration review. Similarly, the performance of the Chairman was considered by the non-executive directors during the annual review of his remuneration, and the Chairman and the Chief Executive reviewed the performance of the non-executive directors. During the year the Board continued to address the improvements to succession planning that were identified by last year's formal Board evaluation.

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

## 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:

	Board (12 meetings)	Audit Committee (3* meetings)	Nomination Committee (0 meetings)	Remuneration Committee (7 meetings)
K C Scobie	12(12)	-	-	7(7)
D R Evans	11(12)	-	-	-
The Rt Hon Lord Freeman	11(12)	3(3)	-	7(7)
I F R Much	11(12)	3(3)	-	7(7)
Air Marshal Sir Peter Norriss	11(12)	3(3)	-	7(7)
D J Price	12(12)	-	-	-
P A Rayner	12(12)	-	-	-

\* One Audit Committee meeting was held in November, shortly after the year end.

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

## Statement on Corporate Governance

(CONTINUED)

### 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.

### AUDIT COMMITTEE

The Rt Hon Lord Freeman, Mr Much and Air Marshal Sir Peter Norriss all served as members of the Audit Committee during the year. The Rt Hon Lord Freeman is Chairman of the Committee. The Committee meets three times 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 and internal audit 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 2006 financial statements and 2007 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 International Financial Reporting Standards;
- reviewing the external auditors' plan for the 2006 and 2007 financial statements and 2007 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; and
- reviewing the work undertaken by the Group's internal audit function.

During the year under review, the Company appointed an Internal Auditor. The initial internal audit programme focussed on a review of financial controls across the Group. It is intended to widen these activities to include an audit of certain non-financial controls and procedures over the course of this year.

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 on corporate finance matters 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 60.

### NOMINATION COMMITTEE

Mr Scobie, Mr Much and Air Marshal Sir Peter Norriss all served on the Nomination Committee during the year. 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.

## REMUNERATION COMMITTEE

The Rt Hon Lord Freeman, Mr Much, Air Marshal Sir Peter Norriss and Mr Scobie all served on the Remuneration Committee during the year. Mr Much is Chairman of the Committee. 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, the Company Secretary, the Business Development Director, the Managing Director of the European Energetics Division and the President of the Group's US operations. 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](http://www.chemring.co.uk)) provides financial and business information on the Group.

The directors are provided with reports and other written briefings from the Company's principal shareholders and analysts, and are regularly informed by the Company 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 30.

## INTERNAL CONTROL AND RISK MANAGEMENT

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

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

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

- The Board assesses the key risks associated with achievement of the Group's business objectives as part of the annual strategic planning process. Out of this process, each business establishes a 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

## Statement on Corporate Governance

(CONTINUED)

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 two divisional Health and Safety Management Committees, 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. The Chief Executive meets formally with health and safety professionals from each business on an annual basis.

The Group's Risk Management Committee meets on a quarterly basis. The Chief Executive, the Finance Director, the Company Secretary, the Business Development Director, the Managing Director of the Energetics Division and the President of the Group's US operations serve on the Committee. The Committee reviews the key risks associated with the achievement of the annual budget and the five year plan for each business, and the risk control procedures implemented. It reports biannually to the Board on the top ten risks from a Group perspective, and monitors the actions being taken to mitigate these.

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 2007, 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 2007, 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 June 2006, with the following exceptions (references to the relevant sections of the revised Combined Code are given in brackets):

- 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).
- 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).

### 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 22 January 2008

**S L ELLARD**  
SECRETARY



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

FOR THE YEAR ENDED 31 OCTOBER 2007

We have audited the Group financial statements of Chemring Group PLC for the year ended 31 October 2007 which comprise the Consolidated Income Statement, the Consolidated Statement of Recognised Income and Expense, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement, the Notes to the Cash Flow Statement and the related Notes 1 to 38. These Group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the individual company financial statements of Chemring Group PLC for the year ended 31 October 2007.

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

The directors' responsibilities for preparing the annual report, the Directors' Remuneration Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities in the Directors' Report.

Our responsibility is to audit the Group financial statements and the part of the Directors' Remuneration Report described as having been audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view, whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether 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 whether in our opinion the information given in the Directors' Report is consistent with

the Group financial statements. The information given in the Directors' Report includes that specific information presented in the Statement by the Chairman, the Review by the Chief Executive and the Review by the Finance Director that is cross referred from the review of the year and results section of the Directors' Report.

In addition, we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Statement on Corporate Governance reflects the Company's compliance with the nine provisions of the 2006 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 statement on internal control covers 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 other information contained in the annual report as described in the contents section including the unaudited part of the Directors' Remuneration Report and consider whether it is consistent with the audited Group financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any further information outside the annual report.

## BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, 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 group financial statements and the part of the Directors' Remuneration



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

(CONTINUED)

Report to be 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 Group financial statements and the part of the Directors' Remuneration Report to be audited.

### OPINION

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 October 2007 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the part of the Directors' Remuneration Report described as having been audited has been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the Group financial statements.

Deloitte & Touche LLP  
Chartered Accountants and Registered Auditors  
Southampton, United Kingdom

22 January 2008



# Consolidated Income Statement

FOR THE YEAR ENDED 31 OCTOBER 2007

	Note	2007 £m	2006 £m
<b>Continuing operations</b>			
<b>Revenue</b>			
- continuing		234.3	187.7
- acquired		20.4	-
	3	<u>254.7</u>	<u>187.7</u>
Cost of sales		<u>(162.4)</u>	<u>(122.6)</u>
<b>Gross profit</b>		<u>92.3</u>	<u>65.1</u>
Distribution costs		(3.8)	(3.1)
Administrative expenses		<u>(30.7)</u>	<u>(24.2)</u>
<b>Operating profit</b>		55.2	37.8
- continuing		2.6	-
- acquired		<u>57.8</u>	<u>37.8</u>
<b>Total operating profit</b>	4,5	<u>57.8</u>	<u>37.8</u>
<b>Operating profit is analysed as:</b>			
Underlying operating profit before intangible amortisation arising from business combinations		61.2	38.5
Intangible amortisation arising from business combinations		<u>(3.4)</u>	<u>(0.7)</u>
		<u>57.8</u>	<u>37.8</u>
Share of post-tax results of associate		0.1	0.1
Finance expense	7	<u>(8.1)</u>	<u>(6.1)</u>
<b>Profit before tax for the year from continuing operations</b>		49.8	31.8
Tax	8	<u>(15.9)</u>	<u>(9.9)</u>
<b>Profit after tax for the year from continuing operations</b>		33.9	21.9
<b>Discontinued operations</b>			
Loss after tax from discontinued operations	33	<u>(1.9)</u>	<u>(8.1)</u>
<b>Profit after tax for the year</b>	27	<u>32.0</u>	<u>13.8</u>
Attributable to:			
Equity holders of the parent		32.1	13.8
Minority interests		<u>(0.1)</u>	<u>-</u>
<b>Earnings per ordinary share</b>			
From continuing operations:	10		
Underlying*		<u>112p</u>	<u>72p</u>
Basic		<u>105p</u>	<u>70p</u>
Diluted		<u>104p</u>	<u>70p</u>
From continuing and discontinued operations:	10		
Basic		<u>99p</u>	<u>44p</u>
Diluted		<u>98p</u>	<u>44p</u>

\* Before intangible amortisation arising from business combinations

# Consolidated Statement of Recognised Income and Expense

FOR THE YEAR ENDED 31 OCTOBER 2007

	Note	2007 £m	2006 £m
Profit after tax for the year		32.0	13.8
Other recognised income and expense			
Gains on cash flow hedges		0.2	0.3
Movement on deferred tax relating to cash flow hedges		(0.1)	(0.1)
Exchange differences on translation of foreign operations		(7.0)	(5.2)
Actuarial gains on defined benefit pension schemes	34	4.4	4.7
Movement on deferred tax relating to pension schemes		(1.5)	(1.4)
Current tax on items taken directly to equity		2.0	1.3
Deferred tax on items taken directly to equity		<u>1.1</u>	<u>0.6</u>
Total recognised income and expense for the year	28	<u>31.1</u>	<u>14.0</u>
Attributable to:			
Equity holders of the parent		31.2	14.0
Minority interest		<u>(0.1)</u>	<u>-</u>



# Consolidated Balance Sheet

AS AT 31 OCTOBER 2007

	Note	2007	2006
		£m	As restated * £m
<b>Non-current assets</b>			
Goodwill	11	94.8	59.7
Other intangible assets	12	35.4	23.8
Development costs	12	1.7	1.1
Property, plant and equipment	13	69.8	57.7
Interest in associate	15	1.0	1.0
Deferred tax	25	9.1	9.6
		211.8	152.9
<b>Current assets</b>			
Inventories	16	51.2	36.3
Trade and other receivables	17	61.9	39.0
Cash and cash equivalents	23	38.7	13.4
Derivative financial instruments	23	0.9	0.2
		152.7	88.9
Assets held for sale	33	-	6.5
<b>Total assets</b>		364.5	248.3
<b>Current liabilities</b>			
Bank loans and overdrafts	20	(22.5)	(11.5)
Obligations under finance leases	21	(0.7)	(0.4)
Trade and other payables	22	(71.4)	(39.6)
Provisions	24	(0.4)	(0.3)
Current tax liabilities		(3.3)	(1.9)
Liabilities held for sale	33	-	(2.4)
		(98.3)	(56.1)
<b>Non-current liabilities</b>			
Bank loans	20	(113.5)	(71.7)
Obligations under finance leases	21	(1.5)	(0.3)
Trade and other payables	22	(0.4)	(0.2)
Provisions	24	(1.3)	-
Deferred tax	25	(12.1)	(9.5)
Preference shares	26	(0.1)	(0.1)
Retirement benefit obligations	34	(13.3)	(16.3)
		(142.2)	(98.1)
<b>Total liabilities</b>		(240.5)	(154.2)
<b>Net assets</b>		124.0	94.1
<b>Equity</b>			
Share capital	26	1.6	1.6
Share premium account	27	60.5	53.6
Special capital reserve	27	12.9	12.9
Hedging reserve	27	0.4	0.2
Revaluation reserve	27	1.6	1.6
Own shares	29	(2.8)	-
Retained earnings	27	49.8	23.9
Equity attributable to equity holders of the parent		124.0	93.8
Minority interest		-	0.3
<b>Total equity</b>		124.0	94.1

These financial statements were approved by the Board of Directors on 22 January 2008.

Signed on behalf of the Board

D J Price

P A Rayner

\* See Note 32

# Consolidated Cash Flow Statement

FOR THE YEAR ENDED 31 OCTOBER 2007

	Note	2007 £m	2006 £m
<b>Cash flows from operating activities</b>			
Cash generated from operations	A	60.6	45.6
Tax paid		<u>(12.0)</u>	<u>(10.6)</u>
<b>Net cash inflow from operating activities</b>		<u>48.6</u>	<u>35.0</u>
<b>Cash flows from investing activities</b>			
Dividends received from associate		0.1	0.1
Purchases of property, plant and equipment		(14.6)	(10.2)
Purchases of intangible assets		(1.4)	(1.8)
Proceeds on disposal of subsidiary undertaking/division		3.2	2.6
Proceeds on disposal of property, plant and equipment		0.2	0.1
Acquisition of subsidiary undertakings (net of cash acquired)	32	<u>(46.9)</u>	<u>(62.8)</u>
<b>Net cash outflow from investing activities</b>		<u>(59.4)</u>	<u>(72.0)</u>
<b>Cash flows from financing activities</b>			
Dividends paid		(6.0)	(3.7)
Interest paid		(7.4)	(5.2)
Proceeds on issue of shares		0.1	26.4
New borrowings		50.7	38.1
Repayments of borrowings		(6.4)	(5.1)
Repayments of obligations under finance leases		(0.7)	(0.9)
Purchase of own shares		<u>(2.8)</u>	<u>-</u>
<b>Net cash inflow from financing activities</b>		<u>27.5</u>	<u>49.6</u>
<b>Increase in cash and cash equivalents during the year</b>		<b>16.7</b>	<b>12.6</b>
Cash and cash equivalents at start of the year		9.0	(2.9)
Effect of foreign exchange rate changes		<u>(0.3)</u>	<u>(0.7)</u>
<b>Cash and cash equivalents at end of the year</b>		<u>25.4</u>	<u>9.0</u>



## Notes to the Consolidated Cash Flow Statement

FOR THE YEAR ENDED 31 OCTOBER 2007

A. Cash generated from operations	2007 £m	2006 £m
Operating profit from continuing operations	55.2	37.8
Operating profit from acquired operations	2.6	-
Operating loss from discontinued operations	(0.4)	(0.6)
Loss on disposal/impairment of discontinued operations	(1.5)	(8.0)
Adjustment for:		
Depreciation of property, plant and equipment	6.8	5.8
Amortisation of intangible assets	4.0	2.0
Impairment of goodwill	-	4.9
Impairment of intangible assets	-	0.8
Negative goodwill included in operating profit	(0.4)	-
Difference between pension contributions paid and amount recognised in income statement	(0.6)	(0.9)
Decrease in provisions	(0.5)	(0.2)
Operating cash flows before movements in working capital	65.2	41.6
Increase in inventories	(4.6)	(1.4)
Increase in trade and other receivables	(9.0)	(0.7)
Increase in trade and other payables	9.0	6.1
<b>Cash generated from operations</b>	<b>60.6</b>	<b>45.6</b>
<b>Reconciliation of net cash flow to movement in net debt</b>		
Increase in cash and cash equivalents during the year	16.7	12.6
Cash inflow from increase in debt and lease financing	(43.6)	(32.1)
Change in net debt resulting from cash flows	(26.9)	(19.5)
New finance leases	(2.1)	(0.3)
Translation difference	0.4	2.4
Amortisation of debt finance costs	(0.4)	(0.3)
Movement in net debt in the year	(29.0)	(17.7)
Net debt at start of the year	(70.6)	(52.9)
<b>Net debt at end of the year</b>	<b>(99.6)</b>	<b>(70.6)</b>

### Analysis of net debt

	As at 1 Nov 2006 £m	Cash flow £m	Non-cash changes £m	Exchange movement £m	As at 31 Oct 2007 £m
Cash at bank and in hand	13.4	25.6	-	(0.3)	38.7
Overdrafts	(4.4)	(8.9)	-	-	(13.3)
	9.0	16.7	-	(0.3)	25.4
Debt due within one year	(7.1)	3.4	(5.7)	0.2	(9.2)
Debt due after one year	(71.7)	(47.7)	5.3	0.6	(113.5)
Finance leases	(0.7)	0.7	(2.1)	(0.1)	(2.2)
Preference shares	(0.1)	-	-	-	(0.1)
	(70.6)	(26.9)	(2.5)	0.4	(99.6)

# Notes to the Group Financial Statements

## 1. GENERAL INFORMATION

Chemring Group PLC is a company incorporated in England and Wales under registration number 86662. The address of the registered office is Chemring House, 1500 Parkway, Whiteley, Fareham, Hampshire PO15 7AF. The nature of the Group's operations and its principal activities are set out in Note 4 and in the Directors' Report on pages 29 to 31. These financial statements are the consolidated financial statements of Chemring Group PLC and its subsidiaries (the "Group").

These financial statements are presented in pounds sterling. Foreign operations are included in accordance with the policy set out in Note 2 "Accounting Policies".

At the date of presentation of these financial statements the following Standards and Interpretations, which have not been applied in these financial statements, were in issue but not yet effective:

- IFRS7 *Financial Instruments: Disclosures* and the related amendment to IAS1 on capital disclosures (effective from 1 January 2007).

IFRS7 and this amendment to IAS1 introduce new disclosures of information about financial instruments and capital management. The impact of these changes to the Group is that additional disclosures will be required concerning the sensitivity analysis to market risk and the management of capital. These will be applied for the year ending 31 October 2008.

- IFRS8 *Operating Segments* (effective from 1 January 2009).

Management considers that current segmental reporting under IAS 14 is substantially the same as IFRS8. IFRS8 will be applied for the year ending 31 October 2010.

- IAS1 Revised - *Presentation of Financial Statements* (effective 1 January 2009).

- IAS23 - *Borrowing Costs* (effective 1 January 2009).

IAS23 prescribes the accounting treatment for borrowing costs that may be capitalised during the period and is a revised version of the Standard. This revised Standard will be applied for the year ending 31 October 2009.

- IFRIC11 IFRS2 - *Group and Treasury Share Transactions*.

IFRIC11 provides guidance on whether share-based payment arrangements, in which suppliers of goods or services of an entity are provided with equity instruments of the entity's parent should be accounted for as cash settled or equity settled in the entity's financial statements. These interpretations will be applied for the year ending 31 October 2008.

- IFRIC14/IAS19 - *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (effective 1 January 2008).

IFRIC14 addresses the interaction between a minimum funding requirement and the limit placed by paragraph 58 IAS19 on the measurement of the defined benefit asset or liability. These interpretations will be applied for the year ending 31 October 2009.

- IFRIC12 - *Service Concession Arrangements* and IFRIC13 - *Customer Loyalty Programmes*.

Management anticipate that the adoption of these two Standards and Interpretations will have no impact on the financial statements of the Group.

## 2. ACCOUNTING POLICIES

### Basis of preparation

These financial statements have been prepared in accordance with IFRS adopted for use in the European Union. These will be those IAS, IFRS and related Interpretations (Standing Interpretations Committee (SIC)/International Financial Reporting Interpretations Committee (IFRIC) interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board (IASB) that have been endorsed by the European Commission (collectively referred to as IFRS). These are subject to ongoing review and endorsement by the European Commission or possible amendment by interpretive guidance from the IASB and the IFRIC and are therefore still subject to change.

### Basis of accounting

The financial statements have been prepared in accordance with IFRS. The particular accounting policies adopted have been applied consistently throughout the current and previous year and are described below.

### Accounting convention

The financial statements are prepared under the historical cost convention, except for the revaluation of certain properties and financial instruments.

### Basis of consolidation

The Group financial statements consolidate those of the Company and all of its subsidiaries. A subsidiary



undertaking is an entity over which the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired are consolidated from the date on which control passes to the Group and the results of disposed subsidiaries are consolidated up to the date on which control passes from the Group.

All companies within the Group make up their financial statements to the same date. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

### Operating profit

Operating profit is stated before the share of results of associates and before finance expense. Operating profit excludes the results of discontinued operations.

### Revenue recognition

Sales comprise the fair value of the consideration received or receivable for deliveries made, work completed or services rendered during the year, net of discounts, VAT and other sales related taxes. 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. An appropriate proportion of total long term contract value, based on the fair value of work performed, is included in revenue and an appropriate level of profit is taken based on the percentage completion method when the final outcome can be reliably assessed. Provision is made in full for foreseeable losses as soon as they are identified.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

### Acquisitions

On acquisition of a subsidiary, the cost is measured as the fair value of the consideration given plus any directly attributable costs. The assets, liabilities and contingent liabilities of a subsidiary that meet the IFRS3 *Business Combinations* recognition criteria are measured at the fair value at the date of acquisition. Where cost exceeds fair value of the net assets acquired the difference is recorded as goodwill.

Where the fair value of the net assets exceeds the cost, the difference is recorded directly in the Income Statement. The accounting policies of subsidiaries are changed where necessary to be consistent with those of the Group.

## Intangible assets

### Goodwill

The purchased goodwill of the Group is regarded as having an indefinite useful economic life and, in accordance with IAS36 *Impairment of Assets*, is not amortised but is subject to annual tests for impairment. In reviewing the carrying value of goodwill of the various businesses the Board has considered the separate plans and cash flows of these businesses consistent with the requirements of IAS36 and is satisfied that these demonstrate that no impairment has occurred in respect of continuing operations. Goodwill arising on acquisition before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. On disposal of a subsidiary, associate or jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

For acquisitions after 1 November 2004 the Group recognises separately from goodwill intangible assets that are separable or arise from contractual or other legal rights and whose fair value can be measured reliably. These intangible assets are amortised on a straight-line basis over their useful economic lives, averaging ten years.

### Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Development expenditure, where it meets certain criteria given below, is capitalised on a straight line basis over typically three years from the date commercial production commences. Development costs not meeting the criteria for capitalisation are expensed as incurred.

An intangible development asset is recognised only if all of the following conditions are met:

- the development costs are separately identifiable;
- the development costs can be measured reliably;
- management are satisfied as to the ultimate technical and commercial viability of the project; and
- it is probable that the asset will generate future economic benefits.

### Patents and trademarks

Patents and trademarks are measured initially at purchase cost and are amortised on a straight-line basis over their estimated useful lives.

# Notes to the Group Financial Statements

(CONTINUED)

## 2. ACCOUNTING POLICIES - CONTINUED

### Property, plant and equipment

Other than revalued land and buildings, property, plant and equipment are held at cost less accumulated depreciation and any recognised impairment loss. 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 - 10 years

### Impairment of non-current assets

Assets that have indefinite lives are tested for impairment annually. Assets that are subject to depreciation or amortisation are reviewed for impairment whenever changes in circumstances indicate that the carrying value may not be recoverable. To the extent that the carrying value exceeds the recoverable amount an impairment loss is recorded for the difference as an expense in the income statement. The recoverable amount used for impairment testing is the higher of the value in use and its fair value less costs of disposal. For the purpose of impairment testing assets are grouped at the lowest levels for which there are separately identifiable cash flows.

### Non-current assets held for sale

Non-current assets and disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. These items are so classified if their carrying amount will be recovered through a sale transaction rather than through continuing use.

### Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost represents materials, direct labour, other direct costs and related production overheads and is determined using the first-in first-out (FIFO) method. Net realisable value is based on estimated selling price, less further costs expected to be incurred to completion and disposal.

Provision is made for slow moving, obsolete and defective items where appropriate.

### Tax

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the Income Statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items of income that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted at the Balance Sheet date.

Deferred tax is expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the Income Statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

### 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 currencies

The individual financial statements of each Group company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group company are expressed in pounds sterling, which is the functional currency of the Company, and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual companies, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in the profit or loss for the period.

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward contracts and options which are accounted for as derivative financial instruments (see below for details of the Group's accounting policies in respect of such derivative financial instruments).

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the Balance Sheet date. Income and expense items are translated at the average exchange rates for the period.

### Financial instruments

Financial assets and liabilities are recognised on the Group's Balance Sheet when the Group becomes a party to the contractual provisions of the instrument.

### Trade receivables

Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

### Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

### Bank borrowings

Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges including premiums payable on settlement or redemption, and direct issue costs are accounted for on an accruals basis to the Income Statement using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

### Trade payables

Trade payables are not interest bearing and are stated at their nominal value.

### Derivative financial instruments

The Group's activities expose it primarily to the financial risks of interest rate and foreign currency transactions, and it uses derivative financial instruments to hedge its exposure to these transactional risks. The Group uses interest rate swap contracts and foreign exchange forward contracts to reduce these exposures and does not use derivative financial instruments for speculative purposes.

Derivative financial instruments are recognised at fair value at the date the derivative contract is entered into and are revalued at fair value at each Balance Sheet date. The method by which any gain or loss is recognised depends on whether the instrument is designated a hedging instrument or not. To be designated as a hedging instrument the instrument must be documented as such at inception and must be assessed at inception and on an ongoing basis to be highly effective in offsetting changes in fair values or cash flows of hedged items.

Hedge accounting principles are used for interest rate swaps and net investment hedges where movements in fair value are held in equity until such time as the underlying amounts of the contract mature. At maturity the amounts held in equity will be recycled to the Income Statement. Changes in fair value of any ineffective portion of net investment hedges and interest rate swaps are recognised in the Income Statement immediately.

Where derivatives do not meet the criteria for hedge accounting the changes in fair value are immediately

# Notes to the Group Financial Statements

(CONTINUED)

## 2. ACCOUNTING POLICIES - CONTINUED

recognised in the Income Statement. The Group does not apply hedge accounting to the foreign currency forward contracts to mitigate against currency fluctuations. Accordingly, gains and losses arising from measuring the contracts at fair value are recognised immediately in the Income Statement.

Embedded derivatives that are not closely related to the host contract are treated as separate derivatives, with unrealised gains and losses reported in the Income Statement.

### Retirement benefit costs

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due. For defined benefit schemes, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside of the profit or loss and presented in the Statement of Recognised Income and Expense (SORIE).

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the Balance Sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the scheme.

### 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 property, plant and equipment 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 Income Statement 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 Income Statement on a straight-line basis over the life of the lease.

### Share-based compensation

The Group operates equity settled and cash settled share-based compensation schemes.

For grants made under the Group's share-based compensation schemes, the fair value is remeasured at each balance sheet date with changes in the fair value recognised in the Income Statement on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest. The valuation of the options utilises a methodology based on the Black-Scholes model.

For equity settled share-based grants, the total amount recognised is based on the fair value of the equity instrument measured at the date the award is made. At each balance sheet date the impact of any revision to vesting estimates is recognised in the income statement over the vesting period. Proceeds received, net of any directly attributable transaction costs, are credited to share capital and share premium.

For cash settled share-based grants, the total amount recognised is based on the fair value of the liability incurred. The fair value of the liability is remeasured at each balance sheet date with changes in the fair value recognised in the Income Statement for the period.

### Post balance sheet events

Following IAS10 *Events after the Balance Sheet Date*, the Group continues to disclose events that it considers material and non-disclosure of which can influence the economic decisions of users of the financial statements.

### Critical accounting judgements and key sources of estimation uncertainty

When applying the Group's accounting policies, management must make assumptions and estimates concerning the future that affect the carrying amounts of assets and liabilities at the balance sheet date and the amounts of revenue and expenses recognised during the accounting period. Such assumptions and estimates are based upon factors such as historical experience, the observance of trends in the industries in which the Group operates, and information available from the Group's customers and other outside sources.

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year include:



#### *Goodwill*

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the entity to determine such assets, to estimate the future cash flows expected to arise from the cash-generating unit and to determine a suitable discount rate in order to calculate present value.

#### *Intangible assets acquired in business combinations*

Under IFRS3 *Business Combinations*, it is necessary to separately identify and value any acquired intangible assets. In order to ascertain the values of the separate assets it is necessary for management to estimate the future cash flows attributable to the asset and estimate their useful economic lives.

#### *Pensions*

The liability recognised in relation to retirement benefit obligations is dependent on a number of assumptions, including discount rate, mortality rate, salary increases and inflation. Any change in these assumptions would change the amount recognised (see Note 34).

#### *Insurance claim*

The Group is pursuing a claim against its former insurance broker, concerning the insurance cover for Kilgore Flares Company LLC and the broker's subsequent handling of a claim following a manufacturing incident at Kilgore Flares Company LLC on 18 April 2001. During the year the Group incurred costs of £0.4 million (2006: £0.1 million) in relation to the claim, which were written-off.

The balance of the claim that had not been recovered from the Group's former insurance broker at the year end was £2.4 million (\$4.9 million) (2006: £2.6 million (\$4.9 million)), which has been included within other debtors. Foreign exchange movements of £0.2 million (2006: £0.2 million) have been recognised through the Statement of Recognised Income and Expense.

## Notes to the Group Financial Statements

(CONTINUED)

### 3. REVENUE

All of the Group's revenue is derived from the sale of goods. The following table provides an analysis of the Group's revenue by geographical market irrespective of the origin of the goods.

Revenue by destination	Continuing operations 2007 £m	Acquisitions 2007 £m	Total 2007 £m	Total 2006 £m
UK	50.6	10.1	60.7	47.5
USA	108.6	0.8	109.4	101.1
Europe	30.9	6.6	37.5	19.4
Middle and Far East	32.8	2.1	34.9	8.3
Australia	8.4	-	8.4	9.1
Rest of the world	3.0	0.8	3.8	2.3
<b>Total</b>	<b>234.3</b>	<b>20.4</b>	<b>254.7</b>	<b>187.7</b>

Discontinued revenue of £3.8 million (2006: £11.3 million) is disclosed in Note 33, giving total revenue of £258.5 million (2006: £199.0 million).

### 4. BUSINESS AND GEOGRAPHICAL SEGMENTS

For management purposes the Group has two operating divisions – Countermeasures and Energetics. These divisions are the basis on which it reports its primary segment information.

Principal activities are as follows:

**Countermeasures:** Expendable countermeasure equipment

**Energetics:** Munitions, propellants, pyrotechnics, battlefield simulation, ordnance clearance systems, flares

A segmental analysis of revenue and operating profit is set out below:

#### Business segments

	2007 £m	2006 £m
<b>Revenue</b>		
Countermeasures	126.5	118.4
Energetics	128.2	69.3
<b>Total revenue from third parties</b>	<b>254.7</b>	<b>187.7</b>
<b>Analysis of underlying operating profit</b>		
	2007 £m	2006 £m
Countermeasures	38.6	33.9
Energetics	27.9	10.4
Charge for share-based payments	(2.4)	(2.2)
Unallocated head office costs	(2.9)	(3.6)
<b>Total underlying operating profit before intangible amortisation</b>	<b>61.2</b>	<b>38.5</b>
Intangible amortisation arising from business combinations	(3.4)	(0.7)
<b>Total operating profit</b>	<b>57.8</b>	<b>37.8</b>

Included within the charge for share-based payments are net costs of £1.4 million (2006: £0.9 million) for equity settled share-based payments.



<b>Balance sheet:</b>	<b>2007</b>	<b>2006</b>
	<b>£m</b>	<b>£m</b>
<b>Assets</b>		
Countermeasures	100.0	102.8
Energetics	240.9	127.2
Interest in associate	1.0	1.0
Unallocated assets	22.6	10.8
<b>Consolidated total assets</b>	<b>364.5</b>	<b>241.8</b>
<b>Liabilities</b>		
Countermeasures	(61.5)	(56.3)
Energetics	(165.5)	(77.7)
Unallocated liabilities	(13.5)	(17.8)
<b>Consolidated total liabilities</b>	<b>(240.5)</b>	<b>(151.8)</b>
Net assets - continuing operations	124.0	90.0
Net assets held for sale	-	4.1
<b>Group net assets</b>	<b>124.0</b>	<b>94.1</b>
<b>Other information:</b>		
<b>Capital additions</b>		
Countermeasures	8.2	9.0
Energetics	7.8	1.7
<b>Depreciation and amortisation</b>		
Countermeasures	4.6	3.5
Energetics	6.2	2.9

## Geographical segments

The Group's operations in the Countermeasures division are located in the UK and the US. The Group's Energetics division operates in the UK, EU countries, Australia and the US.

The following is an analysis of the carrying amount of net segment assets and additions to property, plant and equipment and intangible assets, analysed by the geographical area in which the assets are located. Net segment assets include continuing operations with associates and unallocated segment assets and liabilities (shown within the UK).

	Carrying amount of net segment assets		Additions to property, plant and equipment and intangible assets	
	2007 £m	2006 £m	2007 £m	2006 £m
UK	26.3	25.6	6.4	3.2
USA	55.4	61.2	8.3	7.1
Rest of the world	42.3	3.2	1.3	0.4
	<b>124.0</b>	<b>90.0</b>	<b>16.0</b>	<b>10.7</b>

## Notes to the Group Financial Statements

(CONTINUED)

### 5. OPERATING PROFIT

Operating profit is stated after charging:

	2007 £m	2006 £m
Research and development costs	6.7	5.3
Depreciation	6.4	4.9
- property, plant and equipment	0.4	0.4
- leased assets	0.6	0.4
Amortisation	3.4	0.7
- development costs	0.7	0.9
- arising from business combinations	1.1	0.5
Operating lease rentals	67.2	59.9
- plant and machinery	87.4	53.8
- other	0.2	0.2
Staff costs (see Note 6)		
Cost of inventories recognised as an expense		
Auditors' remuneration for audit services (see below)		

A more detailed analysis of auditors' remuneration on a worldwide basis is provided below:

	2007 £m	2006 £m
Audit fees	0.2	0.2
<b>Other services:</b>		
Auditing accounts of subsidiary companies	0.1	-
Tax services – compliance	0.1	0.1
Tax services – advisory	0.2	0.1
Corporate finance services	0.5	0.5
All other services	-	0.1
	1.1	1.0

Included within the above are £0.5 million (2006: £0.5 million) of corporate finance fees relating to acquisitions and disposals. Also in the Group audit fees is included the amount of £0.1 million (2006: £0.1 million) paid in respect of the parent company.

A description of the work of the Audit Committee is set out in the Statement on Corporate Governance on page 42 and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

During the year the Group incurred professional fees with other accountancy firms in relation to corporate finance services of £0.2 million (2006: £0.1 million).

### 6. STAFF COSTS

The average monthly number of employees within each category (including executive directors) was:

	2007 Number	2006 Number
Production	2,019	1,742
Sales and marketing	573	411
	2,592	2,153

The costs incurred in respect of these employees were:

	£m	£m
Wages and salaries	54.7	49.3
Social security costs	8.9	7.5
Other pension costs	3.6	3.1
	67.2	59.9



## 7. FINANCE EXPENSE

	2007 £m	2006 £m
Bank overdraft and loan interest	1.6	1.1
Medium term loan interest	5.4	3.8
Finance lease interest	0.1	0.1
Amortisation of debt finance costs	0.4	0.3
Interest cost of retirement benefit obligations (see Note 34)	0.6	0.8
	<u>8.1</u>	<u>6.1</u>

## 8. TAX

	2007 £m	2006 £m
Current tax charge	(14.9)	(12.8)
Deferred tax (charge)/credit	<u>(1.0)</u>	<u>2.9</u>
<b>Total current year tax charge</b>	<u>(15.9)</u>	<u>(9.9)</u>

Income tax in the UK is calculated at 30% (2006: 30%) of the estimated assessable profit for the year. Tax for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

The total charge for the year can be reconciled to the Income Statement as follows:

	2007 £m	2006 £m
<b>Profit before tax from continuing operations</b>	<u>49.8</u>	<u>31.8</u>
Tax at the UK corporation tax rate of 30% (2006:30%)	(14.9)	(9.5)
(Expenses)/income not (deductible)/allowable for tax purposes net of tax credits	(0.1)	0.1
Utilisation of tax losses	0.3	0.9
Other	1.6	0.2
Prior year adjustments	(0.1)	-
Overseas profits taxed at rates different to the standard rate	<u>(2.7)</u>	<u>(1.6)</u>
<b>Total current year tax charge</b>	<u>(15.9)</u>	<u>(9.9)</u>

In addition to the income tax expense charged to the Income Statement, a tax credit of £1.5 million (2006: £0.4 million) has been recognised in equity in the year and is included in the Statement of Recognised Income and Expense.

Tax on discontinued operations is shown in Note 33.

## 9. DIVIDENDS

	2007 £m	2006 £m
<b>Dividends on ordinary shares of 5p each</b>		
Final dividend for the year ended 31 October 2006 11.2p (2005: 7.3p)	3.6	2.1
Interim dividend for the year ended 31 October 2007 7.2p (2006: 4.8p)	<u>2.4</u>	<u>1.6</u>
<b>Total dividends</b>	<u>6.0</u>	<u>3.7</u>

The proposed final dividend in respect of the year ended 31 October 2007 of 17.8p per share will, if approved, absorb £5.8 million of shareholders' funds. The dividend is subject to approval by shareholders at the Annual General Meeting and accordingly has not been included as a liability in these financial statements.

## Notes to the Group Financial Statements

(CONTINUED)

### 10. EARNINGS PER SHARE

Earnings per share are based on the average number of shares in issue of 32,470,410 (2006: 31,118,719) and profit on ordinary activities after tax and minority interests of £34.0 million (2006: £21.9 million). Diluted earnings per share has been calculated using a diluted average number of shares in issue of 32,678,486 (2006: 31,323,121) and profit on ordinary activities after tax and minority interests of £34.0 million (2006: £21.9 million).

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

From continuing operations		2007			2006	
		Earnings £m	Ordinary shares Number 000s	EPS Pence	Earnings £m	Ordinary shares Number 000s
Basic		34.0	32,470	105	21.9	31,119
Additional shares issuable other than at fair value in respect of options outstanding		-	208	(1)	-	204
Diluted		34.0	32,678	104	21.9	31,323

#### Reconciliation from basic earnings per share to underlying earnings per share:

Underlying basic earnings has been defined as earnings before intangible amortisation arising from business combinations. The directors consider this measure of earnings allows a more meaningful comparison of earnings trends.

		2007			2006	
		Earnings £m	Ordinary shares Number 000s	EPS Pence	Earnings £m	Ordinary shares Number 000s
Basic		34.0	32,470	105	21.9	31,119
Intangible amortisation arising from business combination (after tax)		2.2	-	7	0.5	-
Underlying		36.2	32,470	112	22.4	31,119

From continuing and discontinued operations		2007			2006	
		Earnings £m	Ordinary shares Number 000s	EPS Pence	Earnings £m	Ordinary shares Number 000s
Basic		32.1	32,470	99	13.8	31,119
Additional shares issuable other than at fair value in respect of options outstanding		-	208	(1)	-	204
Diluted		32.1	32,678	98	13.8	31,323



## 11. GOODWILL

	£m
<b>Cost</b>	
At 1 November 2005	34.7
Recognised on acquisition of subsidiary undertaking (as restated *)	27.9
Foreign exchange adjustments	(2.9)
At 1 November 2006 (as restated *)	59.7
Recognised on acquisition of subsidiary undertakings	35.6
Derecognised on disposal of a subsidiary undertaking	(0.1)
Foreign exchange adjustments	(0.4)
At 31 October 2007	94.8
<b>Accumulated impairment losses</b>	
At 1 November 2005, 1 November 2006 and 31 October 2007	-
<b>Carrying amount</b>	
At 31 October 2007	94.8
At 31 October 2006 (as restated *)	59.7

Goodwill acquired in a business combination is allocated at acquisition to the cash generating units ("CGU") that are expected to benefit from that business combination. The carrying amount of goodwill has been allocated as follows:

<b>Energetics</b>	£m
Chemring Defence Germany GmbH	1.7
Leaffield Engineering Limited	3.5
Technical Ordnance, Inc. (as restated *)	16.3
B.D.L. Systems Limited	6.4
At 31 October 2006 (as restated *)	27.9
Simmel Difesa S.p.A.	34.1
Pirotécnia Oroquieta S.L.	0.2
Goodwill arising from fair value adjustments on prior year acquisitions (**)	1.3
At 31 October 2007	35.6

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

The recoverable amounts of the CGU are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, the growth rates and expected changes to selling prices and direct costs during the period for which management have detailed plans. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGU being measured (the weighted average cost of capital "WACC"). The discount rate used is 10.0% (2006: 10.0%). The growth rates are based on a prudent view of industry growth forecasts adjusted for a premium associated with the high technological nature of the businesses. A growth assumption of 2.5% (2006: 2.5%) has been used. Changes in selling price and direct costs are based on past practices and expectations of future changes in the market. The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next five years and extrapolates cash flows after that period based on growth as described above.

Following a detailed review, no impairment losses for continuing operations have been recognised in the year and no prior impairment losses reversed.

\* See Note 32

\*\* In accordance with IFRS3 fair value adjustments have been made within twelve months of the acquisition dates which has resulted in additional goodwill being recognised in the year (B.D.L. Systems Limited - £1.2 million and Leaffield Engineering Limited - £0.1 million).

## Notes to the Group Financial Statements

(CONTINUED)

### 12. OTHER INTANGIBLE ASSETS

	Development costs £m	Other* £m	Total £m
<b>Cost</b>			
At 1 November 2005	1.4	3.0	4.4
Additions	0.7	-	0.7
Recognised on acquisition of subsidiary undertakings (as restated **)	-	22.2	22.2
Transfers from property, plant and equipment	0.6	-	0.6
Foreign exchange adjustments	-	(0.6)	(0.6)
At 1 November 2006 (as restated **)	2.7	24.6	27.3
Additions	1.3	0.1	1.4
Recognised on acquisition of subsidiary undertakings	-	16.2	16.2
Derecognised on disposal of subsidiary undertaking	-	(0.1)	(0.1)
Foreign exchange adjustments	(0.1)	(1.3)	(1.4)
At 31 October 2007	3.9	39.5	43.4
<b>Amortisation</b>			
At 1 November 2005	0.8	0.1	0.9
Charge for the year	0.4	0.7	1.1
Transfers from property, plant and equipment	0.4	-	0.4
At 1 November 2006	1.6	0.8	2.4
Charge for the year	0.6	3.4	4.0
Foreign exchange adjustments	-	(0.1)	(0.1)
At 31 October 2007	2.2	4.1	6.3
<b>Carrying amount</b>			
At 31 October 2007	1.7	35.4	37.1
At 31 October 2006 (as restated **)	1.1	23.8	24.9

All of these assets are recognised at fair value to acquire and are amortised over their estimated useful lives. Fair values for acquired intangible assets are assessed by reference to future estimated cash flows discounted at an appropriate rate to present value, or by reference to the amount that would have been paid in an arm's length transaction between two knowledgeable and willing parties.

\* Other intangibles comprise intangible assets recognised on acquisition of subsidiary undertakings, of which the most significant are customer relationship assets and order backlog.

\*\* See Note 32.



### 13. PROPERTY, PLANT AND EQUIPMENT

	Freehold land and buildings £m	Plant and equipment £m	Total £m
<b>Cost or Valuation</b>			
At 1 November 2005	26.6	42.7	69.3
Transfer to intangible assets	-	(0.6)	(0.6)
Additions	0.4	9.6	10.0
Acquired on acquisition of subsidiary undertakings	2.4	2.9	5.3
Reclassified as held for sale (see Note 33)	(0.5)	-	(0.5)
Disposals	-	(0.4)	(0.4)
Foreign exchange adjustments	(0.9)	(2.5)	(3.4)
At 1 November 2006	28.0	51.7	79.7
Additions	4.1	10.5	14.6
Acquired on acquisition of subsidiary undertakings	5.1	2.0	7.1
Disposals	-	(0.5)	(0.5)
Foreign exchange adjustments	-	(2.7)	(2.7)
At 31 October 2007	37.2	61.0	98.2
<b>Accumulated depreciation</b>			
At 1 November 2005	2.2	16.3	18.5
Transfer to intangible assets	-	(0.4)	(0.4)
Charge for the year	1.2	4.1	5.3
Reclassified as held for sale (see Note 33)	(0.1)	-	(0.1)
Disposals	-	(0.3)	(0.3)
Foreign exchange adjustments	(0.1)	(0.9)	(1.0)
At 1 November 2006	3.2	18.8	22.0
Charge for the year	1.2	5.6	6.8
Disposals	-	(0.3)	(0.3)
Foreign exchange adjustments	-	(0.1)	(0.1)
At 31 October 2007	4.4	24.0	28.4
<b>Carrying amount</b>			
At 31 October 2007	32.8	37.0	69.8
At 31 October 2006	24.8	32.9	57.7

The carrying amount of the Group's plant and equipment includes an amount of £2.5 million (2006: £2.6 million) in respect of assets held under finance leases.

Land and buildings were revalued at 30 September 1997 by Chestertons Chartered Surveyors, independent valuers not connected with the Group, on the basis of depreciated replacement cost for the two pyrotechnic sites, and on open market for the remainder.

	2007 £m	2006 £m
30 September 1997 depreciated replacement cost	5.8	5.8
Freehold at cost	31.4	22.2
	37.2	28.0

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

	2007 £m	2006 £m
Cost	35.2	26.0
Accumulated depreciation	(4.7)	(3.5)
Historical cost value	30.5	22.5

All other tangible fixed assets are stated at historical cost.

At 31 October 2007 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £1.0 million (2006: £0.9 million).

## Notes to the Group Financial Statements

(CONTINUED)

### 14. SUBSIDIARY UNDERTAKINGS

All subsidiary undertakings have been included in the consolidation. The undertakings held at 31 October 2007 which, in the opinion of the directors, principally affected the results for the year or the net assets of the Group are shown below.

Subsidiary undertaking	Country of incorporation (or registration) and operation	% of issued ordinary share capital controlled by Chemring Group PLC	Activity
Chemring Countermeasures Ltd	England	100	Countermeasures
Chemring Defence UK Ltd	England	100	Energetics
Leaffield Engineering Ltd	England	100	Energetics
Chemring Marine Ltd	England	100	Energetics
B.D.L. Systems Ltd	England	100	Energetics
Chemring Energetics UK Ltd	Scotland	100	Energetics
Chemring Defence Germany GmbH	Germany	100	Energetics
Alloy Surfaces Company, Inc.	USA	100	Countermeasures
Kilgore Flares Company LLC	USA	100	Countermeasures and energetics
Technical Ordnance, Inc.	USA	100	Energetics
Chemring Australia Pty Ltd	Australia	100	Countermeasures and energetics
Pirotécnia Oroquieta S.L.	Spain	100	Energetics
Simmel Difesa S.p.A.	Italy	100	Energetics
Chemring Nobel AS	Norway	100	Energetics
<b>Associated undertaking</b>			
CIRRA S.A.	France	49	Countermeasures

### 15. INTEREST IN ASSOCIATE

	2007 £m	2006 £m
Interest in associate (including goodwill of £0.5 million (2006: £0.5 million))	<u>1.0</u>	<u>1.0</u>
Amounts relating to associate:		
	2007 £m	2006 £m
Assets	0.6	0.7
Liabilities	(0.1)	(0.2)
Sales	0.6	0.6
Profit after tax	<u>0.1</u>	<u>0.1</u>

Results of the associated undertaking relate to the Group's share of CIRRA S.A.

### 16. INVENTORIES

	2007 £m	2006 £m
Raw materials	22.5	19.0
Work in progress	14.7	7.8
Finished goods	<u>14.0</u>	<u>9.5</u>
	<u>51.2</u>	<u>36.3</u>

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



## 17. TRADE AND OTHER RECEIVABLES

	2007 £m	2006 £m
Current		
Trade debtors	51.5	33.4
Prepayments and accrued income	1.8	0.8
Other debtors	<u>8.6</u>	<u>4.8</u>
	<u>61.9</u>	<u>39.0</u>

Included within other debtors is £2.4 million (2006: £2.6 million), recoverable under an insurance claim relating to an incident at Kilgore Flares Company LLC (see Note 2). Included within other debtors is £0.2 million (2006: £0.2 million) of advance corporation tax recoverable.

All amounts shown above are due within one year.

The average credit period taken on sales of goods, adjusted for Group revenue had the acquisitions taken place on the first day of the financial year, is 69 days (2006: 60 days). No interest is charged on the receivables from the date of invoice to payment. There is no provision for irrecoverable amounts from the sale of goods (2006: nil).

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

## 18. CASH AND CASH EQUIVALENTS

Bank balances and cash comprise cash held by the Group and short term deposits with an original maturity of three months or less. The carrying amount of these assets approximates to their fair value.

## 19. CREDIT AND PRICE RISK

The Group's principal financial assets are bank balances and cash, and trade and other receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets.

The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the Balance Sheet are net of allowances for doubtful receivables, based on prior experience and an assessment of the current economic environment.

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies. The Group has no significant concentration of credit risk with exposure spread over a large number of counterparties and customers.

The Group's price risk is principally in relation to the cost of raw materials and is not considered significant. Price risk is managed through negotiations with suppliers and where appropriate the agreement of fixed price supply contracts.

## Notes to the Group Financial Statements

(CONTINUED)

### 20. BANK LOANS AND OVERDRAFTS

	2007 £m	2006 £m
Bank loans and overdrafts	22.5	11.5
UK medium term loans	32.1	39.8
- sterling denominated	22.1	21.4
- US dollar denominated	52.6	6.7
- Euro denominated	3.1	-
- other denominated	3.6	3.8
Overseas medium term loans	136.0	83.2
Borrowings falling due within:		
One year	22.5	11.5
One to two years	18.2	11.2
Two to five years	86.1	45.7
After five years	9.2	14.8
	136.0	83.2
Analysis of borrowings by currency:		
Sterling	54.1	46.6
US dollar	25.7	29.9
Euro	53.1	6.7
Other	3.1	-
<b>Total</b>	<b>136.0</b>	<b>83.2</b>
The weighted average interest rates paid were as follows:		
Bank overdrafts	6.3%	6.0%
UK medium term loans	6.7%	6.4%
- sterling denominated	6.4%	6.5%
- US dollar denominated	5.4%	5.1%
- Euro denominated	6.5%	-
- other denominated	2.7%	3.1%
Overseas medium term loans		

Bank loans and overdrafts held with Bank of Scotland are secured by a full debenture over the assets of all of the Group's subsidiaries and are also subject to cross guarantees between all subsidiaries. Bank loans held with Citizens Bank of Pennsylvania (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.

The overseas medium term loan is secured on the assets of certain of the overseas businesses.

The directors do not believe the fair value of the Group's borrowings to be materially different to the book values.

The Group has the following undrawn borrowing facilities in various currencies available in respect of which all conditions precedent had been met. These facilities are at floating interest rates.

	2007 £m	2006 £m
<b>Undrawn borrowings</b>	<b>22.5</b>	<b>20.4</b>
Expiring between one and five years		



## 21. OBLIGATIONS UNDER FINANCE LEASES

	Minimum lease payments		Present value of minimum lease payments	
	2007	2006	2007	2006
	£m	£m	£m	£m
Amounts payable under finance leases:				
Within one year	0.8	0.4	0.7	0.4
In the second to fifth years	1.2	0.3	1.1	0.3
After five years	0.4	-	0.4	-
Less future finance charges	(0.2)	-	-	-
Present value of lease obligations	2.2	0.7	2.2	0.7
Less amounts due within twelve months shown under current liabilities			(0.7)	(0.4)
Amount due for settlement after twelve months			1.5	0.3

Finance lease obligations attract interest rates of between 2% and 3% above base rate. Lease obligations are denominated in sterling, US dollars, Euro and Australian dollars.

The fair value of the Group's leases approximates to their carrying amounts.

The Group's obligations under finance leases are secured by the lessors' title to the underlying leased assets.

On acquisition of Simmel Difesa S.p.A. £1.5 million of finance leases were assumed by the Group (see Note 32).

## 22. TRADE AND OTHER PAYABLES

	2007	2006
	£m	£m
<b>Current</b>		
Trade creditors	34.4	20.4
Other creditors	17.7	5.8
Other tax and Social Security	3.4	2.0
Accruals and deferred income	15.9	11.4
	71.4	39.6
<b>Non-current</b>	0.4	0.2

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The directors consider that the carrying amount of trade payables approximates to their fair value.

## 23. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

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

The main risks addressed by the financial instruments of the Group are interest rate 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 rate 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, Euro, US dollar and Norwegian Kroner and are subject to floating rates of interest linked to the Bank of Scotland base rate. In order to protect against the risk of higher interest rates, the Group has entered into amortising interest rate swaps for at least 50% of its UK borrowings. 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.

## Notes to the Group Financial Statements

(CONTINUED)

### 23. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS - CONTINUED

**Translation risk:** The Group translates overseas results and net assets in accordance with the accounting policy in Note 2. The translation risk on net assets is mitigated by the transfer of currencies between Group companies and the appropriate use of foreign currency borrowings.

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

The profile of the Group's financial assets and liabilities is as follows:

<b>Financial assets</b>	<b>2007 Total £m</b>	<b>2006 Total £m</b>
Sterling	12.3	6.6
US dollar	23.5	25.8
Australian dollar	1.5	0.6
Euro	13.4	1.7
Other currencies	0.7	-
	<u>51.4</u>	<u>34.7</u>
Offset in the UK	<u>(12.7)</u>	<u>(21.3)</u>
Cash and cash equivalents	<u>38.7</u>	<u>13.4</u>

Financial assets held in the UK enjoy a right of interest offset against overdraft balances. Overseas financial assets have a weighted average interest rate of 3.9% (2006: 3.8%). The financial assets for both years are at floating rate.

<b>Financial liabilities</b>	<b>Floating rate £m</b>	<b>Fixed rate £m</b>	<b>2007 Total £m</b>	<b>Floating rate £m</b>	<b>Fixed rate £m</b>	<b>2006 Total £m</b>
Sterling	(27.9)	(41.2)	(69.1)	(48.4)	(20.3)	(68.7)
US dollar	(3.0)	(22.7)	(25.7)	(11.2)	(18.7)	(29.9)
Euro	(1.6)	(51.5)	(53.1)	-	(6.7)	(6.7)
Other currencies	-	(3.1)	(3.1)	-	-	-
	<u>(32.5)</u>	<u>(118.5)</u>	<u>(151.0)</u>	<u>(59.6)</u>	<u>(45.7)</u>	<u>(105.3)</u>
Offset in the UK			<u>12.7</u>			<u>21.3</u>
			<u>(138.3)</u>			<u>(84.0)</u>
Bank loans and overdrafts			(22.5)			(11.5)
Medium term loans UK			(109.9)			(67.9)
Medium term loans overseas			(3.6)			(3.8)
Obligations under finance leases			(2.2)			(0.7)
Preference shares			(0.1)			(0.1)
			<u>(138.3)</u>			<u>(84.0)</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 2007 was 5.7% (2006: 5.8%) and the weighted average period of funding was five years (2006: five years).

The Group has three amortising interest rate swaps, from floating to fixed rate; one that expires in 2012 at a rate of 4.97% (sterling), one that expires in 2011 at a rate of 4.88% (US dollars) and one that expires in 2011 at a rate of 4.22% (Euro). The fair value of interest rate swaps recognised on the Balance Sheet at 31 October 2007 was £0.6 million (2006: £0.3 million). The Group also has four forward exchange contracts with a fair value of £0.3 million asset (2006: £0.1 million liability). The total of these financial instruments is £0.9 million (2006: £0.2 million).



## 24. PROVISIONS

	Warranty provisions £m	Other provisions £m	Total £m
At 1 November 2006	-	0.3	0.3
Arising on acquisition of subsidiary undertaking	1.9	-	1.9
Utilised in the year	(0.3)	(0.2)	(0.5)
At 31 October 2007	<u>1.6</u>	<u>0.1</u>	<u>1.7</u>
Analysed as:		2007 £m	2006 £m
Included in current liabilities		0.4	0.3
Included in non-current liabilities		<u>1.3</u>	-
		<u>1.7</u>	<u>0.3</u>

The warranty provisions at 31 October 2007 are held by Simmel Difesa S.p.A. and represent management's best estimate of the Group's liability under six year warranties granted, based on past experience for defective products.

The other provisions held at 31 October 2007 are in respect of legal costs and insurance costs associated with a product recall, which was completed post year end.

## 25. DEFERRED TAX

The following are the major deferred tax liabilities/(assets) recognised by the Group and movements thereon during the year.

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Tax losses £m	Other £m	Total £m
At 1 November 2005	6.2	(6.1)	(0.1)	1.5	1.5
Charge/(credit) to income	1.2	-	(1.1)	(3.2)	(3.1)
Charge/(credit) to equity	-	1.4	-	(0.5)	0.9
Amounts arising on acquisition of subsidiary undertakings	(0.6)	-	-	1.3	0.7
Foreign exchange movements	<u>(0.1)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(0.1)</u>
At 1 November 2006	6.7	(4.7)	(1.2)	(0.9)	(0.1)
(Credit)/charge to income	(0.2)	0.1	0.5	0.7	1.1
Charge/(credit) to equity	-	1.5	-	(1.0)	0.5
Amounts arising on acquisition of subsidiary undertakings	0.3	(0.4)	-	2.2	2.1
Foreign exchange movements	<u>(0.4)</u>	<u>-</u>	<u>-</u>	<u>(0.2)</u>	<u>(0.6)</u>
At 31 October 2007	<u>6.4</u>	<u>(3.5)</u>	<u>(0.7)</u>	<u>0.8</u>	<u>3.0</u>

Included within the charge/(credit) to income is a charge of £0.6 million in respect of the reduction in UK corporation tax rate from 30% to 28% which was substantially enacted at the Balance Sheet date.

Certain deferred tax assets and liabilities have been offset in accordance with the Group's accounting policy. Deferred tax balances after offset, for balance sheet purposes are analysed as follows:

	2007 £m	2006 £m
Deferred tax liabilities	12.1	9.5
Deferred tax assets	<u>(9.1)</u>	<u>(9.6)</u>
	<u>3.0</u>	<u>(0.1)</u>

At the Balance Sheet date the Group had unused tax losses of £16.8 million (2006: £16.0 million) potentially available for offset against future profits in certain circumstances. No deferred tax asset has been recognised in respect of this amount because of the unpredictability of future qualifying profit streams. These losses can be carried forward indefinitely.

## Notes to the Group Financial Statements

(CONTINUED)

### 26. SHARE CAPITAL

	2007 £m	2006 £m
<b>Authorised</b>		
43,000,000 ordinary shares of 5p each	<u>2.2</u>	<u>2.2</u>
<b>Issued and fully paid</b>		
32,691,127 (2006: 32,235,076) ordinary shares of 5p each	<u>1.6</u>	<u>1.6</u>

On 30 March 2007, 373,551 ordinary shares were issued at a market value of £6.8 million to partially fund the acquisition of Simmel Difesa S.p.A. During the year, a further 82,500 (2006: 157,500) ordinary shares were issued for a cash consideration of £76,900 under the Group's share schemes.

The Company's authorised share capital also includes 62,500 7% cumulative preference shares of £1 each, which are all issued and fully paid-up.

### 27. RESERVES

	Share premium account £m	Special capital reserve £m	Hedging reserve £m	Revaluation reserve £m	Retained earnings £m	Total £m
At 1 November 2005	27.3	12.9	-	1.6	13.2	55.0
Ordinary shares issued	26.3	-	-	-	-	26.3
Profit after tax for the year	-	-	-	-	13.8	13.8
Minority interest	-	-	-	-	-	-
Dividends paid	-	-	-	-	(3.7)	(3.7)
Net cost of share-based payments	-	-	-	-	0.6	0.6
Actuarial gain net of tax	-	-	-	-	3.3	3.3
Increase in fair value of cash flow hedging derivatives	-	-	0.2	-	-	0.2
Foreign exchange translation losses	-	-	-	-	(5.2)	(5.2)
Tax credits on items taken direct to reserves	-	-	-	-	1.9	1.9
At 1 November 2006	<u>53.6</u>	<u>12.9</u>	<u>0.2</u>	<u>1.6</u>	<u>23.9</u>	<u>92.2</u>
Ordinary shares issued	6.9	-	-	-	-	6.9
Profit after tax for the year	-	-	-	-	32.0	32.0
Minority interest	-	-	-	-	0.1	0.1
Dividends paid	-	-	-	-	(6.0)	(6.0)
Net cost of share-based payments	-	-	-	-	0.9	0.9
Actuarial gain net of tax	-	-	-	-	2.9	2.9
Increase in fair value of cash flow hedging derivatives	-	-	0.2	-	-	0.2
Foreign exchange translation losses	-	-	-	-	(7.0)	(7.0)
Tax credits on items taken direct to reserves	-	-	-	-	3.0	3.0
At 31 October 2007	<u>60.5</u>	<u>12.9</u>	<u>0.4</u>	<u>1.6</u>	<u>49.8</u>	<u>125.2</u>

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

Included within retained earnings is £1.1 million of retained profits (2006: £1.0 million) relating to the associated undertaking and £0.1 million (2006: £0.1 million) of own shares held by the Group's ESOP trustees.



## 28. STATEMENT OF CHANGES IN EQUITY

	2007 £m	2006 £m
Total recognised income and expense for the year (see page 48)	31.1	14.0
Dividends	(6.0)	(3.7)
	<u>25.1</u>	<u>10.3</u>
Ordinary shares issued	-	0.1
Share premium arising	6.9	26.3
Net cost of share-based payments	0.9	0.6
Purchase of minority interest	(0.2)	-
Own shares	(2.8)	-
	<u>29.9</u>	<u>37.3</u>
Net addition to shareholders' funds	29.9	37.3
Opening shareholders' funds	<u>94.1</u>	<u>56.8</u>
Closing shareholders' funds	<u>124.0</u>	<u>94.1</u>

Equity comprises share capital, share premium and retained earnings.

## 29. OWN SHARES

	2007 £m	2006 £m
Balance at 1 November 2006	-	-
Acquired in the year	<u>2.8</u>	<u>-</u>
Balance at 31 October 2007	<u>2.8</u>	<u>-</u>

The own shares reserve represents the cost of shares in Chemring Group PLC purchased in the market and held by the Group to satisfy options under the Group's share-based incentive schemes (see Note 31). During the year 150,000 ordinary shares were acquired. This represents 0.46% of the total issued and fully paid ordinary share capital.

## 30. OBLIGATIONS UNDER NON-CANCELLABLE OPERATING LEASES

	2007 £m	2006 £m
Minimum lease payments under operating leases recognised in the Income Statement in the year	<u>1.8</u>	<u>1.4</u>
At the Balance Sheet date the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:		
Within one year	0.9	0.7
Two to five years	2.6	1.6
More than five years	-	2.9
	<u>3.5</u>	<u>5.2</u>

Operating lease payments represent rentals payable by the Group. Leases are negotiated for an average term of three years and rentals are fixed for the lease period with an option to extend for a further period at the then prevailing market rate.

## Notes to the Group Financial Statements

(CONTINUED)

### 31. SHARE-BASED PAYMENTS

The Group operates share-based compensation arrangements to provide incentives to the Group's senior management and other eligible employees.

Details of the three schemes which operated during the year are as follows:

#### The Chemring Group Performance Share Plan (the "PSP")

Under the PSP conditional awards of ordinary shares are made at nil cost. Awards vest on the third anniversary of the award date. The scheme commenced in March 2006.

	Number of conditional shares	
	2007	2006
Outstanding at the beginning of the year	128,676	-
Awarded during the year	99,420	128,676
Outstanding at the end of the year	228,096	128,676
Subject to vesting at the end of the year	-	-

The Group assumes that all the conditions of the PSP will be met.

As there is no option element the share price is discounted based on the following assumptions:

- Dividend growth at 5% per annum (2006: growth of 1.5p per annum);
- weighted average cost of capital 10%.

The weighted average fair value of awards made during the year was 1,661.5p (2006: 1,115.7p)

#### Restricted Share Award

A one-time award of 125,000 restricted ordinary shares at nil cost was made to Dr David Price on 4 April 2005, shortly after he took up his appointment as Chief Executive. 50% of the award vested in March 2006 and 50% in March 2007.

	Number of restricted shares
Outstanding at 1 November 2006	62,500
Awards vesting during the year to 31 October 2007	(62,500)
Outstanding at 31 October 2007	-

As there is no option element the share price is discounted based on the following assumptions:

- Dividend growth at 1.5p per annum;
- weighted average cost of capital 10%.

There were no awards made during the year ended 31 October 2007 (2006: no awards).

#### The Chemring 1998 Executive Share Option Scheme (the "1998 ESOS")

Under the 1998 ESOS options are granted at a price not less than the market value of the Group's ordinary shares on the date the options are granted.

	Number of share options	2007 Weighted average exercise price Pence	Number of share options	2006 Weighted average exercise price Pence
Outstanding at beginning of year	197,798	512.0	242,798	356.0
Granted during the year	-	-	50,000	1,059.0
Exercised during the year	(20,000)	384.5	(95,000)	228.5
Outstanding at end of year	177,798	598.5	197,798	512.0
Exercisable at end of year	75,000	436.5	5,000	228.5



Share options were exercised throughout the year and the average share price was 1,856.3p (2006: 1,115.0p). The options outstanding at the end of the year have exercise prices ranging from 436.5p to 1,059.0p.

The compensation expense recognised in respect of share options is based on their fair value at the grant date calculated using the Black-Scholes option pricing model.

No options were granted during the year. Assumptions made in calculating the fair values of options granted during the comparative period were as follows:

	2006
Options granted	50,000
Weighted average fair value (pence)	222.0
Weighted average share price (pence)	1,059.0
Weighted average exercise price (pence)	1,059.0
Expected volatility	31%
Expected life	3 years
Risk free interest rate	4.58%
Expected dividend yield	1.96%

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous years. The expected life has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

The Group recognised total expenses of £1.4 million (2006: £0.9 million) in respect of share-based payment transactions during the year.

Expenses of £1.0 million (2006: £1.3 million) were recognised during the year relating to The Chemring Group Phantom Share Option Scheme.

## 32. ACQUISITIONS

The following acquisitions were completed during the year ended 31 October 2007:

Name of business acquired	Activity	Date of acquisition	Proportion of shares acquired %	Cost of acquisition £m
Simmel Difesa S.p.A.	Energetics	30 Mar 2007	100	53.3
Chemring Nobel AS – business and assets	Energetics	29 Jun 2007		3.4
Pirotécnia Oroquieta S.L.	Energetics	20 Jul 2007	49	0.3
				<u>57.0</u>
<b>Satisfied by:</b>				<b>£m</b>
Cash				50.2
Share issue to the vendors of Simmel Difesa S.p.A.				6.8
				<u>57.0</u>
<b>Reconciliation to cash flow statement:</b>				<b>£m</b>
Cash paid for acquisitions in the year				50.2
Cash acquired				(4.6)
Cash paid for acquisitions reported in prior year				1.3
<b>Net cash outflow</b>				<u><b>46.9</b></u>

## Notes to the Group Financial Statements

(CONTINUED)

### 32. ACQUISITIONS - CONTINUED

An analysis of the net assets acquired of Simmel Difesa S.p.A. is shown below:

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets	0.6	15.5	16.1
Property, plant and equipment	2.0	1.9	3.9
Deferred tax	3.1	(5.6)	(2.5)
Inventories	11.0	(1.9)	9.1
Trade receivables	9.7	(0.1)	9.6
Bank and cash balances	4.7	-	4.7
Trade and other payables	(16.2)	(1.3)	(17.5)
Provisions	(8.2)	4.0	(4.2)
Net assets acquired	6.7	12.5	19.2
Goodwill arising on acquisition of Simmel Difesa S.p.A.	-	34.1	34.1
<b>Total</b>	<b>6.7</b>	<b>46.6</b>	<b>53.3</b>

Consideration	£m
Cash	45.8
Share issue	6.8
Costs	0.7
<b>Total</b>	<b>53.3</b>

Included within other payables are finance leases of £1.5 million.

The trade and assets of Chemring Nobel AS had a net book value of NOK42.3 million and were acquired for a consideration of NOK40.5 million (cash NOK37.2 million and costs of NOK3.3 million). Negative goodwill of NOK5.0 million (£0.4 million) arose after fair value adjustments of NOK3.2 million. The negative goodwill has been recognised as exceptional income within the Income Statement in the year.

Adjustments from book value to fair value arise principally from the application of Group accounting policies and the recognition of intangible assets under IFRS3 *Business Combinations and Fair Value Adjustments to Inventories, Receivables, Property, Plant and Equipment*. Intangible assets relate principally to customer relationships and trademarks (see Note 12). Fair values relating to the acquisition of Simmel Difesa S.p.A. and Chemring Nobel AS are provisional and will be finalised within one year of the acquisition date.

Costs include those legal and accounting costs incurred in developing the acquisition contracts and performing due diligence activities.

All intangible assets were recognised at their respective fair values. The residual excess of total cost over the fair value of net assets acquired is recognised as goodwill in the financial statements. Goodwill represents the value of synergies and assembled workforces acquired.

49% of the share capital of Pirotécnia Oroquieta S.L. was acquired on 20 July 2007 for a consideration of €0.5 million (£0.3 million) cash. Chemring Group PLC now holds 100% of the share capital of Pirotécnia Oroquieta S.L.

The acquisitions during the year contributed £20.4 million of revenue and £1.2 million to the Group's profit before tax for the period between the date of acquisition and the Balance Sheet date.

If the acquisitions had been completed on the first day of the financial year, Group revenues and profits before tax for continuing activities for the year would have been approximately £272.5 million and £60.6 million respectively. This information is not necessarily indicative of the results of operations that would have occurred had the operations been acquired at the start of the year, nor of the future results of the combined operations.



## Prior period Balance Sheet restatement

During the prior year the Group acquired Technical Ordnance, Inc.. The fair value of intangible assets acquired of £6.7 million was recognised at 30 April 2006 based on provisional values. The fair values have been finalised since April 2006 and in accordance with IFRS3 an increase in the fair value of customer relationships of £13.0 million has been made retrospectively. An adjustment to goodwill has also been made retrospectively to reflect the adjustment in the fair value. Goodwill has been decreased by £13.0 million. Amortisation charges on acquired intangible assets for the period to 30 April 2007 are such that the cumulative amortisation charged is appropriate for the revised fair value of intangible assets. This is the only adjustment relating to prior periods.

## 33. DISCONTINUED OPERATIONS

The results of the discontinued operations for the year, or to the date of disposal, which have been included in the Consolidated Income Statement, were as follows:

	2007 £m	2006 £m
Revenue	3.8	11.3
Expenses	(4.0)	(12.3)
Trading loss	(0.2)	(1.0)
Loss on disposal/impairment	(1.5)	(8.0)
Loss before tax	(1.7)	(9.0)
Tax	(0.2)	0.9
<b>Loss after tax for the year</b>	<b>(1.9)</b>	<b>(8.1)</b>

On 30 June 2006, the Group sold its McMurdo Lights business to Daniamant Limited for the sum of £2.8 million.

On 21 December 2006, the Group sold the entire issued share capital of Leaffield Marine Limited to the management team for £0.4 million.

On 5 April 2007, the Group sold its McMurdo Marine Electronics business to Signature Industries Limited for £2.8 million. Further deferred contingent consideration of £1.0 million was agreed in December 2007, and is payable by the end of February 2008.

On 18 May 2007, the Group sold the entire issued share capital of I.C.S. Electronics Limited to the management team for £1.

The loss on disposal in the year ended 31 October 2007 includes £0.7 million in respect of closure provisions, predominantly relating to leased premises which the Group no longer occupies.

The tax charge for the year of £0.2 million (2006: tax credit of £0.9 million) was higher (2006: lower) than the standard rate of 30% (2006:30%), primarily as a result of the impairment of goodwill which is not deductible for tax purposes.

Cash flows from discontinued operations	2007 £m	2006 £m
Net cash used on operating activities	(0.9)	(0.8)
Net cash (used)/received on investing activities	(0.1)	1.2
<b>Total</b>	<b>(1.0)</b>	<b>0.4</b>

The major classes of assets and liabilities classified as held for sale are as follows:

	2007 £m	2006 £m
Other intangible assets	-	1.0
Property, plant and equipment	-	0.9
Inventories	-	2.0
Trade and other receivables	-	2.6
<b>Total assets classified as held for sale</b>	<b>-</b>	<b>6.5</b>
Trade and other payables	-	(2.4)
<b>Net assets of disposal group</b>	<b>-</b>	<b>4.1</b>

## Notes to the Group Financial Statements

(CONTINUED)

### 34. PENSIONS

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. In Germany, Chemring Defence Germany GmbH operates a defined benefit scheme (the "CDG Scheme") and in Norway, Chemring Nobel AS operates a defined benefit scheme (the "Chemring Nobel Scheme"). The other UK and overseas arrangements are all defined contribution schemes.

The Staff Scheme and Executive Scheme are funded schemes and the assets of the schemes are held in separate trustee administered funds. Full actuarial valuations for the Staff Scheme and the Executive Scheme as at 6 April 2003 have been prepared and updated to 31 October 2007 by a qualified actuary, using the projected unit credit method.

The Staff Scheme triennial valuation at 6 April 2006 is in the process of being finalised. The Executive Scheme triennial valuation at the same date was signed-off by the trustees and Company on 5 October 2007.

The CDG Scheme is an unfunded scheme. The actuarial liability has been calculated at 31 October 2007 by a qualified actuary using the projected unit credit method. The main assumptions used were a discount rate of 5.3%, inflation rate of 1.8% and rate of increase in deferred pensions of 0%. The net deficit of the CDG Scheme was £0.8 million at 31 October 2007 (2006: £0.9 million).

The Chemring Nobel Scheme is a new scheme established in the year and is an unfunded scheme. The actuarial liability has been calculated at 31 October 2007 by a qualified actuary using the projected unit credit method. The main assumptions used were a discount rate of 4.5%, inflation rate of 3.1% and rate of increase in deferred pensions of 3.1%. The net deficit of the Chemring Nobel Scheme was £1.4 million at 31 October 2007.

The amount recognised in the Balance Sheet in respect of the Group's defined benefit schemes is as follows:

	2007 £m	2006 £m
Present value of funded obligations	(48.3)	(48.5)
Fair value of scheme assets	35.0	32.2
Net liability recognised in the Balance Sheet	(13.3)	(16.3)

Analysis of the net liabilities recognised are as follows:

	2007 £m	2006 £m	Change £m
Chemring Group Staff Pension Scheme	(9.5)	(12.9)	3.4
Chemring Group Executive Pension Scheme	(1.6)	(2.5)	0.9
Chemring Defence Germany Pension Scheme	(0.8)	(0.9)	0.1
Chemring Nobel AS Pension Scheme	(1.4)	-	(1.4)
Net liability recognised in the Balance Sheet	(13.3)	(16.3)	3.0



Amounts recognised in the Income Statement in respect of the defined benefit schemes are as follows:

	2007 £m	2006 £m
<b>Amounts included within operating profit:</b>		
Current service cost	(1.0)	(1.0)
<b>Amounts included as other finance costs:</b>		
Expected return on scheme assets	1.9	1.7
Discount on scheme liabilities	(2.5)	(2.5)
	(0.6)	(0.8)
<b>Net charge</b>	<b>(1.6)</b>	<b>(1.8)</b>

Amounts recognised in the Statement of Recognised Income and Expense (SORIE) are as follows:

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

	2007 £m	2006 £m
Actual return less expected return on pension scheme assets (i)	0.3	2.2
Experience (losses)/gains arising on scheme liabilities (ii)	-	5.5
Changes in assumptions underlying the present value of the scheme liabilities (ii)	4.1	(3.0)
<b>Actuarial gain recognised in SORIE</b>	<b>4.4</b>	<b>4.7</b>

Changes in the present value of the defined benefit obligation are as follows:

	2007 £m	2006 £m
Opening defined benefit obligations	(48.5)	(47.6)
Arising from business combinations	(1.4)	(0.9)
Service cost	(1.0)	(1.0)
Interest cost	(2.5)	(2.5)
Contributions from scheme members	(0.5)	(0.5)
Actuarial gains and losses	4.1	2.5
Benefits paid	1.5	1.5
<b>Closing defined benefit obligation</b>	<b>(48.3)</b>	<b>(48.5)</b>

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

	2007 £m	2006 £m
Opening fair value of scheme assets	32.2	27.4
Expected return on scheme assets	1.9	1.7
Actuarial gains and losses	0.3	2.2
Contributions from scheme members	0.5	0.5
Contributions from sponsoring companies	1.6	1.9
Benefits paid	(1.5)	(1.5)
	35.0	32.2

The total scheme assets of the Staff Scheme and the Executive Scheme updated to 31 October along with the expected rates of return on assets were as follows:

	Long term rate of return expected	2007 £m	Long term rate of return expected	2006 £m
Equities	6.8%	24.5	6.3%	19.1
Bonds	4.8%	10.5	5.1%	12.8
Other assets	-	-	4.3%	0.3
<b>Total fair value of assets</b>		<b>35.0</b>		<b>32.2</b>

The expected rates of return are determined by reference to relevant published indices. The overall expected rate of return is calculated by weighting the individual rates in accordance with the anticipated balance in the scheme's investment portfolio.

## Notes to the Group Financial Statements

(CONTINUED)

### 34. PENSIONS - CONTINUED

History of experience gains and losses:

	IFRS 2007 £m	IFRS 2006 £m	IFRS 2005 £m	UK GAAP 2004 £m	UK GAAP 2003 £m
Present value of funded obligations	(48.3)	(48.5)	(47.6)	(38.8)	(34.4)
Fair value of scheme assets	35.0	32.2	27.4	22.7	20.3
Deficit in the schemes	(13.3)	(16.3)	(20.2)	(16.1)	(14.1)
Experience gains/(losses) on scheme liabilities	-	5.5	(0.3)	(0.9)	2.5
Percentage of scheme liabilities	-	11.2%	0.7%	2.3%	7.3%
Experience gains/(losses) on scheme assets	0.3	2.2	2.2	(0.4)	0.5
Percentage of scheme assets	0.9%	6.9%	8.0%	1.6%	2.2%

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

	2007 £m	2006 £m
Opening deficit in schemes	(16.3)	(20.2)
Arising from business combinations	(1.4)	(0.9)
Current service cost	(1.0)	(1.0)
Contributions	1.6	1.9
Other finance costs	(0.6)	(0.8)
Actuarial gain	4.4	4.7
Closing deficit in the schemes	(13.3)	(16.3)

The principal assumptions used in the actuarial valuations were as follows:

	2007	2006
Discount rate	5.8%	5.05%
Rate of increase in salaries	4.1 – 4.6%	3.8 – 4.3%
Rate of increase in deferred pensions	3.1%	2.8%
Rate of increase in pensions in payment (where applicable)	2.3%	2.9%
Inflation assumption	3.1%	2.8%
Expected return on scheme assets	6.2%	5.7%

In determining the pension liabilities the Group uses mortality assumptions which are based on published mortality tables. For both the Staff and Executive Schemes the actuarial table currently used is PA92(YOB)MC+1.

The assumption considered to be the most significant is the discount rate adopted. If the discount rate in the schemes were to change by 0.1% then it is predicted that the deficit in the schemes would change by approximately £1.0 million.

The Group anticipates contributions to the schemes for the year ending 31 October 2008 will be £1.7 million.

### 35. SELF INSURANCE

The Group is self insured through its captive insurance company CHG Insurance Limited, based in Guernsey. The Group has been self insured for 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, since 31 October 2001. Insurance cover in respect of this risk at a level over that disclosed here is placed with external insurers.

### 36. SIMMEL DIFESA S.P.A. INCIDENT

On 9 October 2007, the Group announced that an incident had occurred at its Simmel Difesa S.p.A. factory in Colleferro, Italy.

The Group launched a full and immediate investigation into the nature of the incident. Further information on the implications of this will be provided when the investigation has been completed.

Simmel Difesa S.p.A. expects to recover its material damage and business interruption losses through insurance policies in place in Italy. Consequently, the Group does not anticipate that a claim will be made on its captive insurance company.



## 37. RELATED PARTY TRANSACTIONS

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

### Trading transactions

There are no trading activities between the Group and its associate.

### Remuneration of key management personnel

The remuneration of the executive directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS24 *Related Party Disclosures*. Further information on the remuneration of individual directors is provided in the audited part of the Directors' Remuneration Report on pages 37 to 39.

The directors of the Company had no material transactions with the Company during the year other than as a result of service agreements.

The remuneration of the executive directors is determined by the Remuneration Committee having regard to the performance of individuals and the market trends.

	2007 £m	2006 £m
Remuneration of the executive directors	0.8	0.8
Share-based payments	0.3	0.3
<b>Total</b>	<b>1.1</b>	<b>1.1</b>

## 38. POST BALANCE SHEET EVENTS

### US Private Placement

On 14 November 2007, the Group completed a \$150 million private placement of ten year fixed interest loan notes in the US with a number of institutional investors. The loan notes, which mature in 2017, carry an interest rate of approximately 6.30%. The proceeds were used to repay existing dollar debt and provide additional working capital facilities for the Group.

### Acquisition of Richmond Electronics & Engineering Limited ("Richmond")

On 5 November 2007, the Group purchased the entire share capital of Richmond Electronics & Engineering Limited ("Richmond") for a consideration of £11 million. The consideration was satisfied by the issue of 50,107 ordinary shares and a balancing cash payment of £10 million. The cash payment was funded with existing bank facilities. Richmond, based in Norfolk, is a specialist in the manufacture of explosive ordnance disposal products. During the year to 30 September 2007, Richmond made an unaudited profit before tax of £1.5 million on revenue of £5.8 million.



# Independent Auditors' Report on the Parent Company Financial Statements

FOR THE YEAR ENDED 31 OCTOBER 2007

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CHEMRING GROUP PLC

We have audited the parent company financial statements of Chemring Group PLC for the year ended 31 October 2007 which comprise the Balance Sheet, the Statement of Total Recognised Gains and Losses, the Reconciliation of Movements in Shareholders' Funds and the related Notes 1 to 12. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Group financial statements of Chemring Group PLC for the year ended 31 October 2007 and on the information in 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

The directors' responsibilities for preparing the annual report, the Directors' Remuneration Report and the parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities in the Directors' Report.

Our responsibility is to audit the parent company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies

Act 1985. We also report to you whether in our opinion the Directors' Report is consistent with the parent company financial statements. The information given in the Directors' Report includes that specific information presented in the Statement by the Chairman, the Review by the Chief Executive and the Review by the Finance Director that is cross referred from the Review of the year and results section of the Directors' Report.

In addition we report to you if, in our opinion, 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 other transactions is not disclosed.

We read the other information contained in the annual report as described in the contents section and consider whether it is consistent with the audited parent company financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any further information outside the annual report.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the individual company financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the individual company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, 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 parent company financial statements 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 parent company financial statements.



## OPINION

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 October 2007;
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the parent company financial statements.

**Deloitte & Touche LLP**  
Chartered Accountants and Registered Auditors  
Southampton, United Kingdom

22 January 2008

## Parent Company Balance Sheet (under UK GAAP)

AS AT 31 OCTOBER 2007

	Note	£m	2007 £m	£m	2006 £m
<b>Fixed assets</b>					
Tangible assets	2		0.5		-
Investments	3		<u>109.7</u>		<u>57.4</u>
			110.2		57.4
<b>Current assets</b>					
Debtors	5	123.1		109.6	
Creditors due within one year	6	<u>(31.4)</u>		<u>(32.1)</u>	
<b>Net current assets</b>			<u>91.7</u>		<u>77.5</u>
<b>Total assets less current liabilities</b>			<u>201.9</u>		<u>134.9</u>
Creditors due after more than one year	7		<u>(109.9)</u>		<u>(67.9)</u>
			<u>92.0</u>		<u>67.0</u>
<b>Capital and reserves</b>					
Called-up share capital	8		1.6		1.6
<b>Reserves</b>					
Share premium account	9		60.5		53.6
Special capital reserve	9		12.9		12.9
Hedge reserve	9		1.0		0.2
Own shares	10		<u>(2.8)</u>		-
Revenue reserves	9		<u>18.8</u>		<u>(1.3)</u>
<b>Shareholders' funds</b>			<u>92.0</u>		<u>67.0</u>

These financial statements were approved by the Board of Directors on 22 January 2008.

Signed on behalf of the Board

D J Price

P A Rayner

REGISTERED NUMBER IN ENGLAND: 86662



## Parent Company Statement of Total Recognised Gains and Losses

FOR THE YEAR ENDED 31 OCTOBER 2007

	Note	2007 £m	2006 As restated* £m
Profit/(loss) for the financial year	9	25.2	(1.2)
Own shares	10	(2.8)	-
Increase in fair value of hedge reserve	9	0.8	0.2
<b>Total recognised gains and losses for the year</b>		<b>23.2</b>	<b>(1.0)</b>
<b>Reconciliation of movements in shareholders' funds</b>			
Profit/(loss) for the financial year		25.2	(1.2)
Dividends		(6.0)	(3.7)
Profit/(loss) for the year		19.2	(4.9)
Other recognised profits		0.8	0.2
Ordinary shares issued	8	-	0.1
Share premium arising	9	6.9	26.3
Share-based payments	8	0.9	0.6
Own shares	10	(2.8)	-
<b>Net addition to shareholders' funds</b>		<b>25.0</b>	<b>22.3</b>
<b>Opening shareholders' funds</b>		<b>67.0</b>	<b>44.7</b>
<b>Closing shareholders' funds</b>		<b>92.0</b>	<b>67.0</b>

\* Currency translation differences have been reclassified to reflect a more appropriate classification.

### Profit attributable to shareholders

In accordance with the concession granted under the Companies Act 1985, section 230(1), the profit and loss account of Chemring Group PLC has not been presented separately in these financial statements. There is no material difference between the results disclosed and the results on an unmodified historical cost basis.

### Cash flow statement

In accordance with the exemption under FRS1 the Company's cash flow statement has not been presented separately in these financial statements.

# Notes to the Parent Company Financial Statements

## 1. CHEMRING GROUP PLC ACCOUNTING POLICIES

The financial statements have been prepared in accordance with applicable United Kingdom accounting standards. The particular accounting policies adopted have been applied consistently throughout the current and previous year and are described below.

### Accounting convention

The financial statements are prepared under the historical cost convention, as modified by the revaluation of property, in accordance with the Companies Act 1985 and applicable accounting standards (UK GAAP).

### Revenue recognition

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to its net carrying amount.

Dividend income from investments is recognised when the shareholder's rights to receive payment have been established.

### Tangible fixed assets

Other than revalued land and buildings, property, plant and equipment are held at cost less accumulated depreciation and any recognised impairment loss. 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 economic useful lives, which are considered to be:

Freehold buildings - up to 50 years

Leasehold buildings - the period of the lease

Plant and equipment - 10 years

### Investment in Group undertakings

Investments are stated at cost less any provision for impairment in value.

### Operating leases

Operating lease rental charges are taken to the profit and loss account on a straight-line basis over the life of the lease.

### Provisions

A provision is recognised when the Company has a present legal or constructive obligation as a result of a past event

and it is probable that settlement will be required of an amount that can be reliably estimated. Long term liabilities and provisions are discounted when the impact is material.

### Current tax

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 substantially enacted, by the Balance Sheet date.

### Deferred tax

Deferred tax is provided in full at the anticipated tax rates on differences arising from the inclusion of items of income and expenditure in tax computations in periods different from those in which they are included in the financial statements. Deferred tax 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 not 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 currencies

The functional currency of the Company is sterling. Transactions 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.

### Pensions

The Company operates defined benefit pension schemes. The defined benefit schemes are multi-employer schemes including employees of other Group companies. It is not considered possible to allocate scheme assets and liabilities between the various companies and accordingly schemes are accounted for as though they were defined contribution schemes. The amount charged to the profit and loss account is the contribution payable in the year. Differences between amounts payable and actually paid are shown as accruals or prepayments in the Balance Sheet.



## Share-based compensation

For grants made under the Company's share-based remuneration schemes, amounts which reflect the fair value of options awarded at the time of grant are charged to the profit and loss account. The valuation of the options utilises a methodology based on the Black-Scholes model.

## 2. TANGIBLE ASSETS

	Land and buildings £m	Plant and equipment £m	Total £m
<b>Cost</b>			
At 1 November 2006	-	0.5	0.5
Additions	0.2	0.3	0.5
At 31 October 2007	0.2	0.8	1.0
<b>Depreciation</b>			
At 1 November 2006 and 31 October 2007	-	0.5	0.5
<b>Net book value</b>			
At 31 October 2007	0.2	0.3	0.5
At 31 October 2006	-	-	-

The Company had no capital commitments at 31 October 2007 (2006: nil).

Land and buildings represent leasehold improvements capitalised in the year.

## 3. INVESTMENTS

	Shares in subsidiary undertakings £m	Loans to subsidiary undertakings £m	Total £m
<b>Cost</b>			
At 1 November 2006	68.4	6.3	74.7
Acquisitions of subsidiary undertakings	53.6	-	53.6
Disposals	(0.4)	-	(0.4)
Foreign exchange	1.0	-	1.0
At 31 October 2007	122.6	6.3	128.9
<b>Provision for impairment</b>			
At 1 November 2006	17.3	-	17.3
Charge for the year	1.9	-	1.9
At 31 October 2007	19.2	-	19.2
<b>Net book value</b>			
At 31 October 2007	103.4	6.3	109.7
At 31 October 2006	51.1	6.3	57.4

## Notes to the Parent Company Financial Statements

(CONTINUED)

### 4. INVESTMENTS IN GROUP UNDERTAKINGS

Subsidiary undertaking	Country of incorporation (or registration) and operation	% of issued ordinary share capital controlled by Chemring Group PLC	Activity
Chemring Countermeasures Ltd	England	100	Countermeasures
Chemring Defence UK Ltd	England	100	Energetics
Leaffield Engineering Ltd	England	100	Energetics
Chemring Marine Ltd	England	100	Energetics
*B.D.L. Systems Ltd	England	100	Energetics
Chemring Energetics UK Ltd	Scotland	100	Energetics
*Chemring Defence Germany GmbH	Germany	100	Energetics
*Alloy Surfaces Company, Inc.	USA	100	Countermeasures
*Kilgore Flares Company LLC	USA	100	Countermeasures and energetics
*Technical Ordnance, Inc.	USA	100	Energetics
*Chemring Australia Pty Ltd	Australia	100	Countermeasures and energetics
*Pirotécnia Oroquieta S.L.	Spain	100	Energetics
Simmel Difesa S.p.A.	Italy	100	Energetics
*Chemring Nobel AS	Norway	100	Energetics
<b>Associated undertaking</b>			
CIRRA S.A.	France	49	Countermeasures

\* Investments held by a subsidiary company.

The directors consider that the carrying value of the investments approximates to their fair value.

### 5. DEBTORS

	2007 £m	2006 £m
Amounts owed by subsidiary undertakings	118.5	104.0
Group relief recoverable	-	3.2
Advance corporation tax recoverable	0.2	0.2
Corporation tax recoverable	2.1	0.2
Deferred tax asset (see Note 11)	1.3	0.9
Other debtors	0.2	0.6
Financial instruments	0.6	0.3
Prepayments and accrued income	0.2	0.2
	<b>123.1</b>	<b>109.6</b>

Financial instruments of £0.6 million (2006: £0.3 million) recognised on the Balance Sheet is in respect of the fair value of interest rate swaps (see Note 23 of the Group financial statements). The directors consider that the carrying value of the debtors approximates to their fair value. Only the amounts owed by subsidiary undertakings are due after more than one year.

### 6. CREDITORS DUE WITHIN ONE YEAR

	2007 £m	2006 £m
Bank overdrafts	9.9	12.2
Bank loans	8.3	6.1
Trade creditors	1.6	0.9
Amounts owed to subsidiary undertakings	6.1	8.1
Other creditors	0.2	0.3
Other taxation and Social Security	0.5	0.1
Accruals and deferred income	4.8	4.4
	<b>31.4</b>	<b>32.1</b>



## 7. CREDITORS DUE AFTER MORE THAN ONE YEAR

	2007 £m	2006 £m
Medium term loan	109.8	67.8
Preference shares (62,500 shares of £1 each)	0.1	0.1
	<u>109.9</u>	<u>67.9</u>

The cumulative preference shares carry an entitlement to a dividend at the rate of 7 pence per share per annum, payable in equal instalments on 30 April and 31 October each year. Holders of the preference shares have the right on winding-up to receive, in priority to any other classes of shares, the sum of £1 per share together with any arrears of dividends.

	2007 £m	2006 £m
Borrowings falling due within:		
One year	18.2	18.3
One to two years	15.8	9.9
Two to five years	85.1	43.4
After five years	8.9	14.5
	<u>128.0</u>	<u>86.1</u>

## 8. CALLED-UP SHARE CAPITAL

	2007 £m	2006 £m
<b>Authorised</b>		
43,000,000 ordinary shares of 5p each	<u>2.2</u>	<u>2.2</u>
<b>Issued, allotted and fully paid</b>		
32,691,127 (2006: 32,235,076) ordinary shares of 5p each	<u>1.6</u>	<u>1.6</u>

The preference shares are presented as a liability (see Note 7) and accordingly are excluded from called-up share capital in the Balance Sheet.

### Share options

The following options to subscribe for the Company's ordinary shares granted under the Group's share-based incentive schemes were outstanding at 31 October 2007:

#### The Chemring 1998 Executive Share Option Scheme

Date of grant	Number of ordinary shares under option	Exercise price per share £	Dates between which options may be exercised
8 Jul 2004	75,000	4.365	8 Jul 2007 – 7 Jul 2014
7 Apr 2005	52,798	4.735	7 Apr 2008 – 6 Apr 2015
1 Feb 2006	50,000	10.590	1 Feb 2009 – 31 Jan 2016

#### The Chemring Group Performance Share Plan

Date of award	Number of ordinary shares awarded	Exercise price per share £	Date when grant will vest
23 Mar 2006	121,420	nil	23 Mar 2009
27 Sep 2006	7,256	nil	27 Sep 2009
24 Jan 2007	99,420	nil	24 Jan 2010

Full details of the schemes are disclosed in Note 31 of the Group's financial statements.

## Notes to the Parent Company Financial Statements

(CONTINUED)

### 9. RESERVES

	Share premium account £m	Special capital reserve £m	Hedging reserve £m	Revenue reserves £m	Total £m
At 1 November 2006	53.6	12.9	0.2	(1.3)	65.4
Ordinary shares issued	6.9	-	-	-	6.9
Profit for the year	-	-	-	25.2	25.2
Increase in fair value of hedging reserve	-	-	0.8	-	0.8
Dividends paid	-	-	-	(6.0)	(6.0)
Net cost of share-based payments	-	-	-	0.9	0.9
At 31 October 2007	60.5	12.9	1.0	18.8	93.2

Included within revenue reserves is £0.1 million (2006: £0.1 million) of own shares held by the Group's ESOP trustees.

The share premium account and special capital reserve are not distributable. A profit after tax of £25.2 million (2006: loss after tax £1.2 million) was recognised in the year. Dividends from subsidiary undertakings of £30.0 million (2006: £12.6 million) were received in the year.

### 10. OWN SHARES

	2007 £m	2006 £m
Balance at 1 November 2006	-	-
Acquired in the year	2.8	-
Balance at 31 October 2007	2.8	-

The own shares reserve represents the cost of ordinary shares in the Company purchased in the market and held by the Company to satisfy awards under the Group's share-based incentive schemes (see Note 31). During the year 150,000 ordinary shares were acquired. This represents 0.46% of the total issued and fully paid ordinary share capital.

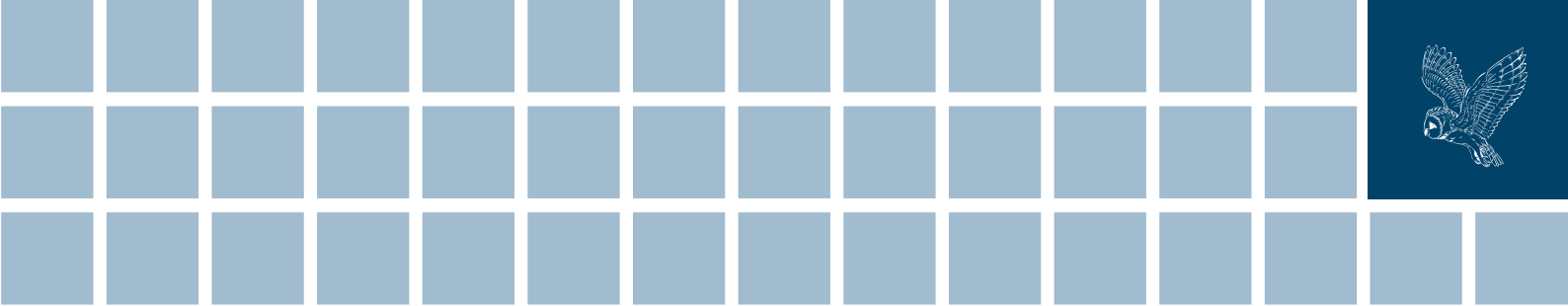
### 11. DEFERRED TAX

	2007 £m	2006 £m
<b>Movement in deferred tax liabilities/(assets) are as follows:</b>		
At 1 November 2006	(0.9)	(0.2)
Credit to profit and loss account	(0.1)	(0.8)
(Credit)/charge to Statement of Total Recognised Gains and Losses	(0.3)	0.1
At 31 October 2007	(1.3)	(0.9)
<b>The amount provided represents:</b>		
Other timing differences	(1.3)	(0.9)

### 12. STAFF COSTS

	2007 Number	2006 Number
The average monthly number of employees (including executive directors) was:		
Total	21	17
	£m	£m
The costs incurred in respect of these employees were:		
Wages and salaries	1.9	2.2
Social security costs	0.2	0.3
Other pension costs	0.9	0.3
	3.0	2.8

Disclosure in respect of directors' emoluments can be found in the Directors' Remuneration Report on pages 32 to 39 of the Group's financial statements.





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