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Ricardo plc Annual Report & Accounts 2006

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USA
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Chicago

UK
Leamington
Shoreham
Cambridge

EUROPE
Stuttgart
Prague
France
Italy

ASIA PACIFIC
Tokyo
Shanghai
India
South Korea

CORPORATE PROFILE

Ricardo is a leading provider of technology, product innovation, engineering solutions and strategic consulting to the world's automotive industries. With a network of advanced and well-equipped technical centres and offices in the UK, North America, China, Japan, Germany and the Czech Republic, we serve a wide and balanced core customer base represented by the leading global automakers, vehicle component and system manufacturers, and automotive regulatory agencies. We are also active in other key market sectors such as motorcycle, heavy duty truck, off-highway, military vehicle, marine and locomotive propulsion system manufacturers, as well as serving many leading teams in all formulae of motorsport.

The need to minimise the environmental impact of future vehicles is a major driver for our own technology research programme, one of the principal means by which Ricardo maintains its technological edge. Recent benefits of this approach are apparent, for example, in the leading position Ricardo now occupies in the development of hybrid vehicle systems and of clean diesel and gasoline engine technologies offering improved fuel economy, reduced CO₂ and low regulated exhaust emissions.

With our commitment to excellence and industry leadership in technology and knowledge, our greatest asset is our people, approximately 70% of whom are highly qualified multi-disciplined professional engineers, consultants and technicians. Together, our vision is to make Ricardo the natural partner of choice for all our customers in all sectors.

FINANCIAL HIGHLIGHTS

Revenue	Increased 9% to	£173.1m
Profit before tax excluding pensions credit (underlying)	increased 26% to	£10.8m
Profit before tax	increased 69% to	£14.5m
Earnings per share excluding pensions credit (underlying)	increased 27% to	18.8p
Earnings per share	increased 62% to	24.0p
Dividends per share (paid and proposed)	increased 4% to	9.4p

Five Year Performance Record

	2002 UK GAAP £m	2003 UK GAAP £m	2004 UK GAAP £m	2005 IFRS £m	2006 IFRS £m
Revenue	143.2	136.6	146.2	158.1	173.1
Underlying profit before tax	16.7	16.1	1.8	8.6	10.8
Profit/(loss) before tax	16.7	15.8	(2.8)	8.6	14.5
Net assets	56.2	64.9	56.2	36.7	50.1
	pence	pence	pence	pence	pence
Underlying earnings per share	25.0p	25.4p	4.3p	14.8p	18.8p
Earnings per share	24.9p	24.8p	(2.6)p	14.8p	24.0p
Dividends per share (paid and proposed)	8.6p	9.0p	9.0p	9.0p	9.4p

The years ended 30 June 2005 and 2006 have been prepared under International Financial Reporting Standards ("IFRS").

The three years ended 30 June 2004 have been prepared under UK GAAP, and exclude the FRS 17 pensions deficit from net assets.

Underlying profit before tax and underlying earnings per share under IFRS for 2006 above excludes a pensions credit of £3.7m due to the capping of future increases in pensionable salaries to RPI. Underlying profit before tax and underlying earnings per share under UK GAAP above exclude the effects of exceptional redundancies and goodwill amortisation.

*"A world-class automotive consultancy
with world-class technologies,
products, customers and staff"*

CHAIRMAN'S STATEMENT

Marcus Beresford CBE

It is a privilege to be part of Ricardo – a world-class automotive consultancy with world-class technologies, products, customers and staff. The year to 30 June 2006 has been a good year and a year of significant developments for the future.

Results

In the year to 30 June 2006, the underlying profit before tax was £10.8m, an increase of 26%. During the year we addressed the deficit in our defined benefit pensions scheme by increasing the employer's special contribution and capping future pensionable salary increases to inflation. This latter change had the effect of creating a credit to the Income Statement totalling £3.7m. Therefore, the profit before tax including this exceptional credit was £14.5m. Earnings per share was 24p, and the underlying earnings per share excluding the pensions credit was 18.8p, up 27% on 14.8p in the previous year. The directors have pleasure in recommending a final dividend of 6.7p per share compared to the previous final dividend of 6.3p. Together with the interim dividend of 2.7p in both years, this represents an increase of 4.4%.

Changes in reporting

We have taken the opportunity to explain the business and the marketplace we operate in more fully than previously in the Business Review section of this Report. This is also the first set of annual results presented under International Financial Reporting Standards ('IFRS'). The impact of IFRS on the results of the previous year is explained in the notes to the financial statements and is not significantly different to the impact announced in a statement on 21 December 2005.

Developments in the year

In November 2005 Dave Shemmans took up his position as Chief Executive Officer, since when he has renewed the group strategy and

strengthened the executive team. Ricardo Strategic Consulting has demonstrated its value to customers and the business. Offices have been established in Japan and China to exploit the growing Asian market. The Prague office has grown and is delivering high value added engineering from an East European cost base. Investment has been made in state of the art test cells in Ricardo Deutschland, which are already in great demand with German customers. The UK and US businesses have both grown as a result of our research-led investments, primarily focused on providing automotive solutions to the world's energy security and environmental concerns.

In February of this year we welcomed David Hall to the board as a non-executive director. I am also pleased to report that Paula Bell has been appointed to join the Board of Directors on 9 October 2006. Her prior experience with Rolls Royce, AWG plc and BAA plc will be very valuable to Ricardo. She takes over from Andrew Goodburn as Group Finance Director with effect from the Annual General Meeting on 10 November 2006, before he retires in January 2007. I would like to welcome Paula and thank Andrew for his excellent service to Ricardo in a vital role over the past 9 years, and wish him a long and happy retirement.

Our success has been as always a team effort. My thanks and those of the board go to all our staff around the world.



M Beresford

FEATURES

JCB DIESELMAX
Efficient-C
Shanghai Automotive
Suzuki Grand Vitara
GM Global V6
Chrysler Hemi® 6.1

JCB DIESELMAX

The world's fastest diesel car

Ricardo's collaboration with JCB in the Dieselmax programme to capture the world land speed record for diesel powered cars started under the strictest confidentiality, with only a handful of JCB and Ricardo staff aware of the programme. But after the public launch in April 2006 it became just the opposite: it was under the powerful floodlights of the international media that, early one August morning on the famous Bonneville salt flats in Utah, the yellow and black projectile streaked into the global record books at over 350 mph (565 km/h), shattering the previous record by over 100 mph.

While the impetus behind the ambitious record bid came from Sir Anthony Bamford, chairman of JCB, Ricardo was a natural partner all along. It had co-developed the four-cylinder JCB444 engine for JCB's world-class construction equipment ranges, to considerable acclaim from users and commentators, and Bamford was eager to prove the engine's prowess by using it to establish new speed records for diesel-powered cars. "I was advised by many people that building our own engine would be a mistake, yet we have proved our critics wrong," he said at the announcement of the record programme. "The JCB444 has been acknowledged as a remarkable piece of engineering,

and I believe that the engineering programme to build the world's fastest diesel-powered automobile is precisely the sort of challenge that we should rise to."

By this stage, development of the spectacular streamliner had already been underway for just over a year. To meet the challenging programme brief of a 350 mph top speed, using standard JCB444 engine blocks and heads, Ricardo defined the vehicle concept of a long, low, twin-engined car with the driver – Wing Commander Andy Green, already famous as the fastest man on earth in the supersonic jet-powered Thrust SSC – in a steeply reclined position between the front and rear motors. After full approval was given in September 2005 Ricardo focused on development of the JCB444-LSR record engines and the advanced ice tank cooling system, while working with the vehicle team to optimise the overall package and weight. The task facing Ricardo's engine experts was daunting indeed. Though they already had huge experience with the JCB engines in the original programme, early extrapolations using Ricardo vehicle simulation code VSIM, factored for the unique conditions at Bonneville with its high temperatures, its variable salt surface and its 4000 (1200 metres) altitude, had shown that each unit

"Nothing comes close to the Efficient-C car. Overall, results were clearly outstanding"

Efficient-C: delivering a 30 per cent drop in fuel consumption

In 2003, against a background of a strong consensus between European governments and the auto industry that the issue of greenhouse gas-forming carbon emissions is of major concern, the UK Department for Transport awarded a key Low Carbon Passenger Car development programme to a consortium led by Ricardo. Responding to the Government's Ultra Low Carbon Car Challenge, the Efficient-C project saw Ricardo, PSA Peugeot Citroën and Qinetiq combine their expertise to produce a fully effective and practical family car with barely half the CO₂ emissions of comparably-sized models commercially available today.

The targets set by the UK Government were demanding, specifying a five-door vehicle in the same size class as today's Peugeot 307 or Citroën C4, but capable of achieving under 100 g/km CO₂ emissions as well as meeting current Euro 4 standards. Running on pump-grade fuel, the vehicle had to meet minimum performance standards and be feasible for production within four to eight years "at an affordable price".

Supported by simulations carried out using Ricardo software suites, the partners soon agreed that a parallel diesel hybrid represented the most promising approach to meeting these demanding targets; it was also decided to base the programme around the Citroën Berlingo, a bulkier and more versatile vehicle than most family hatchbacks, but one which shared their mainstream diesel powertrains. In this way the improvements, once translated across to the more streamlined mainstream cars, would be more impressive still.

While PSA Peugeot Citroën provided hybrid components and control systems and contributed its huge experience as a leading European volume diesel car maker, Qinetiq's background in the UK defence industry brought battery and high-voltage

network expertise; Ricardo, as project leader, took responsibility for complete vehicle integration and the all-important hybrid control system.

The configuration of the drive train, with the 23 kW electric motor placed between the 1.6 litre HDi diesel engine and the five-speed automated manual transmission, allows six different modes of hybrid operation including, notably, a driver-selected electric-only mode for zero-emission city centres – judged important for future consumer appeal. Also significant is the fact that at moderate vehicle loads the diesel engine is deliberately shifted to a higher, more efficient load point as the electric motor switches roles to become a generator and store surplus energy in the lithium-ion battery. In addition, under deceleration the automated manual transmission selects the gear which produces the maximum recuperation of kinetic energy, again stored in the lithium-ion battery.

Reflecting Ricardo's considerable experience with hybrid systems integration, electrical systems power the vehicle's power steering and brake booster; a 288 volt network runs the air conditioning so that comfort can be maintained even when the combustion engine is in fuel-saving shut-down mode. A measure of the sophistication of the control system can be gauged from the fact that the Efficient-C vehicle runs with 70 Mb of bespoke control code – roughly double that of a conventional vehicle.

The headline achievements of the programme are impressive and the powertrain developed by the Efficient-C project has been demonstrated as being one of the world's most energy-efficient, significantly ahead of production gasoline hybrids as well as many other diesel research initiatives. A 30 per cent drop in overall fuel consumption (to 76 mpg, equivalent to 99 g/km CO₂) was achieved compared with the already economical standard

needed to produce 750 hp – around six times the standard JCB444's rated output in its more familiar excavator application. Soon, however, advanced engine performance simulation using the Ricardo WAVE code confirmed that with suitable two-stage turbo boosting and a substantial upgrading of their peripheral systems, the engines would indeed be capable of producing that prodigious power: more critically, those same calculations also showed that with relatively few modifications the standard JCB engine components would be strong enough to withstand the dramatically greater stresses.

A handful of key statistics give a measure of the immense demands the Ricardo engineers had to contend with: each engine needed to draw in 3.3 tonnes of air every hour in order to produce its specified power; 110 litres per hour of lubricating oil had to be pumped through each engine, while

the cooling requirement of eight litres of water per second (ten times that of a normal family car) was fed by a tank crammed with 100 kg of ice, located in the nine-metre projectile's nose.

The 50-man record squad flew out to Bonneville on schedule for the mid-August record bid. So professional and well prepared was the team that with relatively few runs a series of US national records had already fallen in the first week. During the weekend the full-power LSR engines were fitted and, over successive days, the old international speed record of 236 mph was comprehensively demolished and new world records of 328 mph and then more than 350 mph were established. Impressively, the car delivered this extreme performance virtually out of the box, despite only limited testing opportunities before the actual record bid.

"We began this project with one basic aim," said Dr Tim Leverton, project director and JCB's head of engineering. "Everything always comes back to that same starting point; we are doing this to prove our engine. To power the world's fastest diesel car with two JCB engines designed for our construction machines is a huge achievement."

This was a very bold initiative which served to demonstrate the ultimate performance that can be achieved from a diesel engine and the very best of British engineering from Ricardo and JCB.

76mpg

One of the world's most energy-efficient powertrains

diesel vehicle, while at the same time substantially exceeding the performance targets laid down in the specification. These results translate into a CO₂ emissions figure of under 90 g/km for a more aerodynamic vehicle such as the Citroën C4.

Robert Peugeot, vice president of innovation and quality at PSA Peugeot Citroën, commented at Efficient-C's London launch: "This is a technical breakthrough: it's here in front of us. It's a practical solution, but the final decision will be made by customers." With the projected incremental unit cost of the Efficient-C powertrain estimated as £3000 per vehicle, both Ricardo and PSA Peugeot Citroën are involved in activities to reduce costs such that this advanced form of highly efficient powertrain technology can be implemented in products which attract widespread market appeal.

*The **six different modes of hybrid operation** include, notably, a driver-selected electric-only mode for zero emission city centres — judged important for future consumer appeal*

Shanghai Automotive Industry Corporation

Creating a world-class product development capability for SAIC

Shanghai Automotive Industry Corporation (SAIC) is one of China's leading automakers. In 2005 alone it produced over 318,000 mainly GM-brand and VW-badged cars in China to international quality standards through its manufacturing joint ventures with General Motors and Volkswagen AG respectively. As such, SAIC is already a significant automotive manufacturer on the international stage and is growing rapidly: 2005 production was up 34 per cent on the previous year. Yet as a major element of its forward strategy the company aspires to acquire the capability to develop world-class automotive products under its own brand, both for distribution in China as well as for export to major international markets.

In pursuance of its strategy SAIC had in 2004 purchased the intellectual property rights (IPR) of the Rover 75 and 25 products of UK automaker MG Rover, as well as the K series gasoline and G series diesel engine families. However, with the collapse of the MG Rover organisation in April 2005, SAIC

no longer had an engineering partner to assist it in the realisation of new products based on this IPR. Already a trusted strategic adviser to SAIC, Ricardo recommended that a one-off opportunity presented itself in these circumstances to secure a significant proportion of the UK engineering team which had been responsible for the original development of the vehicles and engines for which SAIC had already purchased the IPR.

As the acquisition had extended beyond the individual product designs to the standards and processes used to create them, the recruitment of this engineering talent would provide a significant boost to SAIC's strategy and bring forward the creation and achievement of critical mass of its own in-house product development capability. Ricardo was ideally placed to assist SAIC realise this opportunity by providing the management skills and expertise, local facilities and technical infrastructure, coupled with class-leading automotive technology and global reach.

In partnership with SAIC, Ricardo moved quickly to establish an R&D centre which could form the basis of a UK engineering capability for the Chinese organisation, focusing on advanced research and development and product adaptation for European markets. Named Ricardo (2010) Consultants Ltd ("Ricardo 2010") and currently managed by Ricardo, the company would be developed as the overseas engineering centre of SAIC, but would have ready-made access through Ricardo to the specialist technology, design, test and development facilities of the Ricardo group – assets which would be invaluable for state-of-the-art automotive product development. Ricardo recruited some of the most talented and highly skilled engineering staff of the former MG Rover organisation to Ricardo and the UK engineering team rapidly grew to approximately 150 staff, assisted by fellow engineers and resources as necessary from other Ricardo divisions.

In addition to its role in developing the first new products for SAIC, Ricardo 2010 is assisting in the development of processes and systems for SAIC's growing in-house engineering organisation, the Shanghai Automotive Engineering Academy (SAEA).

The creation of Ricardo 2010 demonstrates Ricardo's highly innovative strategic business acumen. The success of Ricardo 2010 in the form of the first own-brand products of SAIC will further underscore the quality of the team recruited by Ricardo and the automotive technology, facilities, management skills and resources provided to this venture by other Ricardo divisions. The most enduring legacy of this bold initiative, however, will be the future products developed by SAIC with the assistance of the in-house European product development organisation which it plans to grow from Ricardo 2010.

The success of Ricardo 2010 in the form of the first own-brand products of SAIC will further underscore the quality of the team recruited by Ricardo

Suzuki Grand Vitara Diesel

French, Japanese & UK partnership delivers state-of-the-art diesel SUV

In autumn 2005 Suzuki, Renault and Ricardo completed a three-partner programme to deliver a state-of-the-art diesel version of the new-generation Grand Vitara SUV. This challenging project went from feasibility study to series production in a remarkable 19 months.

For half a century Suzuki has enjoyed sustained international success as a car and motorcycle manufacturer. In recent years its lightweight SUVs – like the Grand Vitara, first launched in 1988 – have found a receptive audience all over the world. By 2003, however, the rising popularity of diesel in the European market made the development of a diesel variant a clear imperative, a point borne out since by sales figures for SUVs in the Grand Vitara class.

While projected sales for a diesel Grand Vitara were impressive, they were not of a magnitude to make it worthwhile for Suzuki to develop its own diesel engine. Instead, the company opted to continue its existing policy of buying in diesels, and outsourced the project to Renault Moteurs, the division of the French automaker that sells powertrains to outside clients. Renault Moteurs quickly established that its latest two-litre F9Q engine would fit the new Grand Vitara's engine bay. It would, however, require adaptation for longitudinal – rather than transverse

– installation, and alterations to suit all-wheel drive and off-road use, while continuing to meet stringent emissions targets.

Renault's choice of Ricardo as its development partner owed much to the company's previous experience in developing SUV engines with diesel particulate filters (DPF). A feasibility study began in July 2003, with Ricardo undertaking the task of simulating the emissions performance of the F9Q engine under the bonnet of the heavier and less aerodynamically efficient SUV vehicle. After encouraging results, contracts were signed that November. Thereafter, Ricardo was responsible for the calibration and tuning of the engine to meet all aspects of Grand Vitara usage – from city environments to rough terrain, steep slopes and acute lateral tilts. The company also undertook the simulation and analysis work on the intake system, which had to be developed from scratch.

Two months after the first prototype vehicles arrived from Japan in March 2004, Suzuki decided to adopt permanent four-wheel drive across the whole range, in place of a switchable system. The resultant extra mass and drag had negative implications for fuel economy and – especially – for emissions performance. To remain on track for a

General Motors Global V6

Award-winning Global V6 engine family delivered to tight deadline

At the turn of the last decade GM embarked on an ambitious programme to create a truly class-leading V6 engine capable of global implementation across its brand portfolio. At the same time, it set out to create an innovative new template for powertrain product development. With extensive support from Ricardo, the Global V6 engine team delivered a truly world-class product and set new standards in performance, quality and time to market.

The selection of Ricardo as design and development partner followed previous highly successful collaboration on the development of the 4 cylinder Ecotec (L850) engine. The V6 project team brought together the brightest engineering talents from GM and Ricardo at a purpose-built technical

centre located at Plymouth in the western suburbs of Detroit, with additional support from Ricardo technical centres in Europe and North America.

The extremely tight timescale required for the Global V6 – 14 months shorter than GM's standard prevailing development template – demanded the highly innovative use of resources within the framework of a completely new development process. The Global V6 team was given the flexibility and autonomy to realise this, and a vigorous 'can-do' working culture was fostered, more reminiscent of a race team than of mainstream automotive product development. For example, Ricardo encouraged the practice of marking the completion of each new prototype engine phase with a high-profile celebratory 'first fire' event to which senior management representatives would be invited in order to start the new prototype for the very first time.

No impediment to programme progress was tolerated. At a more fundamental level, the single project base in Plymouth facilitated better communication all round – a crucial enabler of rapid programme delivery. Furthermore, the presence on site of a dedicated build and inspection facility allowed engineers a more intimate involvement in the testing process, while further economies were realised by the re-use of non-critical parts from test engines. In addition to achieving the very challenging product development targets, this highly focused approach resulted in the total resources requirement being less than originally budgeted, with funds returned to GM in the latter stages.

June 2005 launch required imaginative thinking from each project partner. Ricardo suggested alterations to the engine control strategy and, once these were made, the Ricardo specialists effected rapid changes to the engine calibration. Based on simulation work, Ricardo also recommended a change to the final drive ratio.

To meet the shortened project timescale, durability testing of the Grand Vitara diesel was carried out in two hemispheres, with the summer tests taking place in Spain and Chile either side of a successful cold climate test in northern Sweden. With its high altitudes and temperatures, Chile provides a tough driving environment, but the test team recorded positive results – well above the validated 2500 metre altitude required for the European market.

Production of the diesel Grand Vitara began in June 2005, followed by an autumn launch at the Frankfurt auto show. All three project partners agree that the successful conclusion of this complex project – on time and within budget – owed much to excellent communications; this was partly facilitated by a secure web system set up by Ricardo to flag problems and post updates. Further

Grand Vitara diesel derivatives are planned or under consideration by Suzuki, including a three door edition, an automatic transmission variant and a model for the South American market.

*from feasibility to series production
in a remarkable 19 months*

*A very tight timescale **14 months shorter**
than GM's prevailing development template*

Throughout the programme, Ricardo and GM shielded the engineering team from day-to-day project administration. "They were completely focused and just kept reminding themselves: 'It's all about the engine'" said GM chief engineer Tim Cyrus. The fruit of their round-the-clock labours was a 3.6 litre engine which, when compared to its predecessor, delivered 20 per cent more peak power, and 13 per cent more peak torque. Perhaps most impressively, the new V6 recorded a 24 per cent improvement in what GM calls torque-integral – the torque available across the entire operating speed range.

These performance enhancements were all achieved alongside reduced cabin noise levels. All-aluminium construction, four valves per cylinder, dual overhead camshafts, continuously variable cam phasing, and electronic throttle control are among the many state-of-the-art design features of the Global V6 family.

Since the product launch of the V6 in the Cadillac CTS, a wide range of variants have been developed, and the engine has been rolled out across the worldwide GM marques of Holden, Saab and Buick. The turbocharged application for Saab presented its own unique engineering challenges, but the new engine architecture has fitted seamlessly into the new

Saab 9-3 and its new Sport Combi variant, which the company claims as 'the fastest production Saab ever'.

If the Global V6 product range has received public plaudits, the team that delivered it has been recognised internally too. They won the Chairman's Honor Award as well as the 'People Make Quality Happen' award. The high level of designed-in quality at launch was, according to GM metrics, the highest achieved to date by the company. Moreover the turbocharged 2.8 litre Global V6 as installed in the Saab 9-3 was named by automotive publisher Ward's as one of its ten best engines for 2006.

Lessons learned from the Global V6 project have led to the streamlining of a number of GM Powertrain production processes, and Ricardo engineers continue to work alongside colleagues at GM Powertrain's Pontiac headquarters on future implementations of this highly successful engine family.

Chrysler HEMI®

Performance derivative is a role model for rapid programme delivery

In 2002 Chrysler launched an ambitious project to build a family of high-performance models using a new, higher capacity variant of the famed HEMI® V8 engine. Ricardo was a key partner in the ensuing development programme, which used race team techniques to deliver big performance increases against tight budgets and deadlines.

Chrysler's SRT (Street and Racing Technology) engineers are charged with designing high-profile showcase vehicles that offer outstanding performance and value. Their products, though aimed at a volume market, are developed with techniques derived from exotic cars and must generate an excitement among consumers to match. For the HEMI® V8 6.1 project, the challenge was to develop a higher performance version of Chrysler's vaunted 5.7 litre HEMI® engine, and to do it in just over two years – about half the usual project time – on a tight investment budget. Partly conceived as a role model for speeding up engine projects in general, the HEMI® V8 project sought to cut a hundred weeks from the usual development timeline. The selection of an efficient supplier – one able to differentiate honestly between a tight project deadline and an impracticable one – was crucial.

Since 1999, Ricardo engineers had been heavily involved in the development of Chrysler's 5.7 litre HEMI® engine, but there was more to the American company's choice of supplier for its successor than this successful partnership history. Another strong recommendation was Ricardo's ability to produce not just a shortlist of design options, but a single recommendation based on the soundest supporting data and advanced simulation techniques. "Ricardo also brought good programme management" recalls Chrysler SRT director Dan Knott. "You don't often find technical engineering suppliers that can do the very strong technical work and do the simulation work and also have good programme management skills".

After a small team had made an initial assessment, a thirty-strong phalanx of Ricardo engineers and

*The HEMI® V8 project sought to **cut a hundred weeks** from the usual development timeline*

designers was seamlessly integrated into Chrysler's SRT team in Detroit late in 2002. Their brief was to produce an engine that would fit under the bonnet in place of its 5.7 predecessor without requiring any different procedures at the assembly plants – and deliver a 23 per cent increase in horsepower and a substantial increase in torque. The 425 hp target – which was increased from the 390 hp envisaged at the outset of the project – was achieved by adding more engine capacity through a larger cylinder bore, by increasing the compression ratio, and by redesigning the cylinder head, valvetrain, intake manifold and exhaust systems for increased flow. Strength was added to the new HEMI® 6.1 by a reinforced engine block, a forged steel crankshaft and high-strength powdered-metal connecting rods. Maximum peak power output engine speed was increased by 20 per cent to 6000 rev/min.

To achieve these engineering improvements within a two-year timeline was impressive. An important factor in this success was the extensive use made of Ricardo's computer-aided engineering (CAE) expertise – the Ricardo team took the leadership role and supplied half of the programme's CAE support. Another factor in realising these goals was Ricardo's experience in racing and in exotic cars, which translated into a strong sense of teamwork and urgency. As Pete Gladysz, Chrysler's senior

manager at SRT powertrain, commented: "I used Ricardo because ... we would get to the answer 20 to 40 per cent quicker because of their specific knowledge."

The completed 6.1 litre HEMI® engine now features in the Chrysler 300C, the Dodge Charger and Dodge Magnum, and the Jeep Grand Cherokee, each of which can be bought with the added SRT8 designation. The racing philosophy was built into these cars, and they have impressed the public and media alike.

BUSINESS REVIEW

Marketplace
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Financial Position
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Conclusion

"Far from being a mature, static industry, one could consider the automotive sector to be in its global infancy, with opportunity and challenge abounding"

Dave Shemmans Chief Executive Officer

The ever-changing automotive marketplace

The century-old automotive industry (including passenger car, commercial vehicle, motorcycle, off-highway and motorsport), of which Ricardo has been part from the earliest days, is far from static and globally mature. Today, the industry is facing some of its toughest-ever challenges on many important fronts - commercial, legislative, environmental, competitive and technical. The established automotive markets continue to face excess capacity and competitive pressures are sharpened by an ever more demanding consumer base characterised by customers who are increasingly open to change, demanding of features and intolerant of poor quality and reliability.

Energy security, pollution control and improved safety drive the automotive market

With increasing oil prices and a greater focus on the environment, the major global economies are looking to minimise the environmental impact of carbon-based fuels and protect their valuable and limited fossil-fuel based energy resources by legislation and political pressure to reduce emissions and improve fuel consumption. These pressures, together with similar drivers for automotive safety, and consumer demand are driving technological change and increasing the sophistication and cost of the vehicle. However, the combination of overcapacity and intense competition have led to this cost impact not being passed on to the consumer, with the result that industry margins are under pressure more than ever. As margins come under greater pressure and the level of technology increases, there is a greater focus on improving volume and enhancing brand and product attractiveness to gain premium pricing and drive market share up, thus improving plant utilisation.

Technological change, reduced time to market and quality have to be balanced with cost

Core drivers here are quality, reliability, time to market and feature content, together with commonality and inter-company platform sharing to help control development, manufacturing and product costs. In addition, continuous improvements in the engineering process are necessary to reduce costs, to keep up with the demands of product throughput, to deal with the changing technologies and to ensure the high quality and robust introduction of new technology. It is all too easy to damage a once revered brand with a poor product introduction or poor quality. The advent of increasing electronic content is of high concern for many of the manufacturers transitioning from a mechanical-based mindset and method of operation.

Globalisation is opening up new markets, creating new entrants and low-cost sources

At the same time, the industry is facing significant opportunities, driven by the major fast-developing global economies which can offer industry-changing cost bases made accessible through the ever increasing transparency of information

technology, improved logistics, management practice and process. Moreover, as these regions open up to personal mobility and the introduction of passenger car transportation, vast new markets are being introduced and are growing at significant rates. The pace at which new market entrants can succeed is accelerating as opportunities to learn increase and past mistakes can be avoided. Japanese manufacturers long since established the model of entering the market from a lower cost base, learning from the established players, developing a domestic market, improving quality through process and then launching export with localised product. Korean manufacturers soon followed. Chinese manufacturers are now adopting this model.

Established players in the West are being seriously challenged by eastern manufacturers

These pressures are driving significant market share shifts in the industry. Companies once considered as institutional US and European players are losing their previously dominant positions and are in some cases disappearing altogether. This impact is being felt along the value chain both at the OEM level and the Tier 1 level, and past success, even at national level, is certainly no guarantee of future position. The open market decides share in a globally transparent industry which has information on product competitiveness, price and quality readily to hand from internet and industry commentators.

The industry drivers have led to a global shortage of experienced engineering resource

This global demand for new technology, product development and increased product throughput has led to a global shortage of key engineering

resource, particularly in crucial specialist areas such as electronics, software design, systems integration, diesel engineering and hybrid systems designs. At the same time, the need to ensure maximum profitability of existing product through cost-down and warranty improvement has exacerbated the pressure. To balance this shortage, conventional highly serviced areas such as detailed mechanical design and software coding are being commoditised and relocated to lower cost regions. Companies supplying in-demand engineering capability, technology and fast-track, on-time robust development processes will be well positioned.

The global, technological and product-led dynamics create significant opportunities

The requirements for high quality, attractive, legislation-compliant and reliable vehicles delivered from a low-cost, heavily utilised base have never been greater. In today's global automotive industry there is little compromise on product design, product performance, cost, safety or quality – all have to be prioritised to be competitive. Moreover, all need to be continually improved as the position constantly changes, with increasing globalisation bringing greater complexity, competition and opportunity to all those who operate in the industry.

Far from being a mature, static industry, one could consider the automotive sector to be in its global infancy, with opportunity and challenge abounding.

Ricardo strategy – The global premium deep content automotive consultancy

To exploit the opportunities provided by the changing automotive landscape, Ricardo has put in place a new strategy and direction to firmly establish itself as the global premium deep content automotive consultancy. Ricardo will continually review and enhance this strategy and its technology and product offerings to retain its position as a natural first choice at the heart of the value-added automotive consulting market.

Against the industry backdrop described above it is clear that the global industry faces many challenges – from the strategic to the specific, from the system to the component, from the process to the product, and from the global to the national. Ricardo is positioned to apply its intellectual capital to these issues and provide profit-enhancing solutions to the global industry. Its mission is to add value through innovation and technology, with professionalism in all it does.

Uniquely positioned with offerings from blue-chip management consultancy, strategic consulting, advanced research, model-year product development and post-production support, Ricardo can apply itself to solving the most challenging global strategic and delivery issues, whether at the component/system level (eg. engine, transmission, driveline, electronics, chassis) or at the whole-vehicle level. Ricardo prides itself on flexibility, innovation, technical excellence and fast-track assured delivery.

The strategy of the business is underpinned by four cornerstones which reflect the changing and challenging nature of the automotive industry: avoidance of cyclicalities and dependency; focused high-quality growth; high-value services; and low cost through global operation.

Avoidance of cyclicalities and dependence

Cyclicalities is not only a geographic phenomenon driven by economic performance. It can also be a reflection of the maturity of a region. For example,

mature automotive regions may well have the engines and transmissions required and, due to their position in the life-cycle, these regions may be in an upgrade phase where the work would be typified by product application and enhancement. An immature region, on the other hand, may be moving from manufacturing under licence to the self development stage where the work would be typified by new design-to-production programmes.

Technology also has a cyclicalities which needs to be respected, as can be evidenced from the current focus on diesel and hybrids, whilst gasoline remains attractive and is likely to return to focus. Customer performance and sector performance (commercial vehicle vs passenger car) are also cyclical.

Ricardo aims to reduce risk in the business by respecting the inherent cycles within the industry and spreading its services by geography, technology, customer and sector. This also provides a platform for growth.

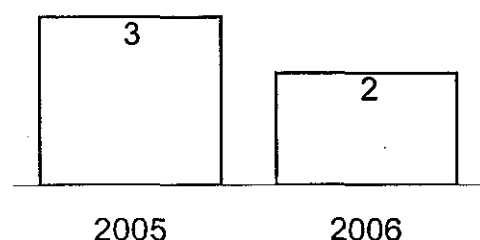
Focused high-quality growth

With a clear focus on research led high-value consulting, and a broad range of services from top-end deep content management consulting to fast track assured product development engineering, Ricardo targets high-quality growth by researching, prioritising, investing in and exploiting new regions, sectors, customers, technologies and services.

The focus is always towards high-value offerings which deliver significant benefit to high-quality

figure 1

Number of clients with revenue for Ricardo exceeding £10m pa



customers. Geographically, the focus is on established automotive regions and fast developing economies. Within each region we look to exploit all services where appropriate, providing a platform for high-quality growth.

High-value services

Ricardo technologies and solutions follow a similar life-cycle to products – in-demand services will be copied, market competition will increase, prices will decay, services will be commoditised, delivery will be off-shored and finally turned into a process or software package. Ricardo recognises this life-cycle and looks to avoid commoditisation by continually investing in new technology, thought leadership and innovation with a clear focus on research-led high-value consulting, where maximum benefit can be offered to the customer and the maximum benefit returned to Ricardo – in some instances sharing the benefit with the customer.

Low cost through global operation

With the opening up of global regions and significantly reduced costs bases, Ricardo can utilise these opportunities to migrate products which have become commoditised to extend profitable life. Moreover, Ricardo utilises these regions for products which are moving towards commodity status to maximise margin and takes advantage of the local supply base for lower-cost components for the niche manufacturing businesses. With an increasingly global, strategic and technically advanced product offering and operation,

the importance of management, information technology, process and logistics is core to ensuring an efficient and effective operation that avoids waste. In addition the existence of engineering centres situated in multiple time zones enables delivery around the clock reducing development time and delivering further value to our customers.

The above four cornerstones of the strategy are delivered through an integrated framework of six brand pillars as follows:

Global

The Global framework reflects the importance of being geographically diverse, both from a market and a delivery perspective. Ricardo facilities are matched to the region, not only to ensure they reflect the customers' needs for local engineering and liaison, but also so that they can take advantage of the ever shifting global cost base and the changing supply of high quality engineering resource. In addition to its established development centres in the US, UK, Germany and the Czech Republic, Ricardo has opened up offices for further development in Japan and China. The Global framework also reflects the servicing of not only the passenger car markets but also other sectors including the commercial vehicle, motorsport and special vehicle markets – markets which are often equally legislatively driven as well as technologically related.

figure 2

Number of product groups exceeding
£10m pa revenue

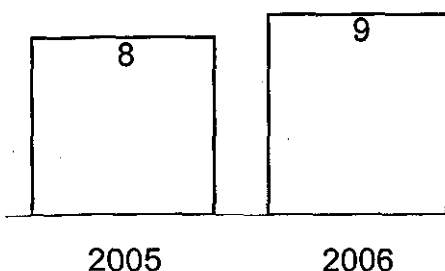
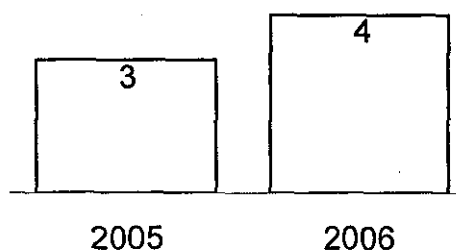


figure 3

Number of countries with revenue for
Ricardo exceeding £15m pa



Premium Brand

The Premium Brand framework reflects more than just the history, the professionalism of service and the future direction of Ricardo. It is also a catalyst for new customers and enables Ricardo to recruit the very best engineering talent. It is a key part of the strategy to uphold the Ricardo brand by maintaining total professionalism in all actions and to promote the brand widely, thus ensuring its protection whenever challenged. Ricardo's Premium Brand, its high-quality talent, its fast-track robust process, its leading-edge technologies and its past track record all raise the barriers to entry for competitors.

World-class technologies and products

The framework for World-class technologies and products is a key differentiator for Ricardo, and one which benefits from significant internal investment and collaborative funding by international governments and clients alike. Innovation and technology are at the heart of the Ricardo value proposition and the excellence of delivery therein is core to the Premium Brand. Ricardo continually upgrades its technologies and products to ensure it stays ahead of the industry. This is accomplished using proven technology road-mapping processes and targeted investment into new ideas, tools, techniques and technology demonstrators. Such investments lead to improved branding and market positioning, new business wins, technical awards and IPR returns, either from demonstrated technical advances, strategic processes or reduced time and cost to market. Ricardo is viewed as a leader in key fuel economy improvement, emissions reduction and performance enhancement areas including hybrid technology, diesel technology, electronics integration, boosted gasoline technology, active safety and advanced transmissions design. Moreover, Ricardo is seen as a proven partner for strategic advice and production programme delivery.

One firm

As an organisation with a global operating footprint – both in terms of market and delivery – Ricardo has adopted a One firm approach to reflect the need for flexibility, team work, speed and global mobility. Each of these is an enabler for geographical growth and global connectivity. This framework manifests itself through global processes, organisation, standards and management, reinforcing the Premium Brand and ensuring that Ricardo customers access the same high level of world-class products and technologies wherever they approach Ricardo.

Right team, right culture

Underpinning all of the above is the core asset of Ricardo: the people – Right team, right culture. For any professional services business it is imperative that the company recruits the best, retains the best and develops the best within an environment of One firm team work. Ricardo is creating a dynamic, winning environment designed to attract the best and provide a stimulating environment with opportunities for global career and technical progression for all, whilst at the same time ensuring that high performers are stretched and developed to the full. To ensure consistency of culture, the values of client commitment, innovation, learning, team spirit and shareholder return are promoted through the management of the operations and are embedded in the processes.

World-class infrastructure

Finally, World-class infrastructure: the machinery of operation which provides the global connectivity, flexibility, management and responsiveness to the customers, employees and shareholders – World-class infrastructure in the shape of facilities, tools, processes, supporting functions, knowledge management, business management and information technology. As with the front-line service and product offerings, Ricardo strives to be professional in all that it does, demonstrating world-class capability in these key areas with global consistency and streamlined process.

Business Performance

Overall, our profit improvement continues and we are seeing the benefits of our re-focused strategy to broaden the geographic reach and client base, which has helped us to deliver a significant profit increase despite poor market conditions in Germany. Asian clients are contributing strongly, and the commercial vehicle and military sectors are bringing an improving balance to Ricardo's business.

Revenue for the financial year to 30 June 2006 was £173m (2005: £158m) with the increase driven by our Strategic Consulting division and our UK and US operations. Against this, our German operation, as predicted, has suffered in the period against a weak market. Group underlying profit before tax and an exceptional pensions credit of £3.7m was £10.8m (2005: £8.6m). Earnings per share excluding the pensions credit increased to 18.8p compared to 14.8p in the prior year. There was a cash generation in the year of £5m and net borrowings reduced to £5.8m.

The final dividend proposed is increased to 6.7p (2005: 6.3p) per ordinary share and will be paid on 24 November 2006 to all shareholders on the register at close of business on 27 October 2006.

Control and electronics continues to operate at full capacity, underpinned by a growth in hybrid programmes, while diesel and transmissions programmes continue to grow on the back of our low emissions research and dual clutch technology investments respectively.

Despite the continued challenges facing some of the major global car manufacturers, the Group order book showed an increase year on year to £72.2m from £69.7m last year.

Strategic Consulting is continuing to develop well and delivered a strong result in the year, underpinned by three significant programmes in Asia and North America. It significantly grew its client base, turnover and profitability with major activities in the key areas of cost reduction and quality, thus delivering profitability improvements to clients.

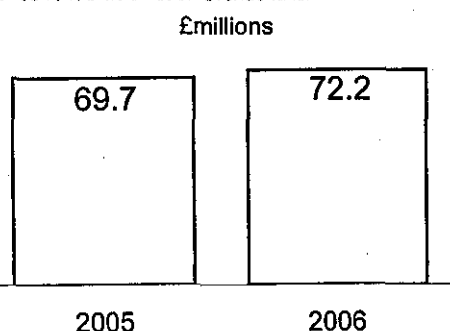
We continue to expand our Prague technical centre in size and breadth. It now encompasses mechanical, electronic and software capabilities, providing all divisions across the Group with a cost-effective engineering resource.

Our business focus and investments remain targeted at increasing the strength and robustness of our client base and the delivery of higher value-added services based on technology and innovation.

Amongst other quantified measures, in this review we have reported performance data or graphically displayed information for revenue, order intake, research and development, cash, pensions deficit, customer satisfaction, accident statistics and energy usage.

Figure 7

Order book Order book value is the value of current orders net of revenue taken.



Technical Consulting

Our technical consulting business has well-equipped technical centres in the UK, North America, Germany and the Czech Republic, and satellite offices in Japan and China. Whilst we manage the performance of the technical consulting business in this way, we draw from wherever necessary to put the best teams possible together for our clients.

UK

Our UK business increased its turnover and profits against the prior year with a better balance of engine, transmissions, vehicle and electronics activity than previously.

The engines business benefited from an increase in demand for diesel technology, driven by future emissions legislation and an increasing market share for diesel in both the passenger car and commercial vehicle sectors. Gasoline engine activity remains low in Europe and continues to be driven by our Asian clients as many look to establish their own family of products for both domestic and export markets.

The programme with Shanghai Automotive Industry Corporation ("SAIC") continues to progress well with new product development being conducted within Ricardo 2010 and other parts of the business. The relationship continues to develop as SAIC becomes a well established customer for Ricardo.

The transmissions business has returned to good levels of activity with some high profile supercar programmes and an increased level of engineering programmes from the commercial, passenger car and motorsport sectors. Our research into dual clutch technology and safety-related torque vectoring is gaining market interest with orders.

The high performance transmissions products operation had a very busy year, with the supply of production units for Bugatti Veyron and Ford GT running at full customer schedule levels.

The vehicle business has had a much improved period, driven by continued activity on established programmes supporting new product introductions and increasing activity from the commercial and military sectors.

The control and electronics business continues to grow and is running at high levels of capacity, underpinned by significant hybrid interest and pending on-board diagnostics and emissions legislation across the globe. We see demand for professional services in this area continuing to grow in the future. We will invest accordingly to support this key strategic technology, which is at the very heart of future automotive engineering.

US

Despite the much-publicised difficulties of the North American car industry, our US operation has delivered increased turnover and profits during the period on the back of orders from a broader client base in the passenger car, commercial vehicle and military segments. We continue to support the major passenger car OEMs with powertrain, vehicle and electronics engineering programmes, although the market is highly competitive. Our commercial vehicle activities are performing strongly, centred on broad-based activity in the marketplace and a healthy client base. The need for new truck engines to meet 2007 and 2010 emissions legislation is driving high utilisation in our new heavy-duty test bed centre in Chicago in particular. As in the wider global marketplace, we are also seeing increased electronics, hybrid, diesel and transmissions activity in North America.

We have restructured the development and marketing of our global software products to report into the US and we are pleased to see the lead product, WAVE, performing strongly in the market. We have also introduced two new design and analysis products, FEARCE and SABR, and software sales overall are contributing well.

Germany

As anticipated, the weakness in the German automotive industry continued throughout the year and impacted those serving the marketplace, including Ricardo, resulting in a loss in the period. This German operating loss, excluding £0.2m in respect of a senior management change at the end of the financial year, occurred in the first seven months. The engineering side of the business, which has until recently been of a lower value-added nature than the rest of Ricardo's business and targeted at fewer customers, has made significant progress in the second half developing new clients, and is starting to win larger high value-added programmes which are not only benefiting the German operation.

Our investment in people, tools and facilities such as heavy-duty test cells continues to increase the level of high value-added capability. By adopting a more client-focused organisation in line with the rest of the Group and by adding a much stronger cross-selling team philosophy, we have enhanced the leadership of the business through structural changes. We are already seeing the initial results of these investments in terms of test-bed commitment and increased orders from a broader client base including the commercial vehicle sector and other automotive sectors. Whilst we anticipate our German business returning to profit in the new financial year we remain cautious of the outlook until the German industry returns to more buoyant levels.

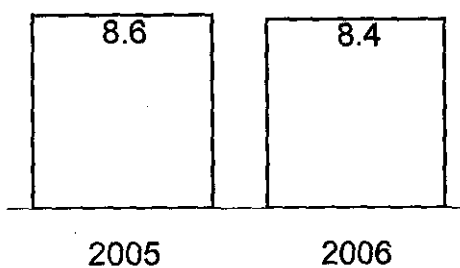
Asia

As previously announced we have opened offices in Tokyo and Shanghai in the past year: these operate as the front-line access to our increasingly important and growing Asian client base, delivering 21% of our yearly order intake. The work secured in the Asian regions (including Japan, China, India, Korea and Malaysia) is primarily fed back to the UK operations but as our Asian customers increasingly have global operations, this will positively impact our US, Czech and German operations.

We continue to expand our capability and staff in the region. In the second half of the financial year we decided to develop our presence further in China by establishing a modest Technical Centre in Shanghai, with the encouragement of our growing customer base there. We see Asian customers providing stability against the difficulties of some US and European manufacturers, and generating long term growth potential based around technology and innovation.

figure 8

Average customer satisfaction rating of projects (out of 10)



Strategic Consulting

Our Strategic Consulting division has had a strong year delivering key programmes for high quality clients globally. It increased turnover and profits from an expanded client base. Our work has now evolved significantly from Ricardo's historic automotive practices in terms of the nature of programmes. We continue to secure strategy and operational improvement programmes against the more traditional consultancy market leaders.

Our offering of automotive specific, deep content management consultancy continues to be well received by clients with high levels of repeat business and contributes well to the Group results. We focus upon projects with high financial and strategic value for clients delivering top line growth and bottom line improvements. Product cost reduction and quality projects are the core activity by volume. In this area, across a number of projects, we have made significant reductions to clients' cost bases for new products, mid-life cycle changes, mature products and life cycle costs through warranty cost reduction. One important differentiator valued by our clients is the combination of business and technical consulting which allows us to deliver detailed, tangible and fully technically validated results, which we

can implement if required. In consequence, the consulting business has passed through significant levels of technical consulting in the year to the rest of the Group as customers move from strategy projects to technology and product development. Our acquisition support, business restructuring and turnaround advisory services have been used by vehicle manufacturers, suppliers and investors and continue to be in demand as the industry addresses the ongoing challenges of globalisation and intense competition. The introduction of new technologies and the drive for new markets is also creating demand for market, product and technology strategy to support growth. We continue to develop service offerings in the business to ensure we remain at the centre of thought leadership in the industry.

Geographically our highly mobile teams are now working in Europe, Asia, North and South America mainly with clients in the passenger car and commercial vehicle sectors. We are steadily building a multi-centre international team of consultants with in-depth automotive experience and remain convinced that our 'deep content' approach will generate growing demand for our services.

"An excellent operating performance with improved margins, coupled with a significant reduction in the pensions deficit"

Andrew Goodburn Finance Director

Financial Position

This is the first set of annual results presented under International Financial Reporting Standards. Net Assets at 30 June 2006 were £50.1m, compared with £36.7m a year earlier. This increase was due mainly to the profit in the period after payment of the dividend and a decrease in the net pensions deficit.

Ricardo 2010

In May 2005, Ricardo signed an agreement with SAIC to set up a UK research and development centre for them at our Leamington premises. A new wholly owned subsidiary named Ricardo (2010) Consultants Limited ("Ricardo 2010") recruited a team of approximately 150 engineers (mainly ex-Rover). Ricardo derives its income from this contract by charging Ricardo 2010 fees for managing and administering the R&D centre plus a service charge for the facility provided. Ricardo 2010 is also a customer for normal Ricardo services. Under the terms of the agreement, SAIC has an option to acquire Ricardo 2010 for £1 and can give three months notice to exercise this option from 1 July 2006. As we fully expect this option to be exercised within our new financial year ending 30 June 2007, we have treated Ricardo 2010 as an asset held for sale within the financial statements for the year ended 30 June 2006. Details of the Ricardo 2010 results may be found in note 10 to the financial statements. SAIC have indicated to us that after exercising their option they intend to remain at our Leamington premises for the foreseeable future and Ricardo will continue to provide administrative services. We also undertake significant engineering projects for SAIC in the core business.

Capital Expenditure

Capital expenditure in the year was £8.4m, which included £2.7m to upgrade four engine test cells in Germany to heavy-duty diesel capability to satisfy the increasing demand to meet the new truck engine emissions legislation. The balance of the

expenditure was necessary to maintain our facilities up to date. At the year end our capital commitments totalled £0.4m.

Looking forward, it will be necessary to upgrade our office buildings at Shoreham-by-Sea which have become rather dated and we have therefore planned to reorganise the site and improve the quality of the buildings to the standard of the rest of the Group. Nevertheless, our capital expenditure is likely to remain less than the depreciation charge for the foreseeable future as we do not anticipate the need for any significant new facilities in Asia.

Working Capital

The increase in trade and other receivables reflects the higher level of revenue and also reflects the fact that payments from some of our newer customers in Asia tend to be slower than the western OEMs. We continually review the recoverability of our debtors and work in progress, and in particular we closely monitor the financial position of the major OEMs in North America. It is important to note that our exposure to the major OEMs in North America has been reducing significantly in recent years.

Tax

We continue to benefit from research and development government tax incentives in both the UK and North America, which has resulted in a low effective tax rate since April 2002. Whilst we expect these tax incentives to continue, an increasing proportion of the work we undertake in the UK is for new customers, particularly in China and India where payments are often subject to withholding taxes, so our overall effective tax rate may increase a little.

figure 9

Net borrowings (£m)

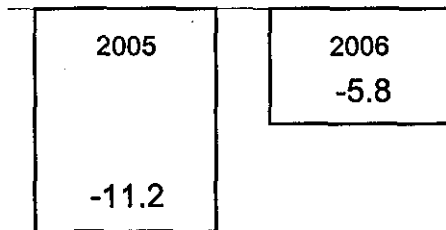
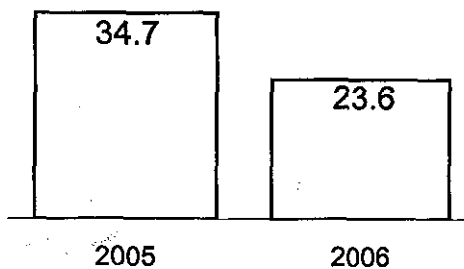


figure 10

Pension deficit (IAS19)



Treasury

During this financial year the Group generated £5m cash, reducing its net borrowings to £5.8m, which gives a gearing of 12%. Provided our level of profits continues to improve, and coupled with capital expenditure at a level less than the depreciation charge and a continuing low effective tax rate, the Group should continue to generate positive cash flows despite increased pension contributions.

At the year end the Group had borrowing facilities of around £35m, which included two Euro loans totalling €23m repayable over the next five years.

As a large proportion of the work carried out in the UK is for European customers, we have a significant exposure to the Euro, which we hedge as appropriate. Most of the work we carry out for our North American customers is undertaken by our US subsidiary and therefore our exposure to the dollar is mostly restricted to the translation of our dollar earnings.

Dividend

This year, as we have started to rebuild profitability, we are proposing to increase the total dividend to 9.4p per share following two years of no increase. This gives a dividend cover of just over two times.

Pensions

During the year the actuary finalised the triennial valuation of the defined benefit pension scheme, which is closed to new entrants. On the ongoing basis the deficit as at 5 April 2005 increased from £9m to £21.9m. The main reasons for this increase were more prudent assumptions being used for future investment returns and mortality, coupled with the falling bond yield and a poor equity investment return over the three-year period. We have also reached agreement with the Trustees firstly to increase the employer's contribution to

15.2% of active members' pensionable salaries, which will be capped to inflation going forward, and, secondly, to pay off the deficit over nine years. This requires an additional £1.7m to be paid into the fund annually. Whilst this additional contribution does not affect the charge to the Income Statement, it is an additional strain on our cash flow.

Under IAS19, the deficit in our defined benefit pension scheme reduced from £34.7m to £23.6m due mainly to a better than anticipated return from the equity investments in the fund, a slightly improved bond yield in the past twelve months and the effect of capping pensionable salaries to inflation. The effect of the capping reduced the deficit by £3.7m which under IAS19 is reflected in the income statement as a pensions credit, rather than through reserves. At 30 June 2006 a little over 70% of the fund was invested in equities and the investment strategy (subject to annual review) is to reduce this proportion to 45% by 2013.

Research & Development

Ricardo has developed a sophisticated process to identify future research needs and to identify programmes and deliverables that provide tangible added value to our products and services. This process is focused on defining future technologies and skills that are most likely to be required by *the automotive industry in the future*. In line with the drive towards more cost-effective research processes, Ricardo has also actively encouraged more collaborative research programmes. Most internally funded research now attracts collaborative support from a range of automotive customers, often with added government funding in the US, Europe and the UK. Key metrics have also been developed to monitor both execution and exploitation of these projects to maximise the potential return on investment.

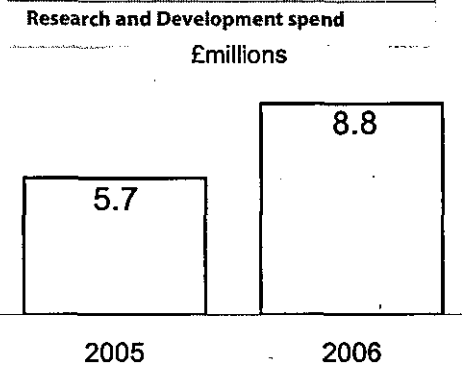
Future priorities are defined through a roadmap and review process that is continuously validated with automotive customers. In addition, Ricardo actively participates in publicly funded technology planning exercises such as the Foresight initiative in the UK and the cross-sector ERTRAC (European Road Transport Research Advisory Council) that produces the Strategic Research Agenda for Europe. Research planning in Europe is entering a new phase

as a result of the complexity of interactions between energy security, carbon emissions, competitiveness, vehicle and road safety and the socio-economic factors or behavioural issues that interact with transport demand, vehicle choice and use.

Vehicle use is predicted to grow in all markets, even where sales growth has stagnated. In Europe, increases of around 32% in passenger kilometres are expected by 2020, and 69% in tonne kilometres for goods. Future needs are currently dominated by demand for cost-effective reductions in carbon and exhaust emissions, together with improvements in vehicle safety. ERTRAC has set a 40% target for improved vehicle efficiency and CO₂ emissions (a fleet average of 95 g/km for new passenger cars by 2020). In addition, a 10% improvement has been defined for heavy-duty trucks and a 40% improvement for buses. This equates to an overall 30% reduction in average CO₂ emissions for the new vehicle fleet in 2020. In 2005 there were over 40,000 fatalities from road transport in the 25 EU member states and over 1 million injuries. A target to reduce fatalities by 50% from 2001 to 2010 does not look possible with current trends. With over 90% of accidents wholly or partly due to human factors there is increasing focus on active or integrated safety technologies that intervene in vehicle steering and braking when potential collisions are predicted.

The strategic research agenda to deliver the environmental targets has identified efficient internal combustion engines and advanced fuels, and hybrid ICE/electric technologies in the short to medium term, with a focus on fuel cell and hydrogen fuel in the longer term. However, there are important contributions that could be made from research into improved road infrastructure and intelligent transport systems using vehicle-to-vehicle and vehicle-to-infrastructure communications.

figure 14



- Our programme to develop an advanced light duty diesel combustion system compatible with the Tier 2 emissions requirements in the US has also made very good progress. A closed-loop control approach based on cylinder pressure measurement has been successfully applied and a range of patent applications has been made for some innovative gas exchange systems.
- The programme to develop a switching 2-stroke to 4-stroke boosted gasoline engine has moved to the hardware stage. An electrohydraulic valve actuation system has been successfully designed and implemented to enable flexible valve operation.
- Good progress has also been made to develop a virtual engineering tool set for low emissions diesel vehicles. This programme includes a more fundamental method of engine control based on the WAVE simulation code developed by Ricardo for engine design optimisation.
- The programme to support planning of the HyCOM initiative to develop hydrogen communities has also been launched successfully. An expert mission to the US has also been carried out to compare European and US perspectives on future hydrogen use.
- An active torque vectoring unit, varying the torque from left to right rear wheels via electronic control, has also now been completed for a demonstration vehicle. The control approach to enhance vehicle handling through torque vectoring has also been developed using our advanced prototyping capabilities.

These communication systems and new sensing technologies will lead to integrated protective safety systems, reducing the probability of accidents and improving road safety for both vehicle occupants and vulnerable road users and pedestrians.

A holistic view of various measures to improve road transport efficiency and reduce carbon emissions is shown in figure 12. This compares the overall benefit to society with the difficulty in implementation.

Whilst efficient powertrains and low carbon fuels will remain a key contributor to environmental benefits, this must be balanced with the potential benefits from improved traffic management and intelligent transport systems. It is also clear that with so many complex interactions, a higher level of strategic analysis will provide a much better understanding of the relative merits of investments in vehicle, infrastructure and education to influence behaviours.

As a key contributor to the strategic research agenda, Ricardo is also well placed to support collaborative R&D programmes where these align with R&D strategy. A summary of European funded programmes where Ricardo leads or plays a major part is shown in figure 11.

Ricardo has also led a range of research projects supported by public funding in the UK that integrate with the Ricardo R&D strategy. These projects are designed to deliver new products and services that add value to Ricardo as shown in figure 13.

A range of collaborative projects is also under way with key customers that will also deliver important new products and technologies in both the short and medium term. The combined R&D programme at Ricardo is organised into a portfolio of Technology Platforms. These platforms align with key product areas and allow a more integrated approach and have

delivered some outstanding benefits during the past year:

- Our low NOx heavy duty diesel engine programme has completed an initial phase of single-cylinder engine tests using a very advanced, flexible fuel injection system. With a high degree of pre-mixed combustion, the emissions levels from these tests are consistent with projected Euro 6 targets.

Corporate Social Responsibility - commitment to stakeholders

Ricardo's approach to all its stakeholders and its responsibilities towards them is underlined by a set of values based around the maxim 'professionalism in all we do'. Ricardo therefore aims to manage its business and communicate with all its stakeholders professionally and responsibly.

The board recognises stakeholders as any person or organisation who is affected by the business. This includes shareholders, clients, staff, suppliers, local communities and those representing the regulatory environment. In addition, a significant amount of Ricardo's work for the automotive industry is aimed either at reducing vehicle emissions or improving safety, which indirectly impacts the environment and society at large.

Responsibility to the board for relations with all our stakeholders lies with the Chief Executive Officer.

Shareholders

We are fully committed to increasing the value of the business to our shareholders and therefore to communicating with our shareholders to reassure them of our focus on enhancing the value of the business. Delivering results and dividends is recognised as an essential part of this. We also recognise that our shareholders give us an independence that is crucial for our clients and that enhancing the value of the business also protects the long term interests of all our stakeholders.

Clients

Our commitment to our clients is fundamental to the future success of the business. We work hard to understand our clients, anticipate their needs and deliver outstanding solutions that give total client satisfaction and improve client performance. We care about our clients, enjoy working with them, and want them to enjoy working with us. We aim to be quick and flexible in our response and easy to work with. We rigorously uphold client confidentiality.

Staff

Values

As part of our transition to becoming one firm globally we have set out to our employees our core values of team spirit, learning, innovation, client commitment and shareholder value. In each of these we expect professionalism in all we do, with no compromise. These will be at the heart of the behaviours we demonstrate in the organisation and they will be reflected in our performance management and reward systems. Our human resource policies seek to combine the aspirations of operating globally and setting minimum standards for all of our businesses whilst at the same time recognising the cultural and legislative differences that exist locally and how we integrate with them. As an organisation primarily based on human capital we pay particular attention to ensuring we have the right environment to increase the motivation of the team, with the right calibre of people through succession planning and development of staff internationally to meet our increasingly global needs.

Responsibility and verification

Our success in achieving our goals with respect to our staff is reviewed by the board, paying particular attention to succession planning and general employee satisfaction. In addition, the Audit Committee, through its internal audit programme, monitors compliance with human resources policies. For the first time, a Group-wide employee satisfaction survey has been carried out by an independent organisation. The response rate and positive engagement of the staff in the process was good. The process has established a good basis for continuous improvement in the achievement of our goals with respect to our staff and therefore with respect to our other stakeholders as well.

Diversity

The Group seeks to employ and develop staff from diverse backgrounds, irrespective of gender, age, disability, race, religion or sexual orientation and increasingly is broadening its nationality pool as

*Ricardo has a long established heritage of **investment in advanced research and innovation**, resulting in new technologies and engineering tools*

global demands require. In certain skills the relevant national populations demonstrate significant biases in gender and these can be reflected in Ricardo's staff make-up. Group policy is that the training, career development and promotion of people with disability should, as far as possible, be identical to that of any other employee. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues. In the US, there is a proactive approach to complying with the Equal Employment Opportunity Commission requirements, which are focused towards equal career enhancement opportunities for all staff and recruits.

Communications

Our policy is to involve employees in the progress and development of the Group. A Group briefing is published internally every month and cascaded to all staff, supplemented by additional divisional briefings and meetings. In the UK a works council has been in place at the Shoreham Technical Centre for many years. A workers' council has been set up in our German business. Since his appointment as Chief Executive Officer in November 2005, Dave Shemmans has delivered briefings on all the main sites to update staff on the strategic direction of the Group, including open question and answer sessions. The quarterly house magazine RQ is also available to all staff.

Developments in the year

There have been a number of management changes implemented during the period to strengthen the operations in Germany, Japan and the UK, to bolster programme delivery and to move towards a more co-ordinated Group operation where we can maximise the resources across the Group, improve quality and avoid duplication. These changes have brought on the best of the internal talent and also attracted external expertise where necessary. The management team has been strengthened with the external recruitment of a president for our Japanese operation, Akio Okamura, and a new business development director for the UK, Raul

Meyer. Both of these roles have been filled with experienced automotive industry people who have spent a major part of their career with blue-chip management consultants. In addition we have strengthened the technical leadership with the recruitment of a new head of vehicle engineering, Don Irvine, a new head of heavy duty engines, Peter Heuser, and a new US-based head of our control & electronics business, Karina Morley, which will increase our penetration of the US control and electronics market and build the business globally. We look forward to their contribution and impact on the market place. Despite the skills shortage, we have managed to increase total staff numbers in the year with high quality staff, mostly into Prague and the Midlands Technical Centre in the UK.

We are also pleased to report that Paula Bell has been appointed to join the board of directors on 9 October 2006 and take over from Andrew Goodburn as Group Finance Director with effect from the Annual General Meeting on 10 November 2006 before he retires in January 2007.

Health & safety

Ricardo is committed to compliance with local health and safety legislation, maintaining a safe working environment, and striving towards a reduction in the level of reportable accidents over time. Training in health and safety awareness, impending changes in relevant legislation and other specialist subjects are fully supported. Health and

figure 15

Reportable accidents
based on UK HSE definitions

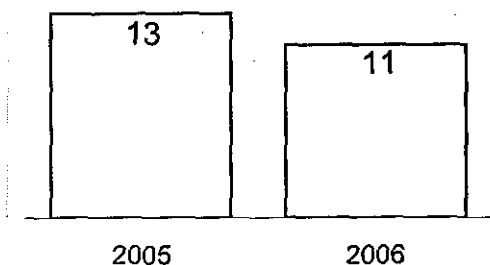
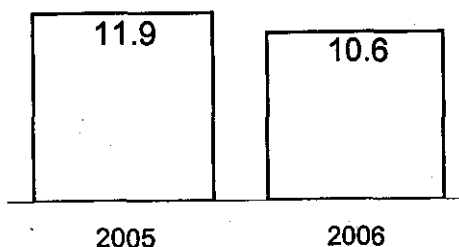


figure 16

CO₂ tonnes per employee

calculated using factors from the United Nations Conference on Trade and Development



safety activities are verified by regular internal audits and inspections, periodic external audit by the British Safety Council in the UK and the Occupational Health and Safety Administration in the US.

New safe systems of work have been developed for hybrid vehicles as new technologies come into the business. We have updated our noise controls in Europe in response to changed legislation. The effects of an increasingly wide geographic base and the need for increased staff flexibility and travel have led to a further review of policy in this area. Ricardo is focusing improvement effort on the development of policies on occupational road risk and stress. Feedback from the employee survey is also being used to develop health and safety improvements.

Additionally, our research agenda recognises Active Safety as a technology platform for research projects, and progress has been made in this area in the year.

The environment

The Board is committed to keeping the environmental impact of the Group's facilities and activities to a minimum. The Board's commitment is embodied in the Ricardo environmental policy, which is widely available via notice boards and the intranet and to the public via the www.ricardo.com website. The drivers for the policy are the need continually to improve and to be responsible members of the local communities in which Ricardo operates. Many of Ricardo's clients require accreditation to ISO 14001 for their key suppliers. The application of the policy is described by appropriate processes and procedures as part of the quality system in each division. Many of these are closely linked to both quality and health and safety procedures. Business processes within the ISO 9001 accreditations are used to ensure staff are appraised, objectives set and their training needs identified.

All major facilities in the UK and the US have been certified to ISO 14001, the environmental

management system standard. Verification under ISO 14001 is by six-monthly surveillance visits from Lloyds Register Quality Assurance and the internal technical audit team. The German business manages environmental matters within its ISO 9001 certification and is working towards the achievement of ISO 14001 accreditation in the near future. Best practice is shared between divisions via discussions between Quality Managers.

The nature of Ricardo's automotive business means that its greatest impact on society is the result of its technological offerings to the automotive industry. Ricardo has a long established heritage of investment in advanced research and innovation, resulting in new technologies and engineering tools.

Ricardo has three principal areas of environmental impact, which are grouped below. The first area is based around the core business of engineered automotive products for the future, where key business drivers are emissions, fuel consumption and noise reduction. This includes Ricardo and client funded projects and engineering products where technology is developed to provide low emissions and high-efficiency technologies for anticipated emissions and fuel economy requirements across the world.

Material selection is the second key impact area. Ricardo supports the EC End of Life Directive via close co-operation with its clients in selecting and testing materials for products it designs and develops. These decisions are normally led by client corporate standards for materials and manufacturing processes.

The third impact area is the testing operations, which is where the majority of the environmental risks in the business exist. The process used to identify these risks is derived from ISO 14001, where we are required to identify areas with potential for significant negative environmental impact. These impacts are reviewed during internal and external

audits and subjected to specialist risk assessments. Our testing activities use fuels and electrical energy to support the positive impacts and meet customer requirements. R&D on improving test methods leads to reducing fuel requirements, particularly in reducing the amount of vehicle testing in calibration programmes. Other impacts include the conventional waste streams, which are monitored to identify potential improvement opportunities and to ensure legislative compliance. Higher-risk parts of the facilities such as fuel stores have containment and inspection regimes which meet local legislative requirements.

Examples of improvement projects include increasing the number of regenerative dynamometers in the UK, US and Germany, which enables the re-use of electricity generated by testing operations leading to the substantial savings and environmental benefits, upgrades to the fuel farm at Shoreham Technical Centre to comply with the Oil Storage Regulations, and consolidating activities into fewer buildings on our current sites to improve energy and operational efficiency.

To improve our environmental focus we have developed a measure of energy usage. This measures the tonnes of CO₂ produced by the business, based on the use of diesel and gasoline fuels for testing and gas and energy use in our facilities. It is normalised to headcount for ease of understanding. Whilst a continuous reduction in CO₂ tonnes per head is targeted, only the energy used directly by the Group is measurable, and the indirect benefits to the environment from the work done may far outweigh any direct negative impacts.

Good relationships are maintained with national and local regulatory organisations such as the Environment Agency and Environmental Health Departments in the UK and the EPA and MDEQ (Michigan Department of Environmental Quality) in the US. Processes are in place to keep up to date on regulatory issues and are subject to regular audits. The amount of environmental legislation is growing, resulting in increasing training and compliance costs. Staff training in health, safety and environmental matters is a priority and is reviewed annually as part of normal appraisal processes.

Other stakeholders

Suppliers

Relations with the supplier community are regarded as an essential ingredient in achieving client and shareholder satisfaction. It is preferred that key suppliers have been certified to ISO 9001 and ISO 14001 as a minimum. All suppliers are encouraged to achieve ISO 9001 accreditation.

Local communities and charities

It is our policy to try to make a positive contribution to all countries and communities in which we operate, particularly targeted towards education. All Ricardo offices support local community activity and give charitable donations, particularly where employees participate in community or charitable fund-raising activities. Where suitable opportunities are presented, the focus is on creating links that are sustainable, and on improving the image and understanding of the business and the engineering profession in the community. Examples include the provision of work experience placements for local schools, the use of facilities for charitable activities and employees acting as school governors.

A particular highlight in the year was the appointment of the UK business's Technology Director, Neville Jackson, as a Visiting Professor at the University of Brighton. This further enhances connections to the Internal Combustion Engine Group at the University and strengthens relationships with the local academic community.

Charitable donations in the year were £20,040 (2005: £17,463).

The Group does not intentionally support political activities, but cannot guarantee that community involvement and charitable donations will not be perceived as having a political ingredient.

Ethics policy

We have an ethics policy which is communicated to all employees. We do not permit bribery, anti-competition or corrupt business practices in any dealings.

Conclusion

This year finished slightly ahead of market expectations, albeit against a more challenging European market than anticipated. The outlook for the global automotive market remains mixed, with continuing strong activity in Asia offset by a subdued Europe and the well publicised problems of the US car industry.

Overall we have had a satisfactory start to the new year, despite activity being lower than last year for the US and, as expected, Strategic Consulting. The UK and Germany are ahead of prior year and the Group's order prospects in total continue to build. This together with our strategy of increasing the geographic, sector and customer spread, gives us confidence for further progress in the new financial year.



Dave Shemmans (Chief Executive Officer)



Andrew Goodburn (Finance Director)

Cautionary statement

This Business Review and certain other sections of this Annual Report contain forward-looking statements that have been made by the directors in good faith based on the information available to them up to the time of their approval of this report. However they should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information.

GOVERNANCE

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Corporate Governance in Practice
Statement of Directors' Responsibilities
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Directors' Remuneration Report
Independent Auditors' Report

Board Members

Marcus Beresford CBE (Chairman)

Marcus Beresford was appointed a non-executive director on 1 October 2003 and Chairman on 1 January 2004. He is 64 years old. He has had a long and distinguished career in the engineering industry, principally with Smiths Industries, Siemens and GKN. He joined the Board of GKN plc in 1992 and was Chief Executive from August 2001 until he retired in December 2002. He is currently a non-executive director of Cobham plc and Spirent plc. He is a fellow of the Institution of Engineering and Technology. Outside the engineering industry he has held various posts, including being a member of the Advisory Committee on Business and the Environment and a Council Member of the Open University.

David Shemmans (Chief Executive Officer)

David Shemmans, 40, joined Ricardo in 1999 as Senior Business Development Manager for Ricardo Consulting Engineers ("RCE"). In 2002 he was appointed Business Development Director for the Ricardo Group and in December 2003, Managing Director of RCE. He was appointed to the Board as Chief Executive Officer Designate and Managing Director International Operations in February 2005, and became the Chief Executive Officer of Ricardo plc on 4 November 2005. Prior to joining Ricardo he was Operations Director and co-founder of Wavedriver Limited (a subsidiary of PowerGen plc). He has also gained consulting and management experience in both listed and private companies. He holds a degree in electronics from UMIST and is a graduate of the Harvard Business School.

Andrew Goodburn (Finance Director)

Andrew Goodburn is 59 years old, having qualified as a Chartered Accountant in 1969. He trained with KPMG before joining the Bowthorpe Group where he spent 11 years in various financial and commercial roles. He then spent 13 years in management consulting. He joined Ricardo in 1993 and was subsequently appointed Finance Director of Ricardo Consulting Engineers Ltd. He was appointed Finance Director of Ricardo plc on 7 April 1997. He will be retiring on 5 January 2007 and, as previously announced, will be replaced as Finance Director at the Annual General Meeting. He is a non-executive director of Caffyns plc.

Ian Percy, CBE (Non-Executive Deputy Chairman)

Ian Percy was appointed a non-executive director on 1 July 2000 and is the senior independent director. He is 64 years old. He is Chairman of Companies House, Deputy Chairman of The Weir Group plc and a non-executive director of a number of private companies. Former positions include Chairman of the Accounts Commission for Scotland and President of the Institute of Chartered Accountants of Scotland. He is an Honorary Professor of Accounting at Aberdeen University.

Jeremy Holt (Executive Director)

Jeremy Holt joined Ricardo in 1998 as President of Ricardo Inc. He was appointed to the Board in January 2001. He continues to be responsible for the operations of Ricardo in the Americas as well as recently having taken responsibility for Ricardo's global software business. Prior to joining Ricardo he held various international positions with engineering, marketing and business responsibilities within the T&N Group. He is 45 years old, UK born and a naturalised citizen of the US.

David Hall (Non-Executive)

David Hall was appointed a non-executive director on 21 February 2006. He is 59 years old. He was formerly at the Boston Consulting Group, the international strategic and management consulting firm, where he started and built up the financial services practice, served on the worldwide Executive Committee, was Chairman of BCG's ten global practice groups and had global responsibility for HR. David is also Chairman of the Financial Services Compensation Scheme and a member of the Advisory Board of Campbell-Lutyens & Co., a specialist private equity investment bank.

Stephen Parker (Executive Director)

Aged 53, Stephen Parker joined Ricardo on 1 August 2002 as the Managing Director of Ricardo Strategic Consulting from A. T. Kearney, one of the world's leading management consulting practices, and was appointed to the Board on the same day. At A. T. Kearney he was employed as a Vice President of their Global Automotive Practice, having responsibility for the provision of strategy and operational consulting to the executive teams of both automotive manufacturers and Tier 1 suppliers. Previous roles include Director of Business Development and General Manager for Perkins Technology Ltd at Perkins Engine Group, a position he held for eight years, as well as eight years at PSA Peugeot Citroën.

Michael Harper (Non-Executive)

Michael Harper was appointed a non-executive director on 24 June 2003. He is 61 years old. He was Chief Executive of Kidde plc until he retired from that position in March 2005. He is currently acting Chief Executive of BBA Group plc, Chairman of The Vitec Group plc, and a non-executive director of UMECO plc and Catlin plc.

David Oglethorpe (Company Secretary)

David Oglethorpe is 44 years old and qualified as a Chartered Accountant with Deloitte, Haskins and Sells in 1988. He joined Ricardo in 1990, and has had various divisional finance director and head office positions before his appointment as Company Secretary in December 2005.

Corporate Governance in Practice

The Combined Code on Corporate Governance

The Combined Code on Corporate Governance as revised by the Financial Reporting Council in July 2003 ("the Code") applies to reporting periods beginning on or after 1 November 2003. Section 1 of the Code applies to companies. Under the UK Listing Authority's Listing Rules which apply to the London Stock Exchange's main market, Ricardo plc is required to report on how it has applied the principles set out in Section 1 of the Code, and either to confirm that it has complied with the provisions of Section 1 of the Code or to provide an explanation of where it has not.

This part of the Annual Report, together with the Directors' Remuneration Report set out on pages 51 to 60, describes how the Company has applied the principles contained in Section 1 of the Code. An explanation of the few areas where the Company has not complied with Section 1 of the Code during the twelve months ended 30 June 2006 is given on page 47.

The Board of Directors

The Board, which is headed by the Chairman who is non-executive, comprised three other non-executive and four executive members as at 30 June 2006, ensuring compliance with the Code, which states that a smaller company should have at least two independent directors. Ricardo was below the FTSE 350 throughout the year immediately prior to the 12 months ended 30 June 2006. The Board met regularly throughout the year with ad hoc meetings being held also. In order more fully to involve all directors in strategic matters, all Board members attend all Board meetings, subject to availability, and the previous practice of separate Strategic Board meetings has been discontinued.

The role of the Board is to provide entrepreneurial leadership of the Company within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board sets strategic aims, reviews management performance and ensures that the necessary financial and human resources are in place to meet its objectives and its obligations to its shareholders and others. The Board has agreed a schedule of matters reserved for the Board. The Board approves the Group's strategy, acquisitions and disposals of businesses, major capital expenditure, major proposals and the annual financial budgets. The Board recommends interim and final dividends. It receives recommendations from the Audit Committee in relation to the appointment of auditors, their remuneration and the policy relating to non-audit services and from the Nomination Committee it receives recommendations regarding Board appointments. The Board agrees the policy for executive directors' remuneration with the Remuneration Committee and determines fees paid to non-executive directors. Board papers are circulated before Board meetings in sufficient time to be meaningful. The Board delegates to management, through the Chief Executive Officer, the implementation of strategy, the overall performance of the Group and the management of the business in a fit and proper manner in keeping with its values and policies.

The division of responsibilities between the Chairman and the Chief Executive Officer is clearly defined and has been approved by the Board. The Chairman's primary responsibility is ensuring the effectiveness of the Board and setting its agenda. The Chief Executive has direct charge of the Group on a day to day basis and is accountable to the Board for the financial and operational performance of the Group. The Chief Executive also chairs the

Ricardo Operating Board which deals with operational issues. It met five times in the year and includes the Managing Directors of subsidiary companies and other senior executives. The minutes of the meetings are circulated to the Board.

The performance of the Board is evaluated each year by means of a detailed questionnaire which each director completes. The appraisal reviews whether there is good leadership and a clear strategy and objectives, the structure of the Board as to the appropriateness of its skill level and mix of experience, the way Board meetings are conducted and administered and the content of those meetings, the effectiveness of the various committees, the appropriateness of relationships and communications between Board members and with non-Board members, and whether corporate governance risk management issues are handled in a satisfactory manner. The questionnaire also reviews the performance of each individual non-executive director. The results of the questionnaire are reviewed by the Board and appropriate improvements implemented.

A new director, on appointment, is briefed on the activities of the Company, and receives a full, formal and tailored induction. Non-executive directors are briefed on issues arising at Board meetings if required and non-executive directors have access to the Chairman and the Chief Executive Officer at any time. Ongoing training is provided as needed including presentations by the operating units on specific aspects of the business, supplemented by visits to key locations and meetings with key senior executives. Directors are updated continually on the Group's business and by means of Board presentations on matters including insurance, pensions, social, ethical, environmental and health and safety issues. In the furtherance of their duties or in relation to acts carried out by the Board or the Company, each director has been informed that they are entitled to seek independent professional advice at the expense of the Company. The Company maintains appropriate cover under a Directors' and Officers' liability insurance policy if legal action is taken against any director. Each director has access to the services of the Company Secretary if required.

Each director is appraised through the normal appraisal process. The Chief Executive Officer is appraised by the Chairman, the other executive Board members are appraised by the Chief Executive Officer, and the non-executive Board members other than the Chairman are appraised by the Chairman. Under the leadership of the senior independent director, the non-executive Board members hold a meeting without the Chairman being present to appraise the Chairman's performance.

The non-executive directors are considered by the Board to be independent of management and are free to exercise independence of judgement. They have never been employees of the Company nor have they participated in any of the Company's share schemes, pension schemes or bonus arrangements. They receive no other remuneration from the Company other than the directors' fees and travel expenses. Confirmation has been sought and received from each non-executive director that he:

- does not have, and has not had within the last three years, a material business relationship with the Company, either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the Company;
- has no close family ties with any of the Company's advisers, directors or senior employees;

- holds no cross-directorships or has significant links with other directors through involvement in other companies or bodies; and
- does not represent a significant shareholder.

Confirmation was sought and received from the Chairman, of the above, at the date of his appointment but is also sought and received annually. Directors are subject to election at the Annual General Meeting following their appointment and are subject to re-election at least every three years. The Chairman met during the year with the

other non-executives and without the executive directors being present. The non-executive Deputy Chairman, Ian Percy, is the senior independent director who is available to shareholders if contact through normal channels is inappropriate or has failed to resolve an issue.

The table below shows the number of Board meetings and Audit, Remuneration and Nomination Committee meetings held during the year and the attendance of each director.

	Board meetings	Committee meetings		
		Audit	Remuneration	Nomination
Number of meetings in the year	10	6	6	2
Number attended:				
Marcus Beresford	10	6	6	2
Ian Percy	10	6	5	1
Michael Harper	10	6	6	2
David Hall (appointed 21 February 2006)	4		1	
Dave Shemmans	10			2
Andrew Goodburn	10			
Jeremy Holt	8			
Steve Parker	8			
Rodney Westhead (resigned 4 November 2005)	3			
Clive Hickman (resigned 31 August 2005)				

The Audit Committee

The Audit Committee is established by and is responsible to the Board. It has written terms of reference. Its main responsibilities are:

- to monitor and be satisfied with the truth and fairness of the Company's financial statements before submission to the Board for approval, ensuring their compliance with the appropriate accounting standards, the law and the Listing Rules of the UK Listing Authority;
- to review the Company's internal financial controls and internal control and risk management systems, and to review the effectiveness of the internal audit function and ensure that it is adequately resourced;
- to make recommendations to the Board in relation to the appointment and re-appointment of the external auditors and their remuneration, following appointment or re-appointment by the shareholders in general meeting, and to review the scope and planning of the audit and be satisfied with the auditors' independence, objectivity and effectiveness on an ongoing basis; and
- to implement the policy relating to any non-audit services performed by the external auditors.

Ian Percy, the Chairman of the Audit Committee, is currently Chairman of Companies House and has wide experience as Chairman of audit committees. He was formerly Chairman of the Accounts Commission for Scotland and President of the Institute of Chartered Accountants for Scotland. He therefore has recent and relevant experience. The other members of the Audit Committee Marcus Beresford, Michael Harper and David Hall, all of whom are non-executive directors, have gained wide experience in regulatory and risk issues. Appointments to the Audit Committee are made by the Board on the recommendation of the Nomination Committee

which takes into account the particular skills and attributes required to fulfil particular roles. The members of the Audit Committee are remunerated at a level which takes account of their responsibilities. The Audit Committee is authorised by the Board to seek and obtain any information it requires from any officer or employee of the Company and to obtain external legal or other independent professional advice as is deemed necessary by it.

Meetings of the Audit Committee are held at least three times a year to coincide with the review of the scope of the external and internal audit and observations arising from their work in relation to internal control and to review the financial statements in September and February each year. Three additional meetings were held in the year principally to review the impact of International Financial Reporting Standards. The external auditors are invited to all meetings and meet with the Audit Committee without management being present at least once a year. At the Audit Committee meeting in September it carries out a full review of the year end financial statements and of the audit, using as a basis the Report to the Audit Committee prepared by the external auditors and taking into account any significant accounting policies, any changes to them and any significant estimates or judgments. Questions are asked of management of any significant or unusual transactions where the accounting treatment could be open to different interpretations. A similar but less detailed investigation is carried out in February when the Interim Report is reviewed.

The Audit Committee receives reports from management and internal audit on the effectiveness of the system of internal controls. It also receives from the external auditors a report of matters arising during the course of the audit which the auditors deem to be of significance for the Audit Committee's attention.

The external auditors are required to give the Audit Committee information about policies and processes for maintaining their

independence and compliance regarding the rotation of audit partners and staff. The Audit Committee considers all relationships between the external auditors and the Company to ensure that they do not compromise the auditors' judgement or independence particularly with the provision of non-audit services where a policy relating to these has been agreed by the Board. Essentially the external auditors would be excluded from carrying out non-audit services if they are put in the position of auditing their own work, making management decisions for the Company, if a mutual interest between the Company and the auditors is created or if the auditors take on the role of an advocate for the Company. If the external auditors carry out non-audit services and the cost of these services is estimated to exceed £20,000, prior approval by the Audit Committee is required.

During the year a review of the internal audit process was carried out. The audit plan for the year was reviewed as was the staffing, which consists of suitably qualified staff from the Company, to carry out the audits. The resources were considered adequate. The internal audit reports were reviewed as was management's response to the findings and recommendations. The Audit Committee considers that the internal audit process is an effective tool in the overall context of the Company's risk management system. The Audit Committee meets annually with the internal auditor without the management being present.

The 1998 Public Interest Disclosure Act ("the Act") aims to promote greater openness in the workplace and ensure that "whistle blowers" are protected. The Company maintains a policy in accordance with the Act which allows employees to raise concerns on a confidential basis if they have reasonable grounds for believing that there is serious malpractice within the Company. The policy is designed to deal with concerns, which must be raised without malice and in good faith, in relation to specific issues which are in the public interest and which fall outside the scope of other Company policies and procedures. There is a specific complaints procedure laid down and action will be taken in those cases where the complaint is shown to be justified. The individual making the disclosure will be informed of what action is to be taken and a formal written record will be kept of each stage of the procedure. The "whistle blowing" policy is published internally on the Company's intranet site.

The Remuneration Committee

The Remuneration Committee, which is chaired by Michael Harper, also comprises the non-executive directors and is described in the *Directors' Remuneration Report* on pages 51 to 60.

The Nomination Committee

The Nomination Committee, having evaluated the balance of skills, knowledge and experience on the Board, makes recommendations to the Board of executive and non-executive appointments. Before such recommendations are made, descriptions of the roles and skills required in fulfilling these roles are prepared for particular appointments. To attract suitable candidates, appropriate external advice is taken and interviews conducted by at least two members of the Nomination Committee to ensure a balanced view. Prior to the announcement of a new Finance Director to replace Andrew Goodburn before he retires in January 2007, Paula Bell along with other potential candidates went through a rigorous interview process with an outside agency before her appointment was verified by the Board. David Hall also went through a rigorous selection and interview process leading to his appointment as a non-executive

director in February 2006. He was formerly at the Boston Consulting Group and will strengthen the strategic consulting input to the Board. When an appointment of a non-executive director is made, a formal letter is sent setting out clearly what is expected regarding time commitment, committee membership and involvement outside Board meetings. The chosen candidate is required to disclose to the Board any other significant commitments before the appointment can be ratified. The Committee has written terms of reference, and comprises Marcus Beresford (Chairman), the other non-executive directors (Ian Percy, Michael Harper and David Hall) and Dave Shemmans (Chief Executive) and meets at least once a year and at other times as appropriate. In the year ended 30 June 2006, the Committee met twice. The Chairman of the Committee is the Chairman of the Board, Marcus Beresford, except when a new Chairman of the Board is being sought, when it is the senior independent director, Ian Percy. The leadership needs and succession planning of the Company are regularly monitored as are the size and structure of the Board with consideration being given to the training needs of the executive and non-executive members. Non-executive directors are subject to rigorous review when they are continuing to serve on the Board for any term beyond six years.

Boards of subsidiary companies

The Group has a policy of appointing industry experts to participate in its local operating boards, thus bringing broader global experience to the Group. Sivert Hiljemark, formerly at Volvo Cars (UK), Walter Aspatore of Amherst Partners, LLC, Professor Wallentowitz of Aachen University and Akira Kijima, formerly at Mitsubishi Motor Corporation, are members of the UK, US, German and Japanese local boards respectively.

Shareholder communications

The Chief Executive and the Finance Director regularly meet with institutional shareholders to foster a mutual understanding of objectives. Additionally the Chairman and the senior independent director are available for discussions with major shareholders if required. Surveys of shareholder opinion are normally carried out following announcements of results and are circulated to the Board.

The Annual General Meeting ("AGM") in November 2005 was attended by all directors in office at the time of the meeting. The directors encourage the participation of all shareholders, including private investors, at the AGM and as a matter of policy the level of proxy votes (for, against and vote withheld) lodged on each resolution is declared at the meeting and with effect from the November 2006 AGM will also be displayed on the Company's website. The Annual Report and Accounts is published on our website www.ricardo.com and can be accessed by our shareholders.

Going Concern

After making enquiries, the directors have confidence that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the Report and Accounts.

Internal control and risk management

The Board is responsible for the Group's system of internal controls and for reviewing its effectiveness. Such a system is designed to

manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

Each part of the Group highlights potential financial and non-financial risks which may impact on the business as part of the monthly management reporting procedures. The Board receives these monthly management reports and monitors the position at Board meetings.

As part of the risk management process, directors and senior managers are required to certify on a bi-annual basis that they have established effective controls to manage risk and to comply with legislation and Group procedures. The procedures have been put in place to ensure that effective control and risk management is embedded in the Group and that the Group is in a position to react as appropriate as new risks arise.

The Board confirms that there are ongoing processes for identifying, evaluating and mitigating the significant risks faced by the Group. The processes have been in place during the year under review and up to the date of approval of the Annual Report and Accounts, consistent with the updated Turnbull Committee guidance for directors on internal control.

The Group's internal financial control and monitoring procedures include:

- clear responsibility on the part of line and financial management for the maintenance of good financial controls and the production of accurate and timely financial management information;
- the control of key financial risks through clearly laid down authorisation levels and appropriate segregation of accounting duties, the control of key project risks through project delivery systems and the control of other key business risks via a number of processes and activities recorded in the Group's risk register;
- detailed monthly budgeting and reporting of trading results, balance sheets and cash flows, with regular review by management of variances from budget;
- reporting on compliance with internal financial controls and procedures by Group internal audit; and
- review of reports issued by the external auditors.

The Audit Committee, on behalf of the Board, reviews reports from both the internal and external auditors together with management's response regarding proposed actions. In this manner they have reviewed the effectiveness of the system of internal controls for the period covered by the Accounts.

Compliance with the Code

The Company has not complied with Section 1 of the Code with respect to:

- The Chairman's membership of the Remuneration and Audit Committees: it is recognised that the Code does not treat the Chairman as independent after appointment and therefore the Chairman should not sit on the Audit or Remuneration Committees. However the Board takes the view that as the number of non-executive directors is only four, including the Chairman, his participation is important for the Committees to gain the benefit of his external expertise and experience in areas the Board considers important. The Chairman does not chair either of those Committees. It is noted that the June 2006 revision to the Code (which has not yet been adopted by the UK Listing Authority) now states that the Chairman where considered independent on appointment may be a member of the Remuneration Committee provided he is not also the chair of the Committee.
- The Code states that a majority of members of the nomination committee should be independent non-executive directors. Due to the balance of skills, knowledge and experience appropriate for members of the nomination committee, the Company considered that it was appropriate for the Chairman and the Chief Executive to be members of the Nomination Committee in addition to the other non-executive directors. Subsequent to the appointment of David Hall as non-executive director on 21 February 2006 and his appointment to the Nomination Committee, the Company has complied with this requirement.

In all other respects the directors consider that the Company has complied with the provisions of Section 1 of the Code during the year ended 30 June 2006.

Statement of Directors' Responsibilities

Statement of Directors' Responsibilities in respect of the Annual Report, the Directors' Remuneration Report and the financial statements

The directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The directors are responsible for preparing financial statements for each financial year which give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether the financial statements comply with IFRSs as adopted by the European Union; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 1985 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' Report

The directors present their report and the financial statements for the year ended 30 June 2006.

Business activity

The principal activities of the Group are the provision of technical and strategic consulting to industry, commerce and other agencies.

Business Review

The directors have prepared a Business Review which is set out on pages 21 to 39 and amongst other things covers:

- a review of the Group's operations and prospects;
- business performance;
- employee involvement and corporate social responsibility.

In addition a segmental analysis is given in note 2 to the financial statements.

Dividends

The directors propose a final dividend of 6.7p (2005 – 6.3p) per share, amounting to £3,396,815, payable on 24 November 2006 to shareholders on the register at close of business on 27 October 2006. The final dividend proposed will make a total of 9.3p (2005 – 9.0p) per share for the year.

Directors

The directors who served on the Board and on Board Committees during the year were:

Non-executive directors:

Marcus Beresford, CBE, M.A.Mech.Sc., FIET, Chairman
Professor Ian Percy, CBE, LLD, CA
Michael Harper, MSc, CCMI, FRAeS
David Hall, MA, MSc (appointed 21 February 2006)

Executive directors:

Dave Shemmans BEng
Andrew Goodburn, FCA
Steve Parker
Jeremy Holt, BEng, MBA
Rodney Westhead, FCA (resigned 4 November 2005)
Dr. Clive Hickman, BSc, CEng, FIMech E (resigned 31 August 2005)

Board Committees

Audit: Ian Percy (Chairman); Marcus Beresford; Michael Harper; David Hall.

Remuneration: Michael Harper (Chairman); Marcus Beresford; Ian Percy; David Hall.

Nomination: Marcus Beresford (Chairman); Ian Percy; Michael Harper; David Hall; Dave Shemmans.

Details of the Board of Directors and Board Committees can be found on pages 44 to 46.

Directors' interests and indemnity arrangements

At no time during the year did any director hold a material interest in any contract of significance with the Company or any of its subsidiary undertakings other than a third party indemnity provision between each director and the Company and service contracts between each executive director and the Company.

The Company has purchased and maintained throughout the year Directors' and Officers' liability insurance in respect of itself and its directors. The directors also have the benefit of the indemnity provisions in the Company's Articles of Association. The Company has entered into letter agreements for the benefit of current directors of the Company in respect of liabilities which may attach to them in their capacity as directors of the Company or associated companies. These provisions, which are qualifying third party indemnity provisions as defined in section 309A of the Companies Act 1985 ("the Act"), were put in place following the Annual General Meeting in November 2005 and are currently in force.

Details of directors' remuneration, service contracts and interests in the shares of the Company are set out in the Directors' Remuneration Report on pages 51 to 60.

Disclosure of information

So far as the directors in service at the year end are aware, there is no information needed by the Company's auditors in connection with preparing their report of which the Company's auditors are unaware. The directors have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Sections 80 and 95 authorities

The directors will seek to renew authorities under Sections 80 and 95 of the Act at the Annual General Meeting, empowering them respectively to allot shares and to allot shares for cash other than pro rata to existing shareholders (as would otherwise be required by Section 89 of the Act), in both cases subject to specified limits and periods as stated in the notice. The authority to allot shares would be in respect of ordinary shares with a maximum nominal value of £4,182,645, which represents 33% of the issued ordinary share capital at the date hereof. The directors have no present intention to exercise this authority, but would then have the flexibility to issue new shares up to this limit should they decide that it would be in the interests of the Company to do so.

The maximum nominal value of shares which may be allotted for cash otherwise than pro rata to existing shareholders would be £633,734, equivalent to 5% of the issued share capital at the date hereof.

No issue will be made which would effectively alter the control of the Company, or the nature of its business, without the prior approval of the shareholders in general meeting.

Purchase of own shares

The Company's Articles permit the Company to buy back its own shares with authority from its members and a resolution to this effect will be proposed at the Annual General Meeting. The directors are seeking to renew the authority to buy back up to 10% of its issued shares, which they will exercise only if circumstances arise in which they consider such purchases to be in the interests of shareholders generally and earnings per share ("EPS") can be improved further.

Performance targets based on EPS attaching to employee incentive schemes will be adjusted accordingly if the authority is exercised.

Substantial shareholders

The Company is informed that, at 1 September 2006, the following are holders of more than 3% of the Company's issued share capital:

Non-beneficial interests	Number of shares	% of issued share capital
Liontrust Asset Management	4,567,198	9.01
Legal & General Investment Management	4,429,389	8.74
JP Morgan Fleming Asset Management	4,300,920	8.48
UBS Global Asset Management	3,321,571	6.55
Morley Fund Management	2,909,406	5.74
F&C Asset Management	1,571,100	3.10

Electronic voting

This year the Company is again offering those members who wish to do so the choice of recording a proxy vote electronically. Details of how to do this are to be found in the notice of the Annual General Meeting and on the proxy form. Recording a proxy vote, either electronically or by filling in the form by hand, does not preclude members from attending and voting at the meeting should they so wish.

Auditors

The directors propose that PricewaterhouseCoopers LLP be re-appointed as auditors of the Company, and a resolution to that effect will be proposed at the Annual General Meeting.

By order of the Board



David Oglethorpe
Secretary

18 September 2006

Directors' Remuneration Report

Introduction

This report describes the Group's remuneration policy as it applies both to directors and more generally to senior executives. Detailed disclosures in relation to directors' remuneration are provided. The report explains how the Group has applied the principles of the Combined Code on Corporate Governance in relation to the remuneration of directors and has been prepared in accordance with the Directors' Remuneration Report Regulations 2002. These regulations require that part of the information is subject to audit, and this information is set out on pages 56 to 60.

The Company will seek the approval of this report by shareholders at the forthcoming Annual General Meeting on 10 November 2006.

The Remuneration Committee

The Board of Directors is responsible for executive remuneration policy. It has established a Remuneration Committee, which is chaired by Michael Harper, and is comprised of the non-executive directors, all of whom possess relevant and recent experience. The non-executive directors have no personal financial interest other than as shareholders in matters to be decided, no potential conflicts of interest arising from cross directorships and no day-to-day involvement in running the business. Biographical details of the members of the committee are shown on pages 42 and 43, details of attendance at the meetings of the committee during the year ended 30 June 2006 are shown on page 45, and directors' shareholdings are shown on page 60. The remuneration of the non-executive directors other than the Chairman of the Board is the responsibility of the executive members of the Board.

The Remuneration Committee has written terms of reference, which are available at www.ricardo.com, and is responsible for:

- recommending to and agreeing with the Board the policy for executive remuneration,
- agreeing the terms and conditions of employment for executive directors, including their individual annual remuneration and pension arrangements,
- agreeing the targets for any performance related bonus and share schemes,
- agreeing the remuneration of the Chairman of the Board (which is done in his absence), and
- agreeing the terms of reference of any remuneration consultants it appoints for the purpose of giving advice.

In July 2005 the Remuneration Committee appointed Deloitte & Touche LLP as independent remuneration advisors. During the year ended 30 June 2006, Deloitte & Touche LLP have also provided the Company with a small amount of advice on matters relating to International Financial Reporting Standards. The Committee is also supported by the Group Head of Human Resources (Malcolm Greenslade) and the Company Secretary.

Remuneration Policy

Executive Directors

The objective of the executive remuneration policy is to provide remuneration packages that will retain talented people in the business and enable the recruitment of appropriately skilled and experienced

newcomers. Therefore Ricardo's executive remuneration policy is to set levels of salary and other remuneration package elements such that in total they are competitive relative to similar roles in other companies and consultancy organisations of Ricardo's size, complexity and international reach. Remuneration packages for each executive director and their fixed and variable elements are reviewed annually. A significant element of potential remuneration is performance linked, both through the annual bonus scheme and through participation in share incentive schemes. Share incentive schemes, coupled with the share retention policy, ensure that executive directors' interests are closely aligned with shareholders' interests. Through its Chairman, the Remuneration Committee maintains contact with and seeks the views of the Company's principal shareholders as necessary.

Remuneration policy – current arrangements and intended changes for 2006/07 and subsequent years

During the year, the Committee reviewed the executive remuneration policy. The current and future intended policies are described below.

In summary, the main future changes will be:

- **Annual bonus** – The current policy is for bonuses for most executives to be based upon achievement of group profit before tax alone. In future, Chief Executive Officer and Finance Director bonuses will be determined based upon achievement of targeted real growth in underlying EPS. For other executives, bonus levels will be based upon appropriate and varying mixes of group and business unit results.
- **Deferred bonus** – The Company is implementing a deferred bonus plan for senior executives. As a result, maximum bonus opportunity will increase, although a proportion of this bonus will be deferred into shares (normally 33% for executive directors). No matching award will be provided under this arrangement. Vesting will be subject to continued employment for a three year period. (In the case of Steve Parker as explained on page 55, 50% of the bonus based on Ricardo Strategic Consulting results will be deferred into shares, with vesting subject to continued employment for a two year period).
- **Long Term Incentive Plan ("LTIP")** – The existing LTIP will expire in November 2006. The Company is seeking shareholder approval at the November 2006 AGM to implement a replacement LTIP. The key features of the replacement LTIP are similar to the current arrangements, with the exception of the performance conditions. 50% of the award will be subject to a relative Total Shareholder Return ("TSR") performance condition and 50% of the award will vest according to a normalised EPS growth scale. The TSR comparator group for the replacement LTIP will be the FTSE Small Cap Index (excluding financial services companies and investment trusts).
- **All-employee incentives** – It is proposed to implement a new UK tax-approved all-employee incentive plan. The Company is therefore also seeking shareholder approval at the November 2006 AGM to implement a Share Incentive Plan ("SIP").

Further detail in relation to each of these changes is provided below in the relevant section of this report.

Basic salary – current and continuing policy

Basic salaries are normally reviewed annually on 1 July, and are based on a number of factors including market rates together with the individual director's experience, responsibilities and performance.

Annual performance related bonus – arrangements for the year ended 30 June 2006

The potential to earn bonus was based on benchmarked practice in the prevailing market and consisted of elements of Group and, in the case of Steve Parker, Ricardo Strategic Consulting performance. The Committee set demanding profit before tax targets and determined bonus payments for performance against these targets.

In relation to the Group results, a minimum threshold was set at a substantial increase over the previous year's performance, below

which no bonus would be payable. In the event, the minimum threshold of that scheme was exceeded, and therefore amounts will be paid to executive directors as shown in the table below.

In addition, Steve Parker earned a bonus based on Ricardo Strategic Consulting profit targets for the year ended 30 June 2006. Ricardo Strategic Consulting's performance has been excellent and Steve Parker has earned the maximum amount payable to him under that element of his bonus opportunity, ie 140% of basic salary. Half of this bonus element will be deferred into shares vesting after two years.

Basic salary and bonus levels for the year ended 30 June 2006 were as follows:

		Basic salary	Maximum bonus potential	Actual bonus
Dave Shemmans	– Chief Executive Officer	£265,000*	75%	9%
Andrew Goodburn	– Finance Director	£198,000	60%	7%
Steve Parker	– Managing Director – Ricardo Strategic Consulting	£320,000	200%	147%
Jeremy Holt	– President – Ricardo Inc.	\$335,000	80%	10%

*from November 2005

Annual performance related bonus – arrangements for the year ending 30 June 2007 onwards

For the year ending 30 June 2007, the following revisions have been made to the bonus policy:

- For participants in business units, bonus levels will be based upon appropriate and varying mixes of Group and business unit results. If Group performance targets are not met, the bonus element based on business unit results may still be payable, subject to Remuneration Committee discretion.
- Bonuses will be determined based on achievement of profit before tax targets for all participants other than the Chief Executive Officer and Finance Director, whose bonuses will be determined based on achievement of targeted real growth in normalised EPS.

Deferred bonus – arrangements for the year ending 30 June 2007 onwards

Ricardo has introduced a compulsory deferred bonus in shares effective from the year ending 30 June 2007 that will apply to performance related bonuses for executive directors and selected senior executives. This will:

- provide for further alignment of executives' and shareholders' interests,
- provide an enhanced retention element, and
- facilitate executive directors to attain a target shareholding to a value of at least basic annual salary within 5 years of appointment.

No matching awards will be provided in relation to the deferrals.

Vesting of deferred bonuses will be subject to continued employment for a three-year period from the award date (other than in the case of Steve Parker as explained above).

LTIP – current arrangements

The objective of making awards under long term incentive plans is to focus the efforts of executive directors and other senior executives on the long term performance of the Group in a way which aligns with the interests of shareholders.

The current LTIP was approved by shareholders in November 1996 and expires in November 2006. (The Board of Directors will be seeking shareholder approval at the forthcoming Annual General Meeting for a replacement LTIP to be effective from the date of approval, and further details in relation to the replacement are provided below.)

Under the LTIP, a plan cycle lasting for three financial years may start each year. Provisional awards of ordinary shares are made based on a proportion of basic salary at the start of each plan cycle. The eventual number of shares which participants in a plan cycle may receive, if any, is dependent on Ricardo's performance over the three year period relative to a selected comparator group. Provisional awards would not in any event exceed 100% of basic salary.

Provisional share awards for the executive directors in service at 30 June 2006 under the current LTIP scheme are as follows:

Provisional awards in relation to basic salary at time of award (actual amounts vesting depending on performance)	Plan Cycle ending 2007	Plan Cycle ending 2008
Dave Shemmans	40%	75%
Andrew Goodburn	45%	50%
Steve Parker	45%	–
Jeremy Holt	45%	50%

Under the current LTIP, amounts vesting depend on Ricardo plc's TSR performance against FTSE 250 companies (excluding investment trusts and financial services companies). Awards lapse at performance below median. 25% of the award vests for median performance. Awards vest in full for upper quartile performance. For levels of performance between median and upper quartile, there is partial vesting on a sliding scale.

LTIP – proposed arrangements from November 2006 onwards

As outlined above, the existing LTIP will expire in November 2006. Therefore the Company is seeking shareholder approval at the November 2006 AGM to implement a replacement LTIP ("2006 LTIP"), and further details in relation to the 2006 LTIP are provided below. A more detailed description is provided in the notice of AGM sent to shareholders separately.

With the exception of the performance conditions, the key features of the 2006 LTIP are similar to the current arrangements. In summary, the terms of the proposed replacement LTIP are:

- the 2006 LTIP will again be a performance share plan in which awards of shares are made with a three year vesting period;
- award levels are proposed to be similar to those under the current arrangements;
- 50% of any award will be subject to a relative TSR performance condition with vesting on the same basis as the current scheme. The TSR comparator group for the 2006 LTIP will be the FTSE Small Cap Index (excluding financial services companies and investment trusts), as Ricardo is a constituent of this group; and
- 50% of any award will vest according to a normalised EPS growth scale. The Company will set scaled normalised EPS performance targets, which will be suitably stretching, taking into account the economic/market outlook, business plan and investor expectations at the time of each option grant.

Subject to shareholder approval of the 2006 LTIP, for any initial awards it is proposed that the following performance conditions/ vesting schedule will apply:

Real normalised EPS growth	Vesting
Less than 3% per annum	Nil
3% per annum	30% of grant
10% per annum	100% of grant

For performance between 3% per annum and 10% per annum real growth in normalised EPS, awards will vest on a straight line basis.

The Committee believes that this proposed target range for awards will be stretching, taking account of current business forecasts and plans. Performance targets will be reviewed for any subsequent awards taking account of prevailing conditions at the time.

Share option schemes – current arrangements

During the year the following share option schemes were relevant to this report:

- The 2004 Executive Approved/Unapproved Share Option Plan ("the 2004 Plan") which was adopted by shareholders in November 2004;
- The 1994 Executive Approved/Unapproved Share Option Scheme ("the 1994 Scheme"), which was adopted by shareholders in November 1994 and which expired in November 2004, but under the terms of which a number of unexercised

grants continue to subsist; and

- The Ricardo plc 2000 Savings Related Share Option Scheme, a standard HMRC-approved all employee SAYE scheme under the terms of which a number of unexercised grants also continue to subsist.

The 2004 Plan requires that options granted be made subject to the achievement of demanding performance criteria. The performance criteria attaching to options granted under this plan historically require that as a minimum the cumulative growth in the Group's normalised EPS over the next three years, from a base point of the average of the Group's normalised EPS figures for the previous two years, exceeds that of the Retail Price Index ("RPI") by 3% per annum or more. Options can only be exercised in full if cumulative growth in the Group's normalised EPS from the base point exceeds the growth in RPI by 6% per annum or more. For performance between 3% per annum and 6% per annum, an option can be exercised based on a sliding scale. If normalised EPS growth fails to exceed that of RPI by at least 3% per annum cumulatively over the three years, the option will lapse.

The maximum value of grants made to individual participants in any one year may not exceed 100% of salary.

Options will not normally be granted in the same year to an individual who is also in receipt of an LTIP award. However, the Company may make executive share option grants from time to time in exceptional circumstances such as in strategically important recruitment or retention situations or to meet changing competitive market pressures such as might exist in the various key geographies in which Ricardo executives are based. Where such options are granted, stretching performance conditions will be attached, which will be set at the time of grant.

The Company did not grant any options to executive directors during the year.

Under the 1994 Scheme, no further options could be granted after 4 November 2004. The performance criteria attaching to subsisting options granted under the 1994 Scheme require that the Group's normalised EPS must increase on average by at least 7.5% per annum (adjusted for inflation), over the three year period after the grant date, before the option may be exercised. If the Group's normalised EPS performance fails to meet this target, the period over which performance is measured is extended to four years and if necessary again to five years, in both cases still requiring the average growth in normalised EPS over the period to exceed 7.5% per annum (adjusted for inflation). If the Group's performance fails to achieve this target after five years, the option lapses.

The Ricardo plc 2000 Savings Related Share Option Scheme is an HMRC-approved, all employee savings contract based SAYE scheme. No SAYE options have been granted since October 2002.

Share option schemes – proposed arrangements for 2006/07
No change is proposed to the current policy.

A grant to the Finance Director Designate, Paula Bell, is planned at 50% of basic salary on commencement of service in October 2006. The performance conditions intended to be attached to that grant will be 30% vesting at 3% real growth in normalised EPS per annum and 100% vesting at 10% real growth in normalised EPS per annum, and with options vesting on a straight line basis for performance in between 3% and 10% real growth in normalised EPS per annum.

Dilution limits

The number of shares that may be issued under all Ricardo employee share plans in any ten year rolling period will be restricted to 10% of the issued ordinary share capital of the Company and 5% of the issued ordinary share capital of the Company for discretionary employee share plans.

Pensions

UK executive directors are members of the Ricardo Group Pension Fund ("RGPF") at the invitation of the Company. The RGPF is established under trust, contracted out of the State Earnings Related Pension Scheme and approved by HMRC under the Income and Corporation Taxes Act 1988. The Company has elected to continue to apply the HMRC cap to participants in its UK defined benefit pension scheme from 6 April 2006. Under the rules of the RGPF, performance related bonuses do not form part of pensionable earnings. The RGPF is now closed to new employees.

The RGPF provides Dave Shemmans with a pension of up to two thirds of basic salary (up to the cap) on retirement at age 65 after 25 or more years' service. Members' contributions are required at the rate of 5.75% of pensionable earnings.

The RGPF provides Andrew Goodburn and Steve Parker with a pension of up to two thirds of basic salary (up to the cap) on retirement at age 62 after 20 or more years' service. Members' contributions are required at the rate of 8% of pensionable earnings.

At retirement, members may commute a portion of their pension for a cash sum. Retirement before the pension age is subject to actuarial reduction other than for Andrew Goodburn and Steve Parker for whom no actuarial deduction is made if they retire between the ages of 60 and 62. The right to a pension on early retirement is only available with the consent of the Company and the Trustees and the individual must be over 50 or retiring due to ill health. The total pension paid by the fund in excess of the guaranteed minimum pension will increase annually at the rate of 5% compound or by the rise in the Retail Prices Index if lower. On death in service, a lump sum of four times annual salary at date of death is payable subject to the medical requirements of the insurance company, together with a spouse's pension of 35% of annual salary and a pension per child of 12.5% of annual salary, subject to a maximum limit of 25%, until the child attains the age of 21.

On death after retirement, a spouse's pension is paid at 50% of the

member's pre-commutation pension and if death occurs within five years after retirement a lump sum equal to the member's monthly rate of pensionable pay by the fund at the date of death multiplied by the number of unpaid monthly instalments to the end of that five year period.

In addition, for Andrew Goodburn, in lieu of a prior FURBS arrangement, the Company paid £140,505, less tax of £56,202, into a defined contribution plan during the period from 1 July 2005 to 5 April 2006. As a result of changes to pension legislation effective from April 2006, the Remuneration Committee has agreed with Andrew Goodburn to cease contributions to the previous defined contribution pension arrangement with effect from 6 April 2006, and to commence payment of additional company contributions of £187,272 gross per annum under a salary sacrifice arrangement with effect from 6 April 2006.

Pension arrangements for Steve Parker are outlined below.

Jeremy Holt is a member of Ricardo, Inc.'s 401K retirement benefits plan and the (US) Supplemental Executive Retirement Plan, which are defined contribution plans.

Other benefits

The Company provides other cash benefits and benefits in kind in line with market practice. These include a company car or cash alternative, private fuel, private medical insurance, life assurance, payments in lieu of pension provision for UK earnings over the HMRC cap, which the Company has elected to continue to apply to participants in its UK defined benefit pension scheme from 6 April 2006. The Company also pays or reimburses non-executive directors in respect of taxable travel expenses.

Service agreements

The Board's policy on setting notice periods for directors is that these should not exceed one year. It recognises, however, that it may be necessary in the case of new executive appointments to offer an initial longer notice period, which would subsequently reduce to one year after the expiry of that period. All future appointments to the Board will comply with this requirement.

All current executive directors have service agreements terminable on one year's notice. The details of the service contracts of the executive directors are as follows:

	Date of service contract	Length of contract	Notice period
Dave Shemmans	7 April 2005	1 year rolling	12 months
Andrew Goodburn	7 October 1998	1 year rolling	12 months
Steve Parker	2 November 2005	1 year rolling	12 months
Jeremy Holt	18 December 2001	1 year rolling	12 months

The contractual termination provision is payment in lieu of notice equal to one year's basic salary or the amount of any unexpired notice and any accrued bonus to the date of termination. If the Company terminates a director's service contract, not in accordance with its terms, there is an obligation on the director to mitigate any loss which he may suffer and this will be taken into account by the Committee when determining what compensation, if any, should be paid to the departing director. In the case of Dave Shemmans' and

Paula Bell's contracts, specific mitigation provisions are included. No compensation is paid for summary dismissal.

Share retention policy

The Board operates a share retention policy for the executive directors. Each is required within 5 years of the later of the date of appointment and any award under any of the share plans subsequent to the adoption of the policy in November 2004 to own shares in the Company with a value at least equal to one times basic annual salary.

External appointments

The Board recognises the benefit that Ricardo can obtain if executive directors of Ricardo serve as non-executive directors of other companies. Subject to review in each case, the Remuneration Committee's general policy is that executive directors may accept non-executive directorships with other companies, so long as there is no conflict of interest and their effectiveness is not impaired. Andrew Goodburn holds a non-executive directorship with another company for which fees of £17,700 were earned in the year. Directors may retain any such fees.

Remuneration arrangements for Steve Parker

As part of the wider remuneration policy review described above, Steve Parker's remuneration arrangements were also reviewed and amended. These have largely been described above but further background and a summary is set out below for completeness.

Steve Parker was recruited from A.T. Kearney in 2002 to establish and develop a new strategic consulting business within Ricardo. This business has grown to revenue and operating profit of £13.9m and £2.6m respectively. From the outset the Remuneration Committee and the Board recognised that to attract and retain high calibre individuals from the strategic consulting world, it would be necessary to provide remuneration potentials at levels competitive with senior roles in the automotive industry strategic consultancy market. This remuneration market is distinct from that for Ricardo's engineering services consultancy. As such, Steve Parker's remuneration is aligned

to benchmarks drawn from similar roles in other strategic consultancies. The Board and the Remuneration Committee continue to believe that Ricardo's move into strategic automotive consulting is to be supported and separate remuneration arrangements to retain Steve Parker continue to be appropriate.

As a result of this review, the following changes were made to Steve Parker's remuneration arrangements with effect from 1 July 2005:

- Base salary increase from £232,000 to £320,000;
- No further participation in the LTIP (previously he has typically been awarded 45% of annual salary)
- Option grants may continue to be made from time to time at the discretion of the Committee;
- Annual employer pension contribution increased from £55,000 to £125,000, a proportion of which is used to fund company contributions into the company defined benefit pension scheme, and the balance of which is invested at the discretion of Steve Parker; and
- No further pension supplement of 15% of the difference between base salary and the HMRC cap (currently £105,600).

A summary comparison of Steve Parker's previous and revised package is outlined in the table below:

	Year ended 30 June 2005	Year ended 30 June 2006
Base salary	£232,000	£320,000
Maximum annual bonus	140% based on Ricardo Strategic Consulting results, plus 60% based on Group results (with 50% compulsory deferral of any Consulting element payout)	140% based on Ricardo Strategic Consulting results, plus 60% based on Group results (with 50% compulsory deferral of any Consulting element payout)
LTIP	45%	NIL
Share options	At Committee discretion (160,000 granted)	At Committee discretion (none granted)
Pension	£55,000	£125,000
Pension supplement	£18,960	NIL

The Committee believes that these changes are in shareholders' interests in that they will assist in continuing to create a platform for a potentially important part of Ricardo's growth strategy.

*All-employee share plans**Proposed arrangements for 2006/07*

It is the Company's intention to implement an HMRC-approved Share Incentive Plan ("SIP") in the forthcoming year in order to further encourage share ownership. The Company intends to seek shareholder approval for the new SIP at the AGM in November 2006.

The SIP will provide for partnership, matching and free shares, either by delivery of market purchased or newly issued shares. The exact implementation policy for the SIP will be determined from time to time. It is anticipated that the Company will initially offer partnership shares only.

Under the legislation, the tax approved status of a SIP only applies to UK employees and it is therefore proposed that the SIP will initially not apply to overseas employees, although this position will be reviewed from time to time.

Non-executive directors

The Board determines the fees paid to non-executive directors, the aggregate limit for which is laid down in the Articles of Association. The fees, which were reviewed in the year, are set in line with prevailing market conditions and at a level which will attract individuals with the necessary experience and ability to make a significant contribution to the Group's affairs. For non-executives other than the Chairman, the fees comprise a basic fee of between £30,000 and £31,850 per annum with an additional amount of £3,000 paid to each of the Chairmen of the Audit and Remuneration Committees and an additional amount of £4,000 paid to Ian Percy in his role as the senior independent director. Non-executive directors are not involved in any discussion or decision about their own remuneration. The same applies to the Chairman of the Board whose remuneration is determined by the Board on the recommendation of the Committee.

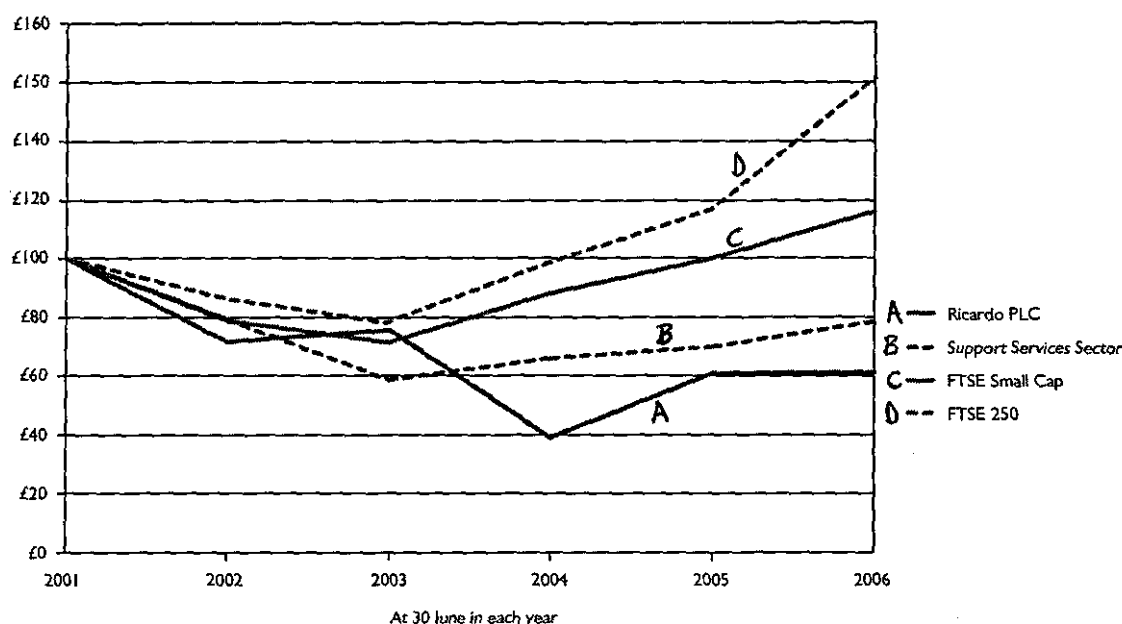
The non-executive directors do not participate in any of the Company's share schemes, pension schemes or bonus arrangements nor do they have service agreements. They are appointed for a period of two or three years by letter of appointment and are entitled

to one month's notice of early termination for which no compensation is payable. The unexpired terms of the non-executive directors at 30 June 2006 are:

Marcus Beresford	15 months
Ian Percy	36 months
Michael Harper	12 months
David Hall	3 years from the AGM on 10 November 2006

Performance graph

The graph below based on data from Hemscott shows, for a notional amount invested of £100, the Company's TSR (share price movement plus dividends reinvested) over the last five financial years compared to the performance both of the FTSE Support Services sector and the FTSE Small Cap and FTSE 250 indices. In the directors' opinion, the Support Services sector is the index with the most comparable companies when considering their activities, and the Small Cap index represents an appropriate index against which the TSR should be measured when considering the Company's size. The FTSE 250 index has been used for LTIP performance criteria to date.



Auditable part

The auditable part of the directors' remuneration report is set out below on pages 56 to 60.

Directors' emoluments

The emoluments for the directors who served during the year were as follows:

	Basic salary and fees £'000	Performance related bonus £'000	Other cash benefits £'000	Benefits in kind (a) £'000	Termination payments £'000	Total 2006 £'000	Total 2005 £'000
<i>Executive directors</i>							
Dave Shemmans (b)	248	24	37	2	—	311	101
Andrew Goodburn	198	15	77	10	—	300	313
Steve Parker	320	472	15	8	—	815	584
Jeremy Holt (c)	189	18	—	6	—	213	221
Rodney Westhead (d)	113	67	80	19	—	279	450
Clive Hickman (e)	33	17	5	3	105	163	215
<i>Non-executive directors</i>							
Marcus Beresford	104	—	—	9	—	113	106
Ian Percy	39	—	6	—	—	45	40
Michael Harper	35	—	2	—	—	37	32
David Hall (f)	11	—	1	—	—	12	—
	1,290	613	223	57	105	2,288	2,062

- (a) Benefits in kind for the UK based executive directors include private medical insurance and life assurance cover. Jeremy Holt and Rodney Westhead had the benefit of company cars, with fuel being provided for Rodney Westhead. Pensions advice was also paid for on behalf of Steve Parker. Taxable travel costs were paid on behalf of Marcus Beresford.
- (b) Appointed 17 February 2005 as Chief Executive Officer designate, taking on the position of Chief Executive Officer on the resignation of Rodney Westhead on 4 November 2005. Dave Shemmans' salary was £215,000 upon appointment to the Board in February 2005 and was increased to £265,000 in November 2005 when he took on the position of Chief Executive Officer.
- (c) Jeremy Holt was remunerated in US dollars, translated at a dollar/sterling exchange rate of 1.7784 (2005: 1.8558).
- (d) Rodney Westhead resigned from the Board on 4 November at the Annual General Meeting and retired on 9 November 2005. In the light of his retirement during the year, the following arrangements were made:
- Cash bonus of equivalent value to the 2004 LTIP that would have been received under normal circumstances, time pro-rated to retirement and subject to the normal LTIP TSR performance conditions. As the performance condition was met in part, Rodney Westhead received a cash sum of £57,200 upon retirement.
 - In a review of executive base salaries in July 2005, the Remuneration Committee decided not to increase Rodney Westhead's base salary. This was in shareholders' interests, as it was not considered appropriate to increase his final salary for defined benefit pension purposes. The Committee also decided not to provide any long-term incentive arrangements for the year ended 30 June 2006. In recognition of foregoing this salary increase and 2005 long term incentive participation, Rodney Westhead received an additional cash sum upon retirement of £70,000.
 - £10,000 cash bonus relating to performance from 1 July 2005 to retirement.
- (e) Clive Hickman resigned on 31 August 2005.
- (f) David Hall was appointed on 21 February 2006.

Directors' pensions

With respect to defined benefit pension schemes, executive directors' accrued benefits and transfer values were as follows:

	Additional accrued pension benefits earned in the year (excluding inflation) £'000	Additional accrued pension benefits earned in the year (excluding inflation) £'000	Accrued pension entitlement £'000	Transfer value at 30 June 2006 £'000	Transfer value at 30 June 2005 £'000	Increase in transfer value less members' contributions £'000	Additional transfer value accrued in excess of members' contributions (excluding inflation) £'000
Dave Shemmans	2	2	9	37	27	3	7
Andrew Goodburn	4	4	45	704	614	74	55
Steve Parker	4	4	14	143	98	37	37
Rodney Westhead	1	1	45	839	828	2	14
Clive Hickman	2	2	30	281	258	21	20

The increase in the accrued pension entitlement is the difference between the accrued benefit at the year-end and that at the previous year-end. All transfer values have been calculated on the basis of actuarial advice consistent with Actuarial Guidance Notice GNI 1. None of the transfer value figures represents sums payable to the directors and, therefore, cannot be meaningfully added to annual remuneration. The increase in the transfer value less directors' contributions is the increase in the value of accrued benefits during the year after deducting the director's personal contributions. The transfer value of the increase in accrued benefits, required by the Listing Rules, discloses the current value of the increase in accrued benefits that the director has earned in the period, whereas the change in his transfer value, required by the Companies Act, discloses the absolute increase or decrease in his transfer value and includes the change in value of the accrued benefits that results from market volatility affecting the transfer value at the beginning of the year, as well as the additional value earned in the year.

In addition Rodney Westhead had a FURBS entitlement that was settled on his retirement. The total accrued FURBS lump sum entitlement as at 30 June 2005 was £1,631,000. During the year payments of £174,000 were paid into the FURBS fund in final settlement of all liabilities.

With respect to defined contribution pension schemes, contributions paid or payable were as follows:

	2006 £'000
Andrew Goodburn	131
Steve Parker	88
Jeremy Holt	39

Directors' interests in shares provisionally awarded under the Long Term Incentive Plan

	Cycle ending	Award date	Share price at award date pence	At 1 July 2005 Number	Shares provisionally allocated Number	Lapsed Number	Shares vested Number	At 30 June 2006 Number	Value Vested £'000	Vesting date
Dave Shemmans	Jun 05	Sep 02	365.0	7,897	–	(7,897)	–	–	–	–
	Jun 06	Sep 03	372.5	6,304	–	–	–	6,304	–	–
	Jun 07	Dec 04	185.0	31,517	–	–	–	31,517	–	–
	Jun 08	Dec 05	301.0	–	53,571	–	–	53,571	–	–
Andrew Goodburn	Jun 05	Sep 02	365.0	23,900	–	(23,900)	–	–	–	–
	Jun 06	Sep 03	372.5	27,344	–	–	–	27,344	–	–
	Jun 07	Dec 04	185.0	45,673	–	–	–	45,673	–	–
	Jun 08	Dec 05	301.0	–	32,890	–	–	32,890	–	–
Steve Parker	Jun 05	Sep 02	365.0	29,096	–	(29,096)	–	–	–	–
	Jun 06	Sep 03	372.5	33,246	–	–	–	33,246	–	–
	Jun 07	Dec 04	185.0	55,769	–	–	–	55,769	–	–
Jeremy Holt	Jun 05	Sep 02	365.0	26,194	–	(26,194)	–	–	–	–
	Jun 06	Sep 03	372.5	28,156	–	–	–	28,156	–	–
	Jun 07	Dec 04	185.0	43,100	–	–	–	43,100	–	–
	Jun 08	Dec 05	301.0	–	31,107	–	–	31,107	–	–
Rodney Westhead	Jun 05	Sep 02	365.0	39,487	–	(39,487)	–	–	–	–
	Jun 06	Sep 03	372.5	45,125	–	(45,125)	–	–	–	–
Clive Hickman	Jun 05	Sep 02	365.0	19,051	–	(19,051)	–	–	–	–
	Jun 06	Sep 03	372.5	21,815	–	(21,815)	–	–	–	–
	Jun 07	Dec 04	185.0	40,865	–	(24,973)	(15,892)	–	48*	30 Sep 05

*The mid-market closing price of the Company's shares on 30 September 2005 was 301.0p.

For the Plan Cycle ended June 2006, the share award has lapsed in full. For the Plan Cycles ending 30 June 2007 and 2008, amounts vesting depend on Ricardo plc's TSR performance for the three financial years ending on those dates against FTSE 250 companies, excluding investment trusts and financial services companies. Awards

lapse at performance below median. 25% of the award vests for median performance. Awards vest in full for upper quartile performance. For levels of performance between median and upper quartile, there is partial vesting on a sliding scale.

Directors' interests in share options

The 2004 Executive Share Option Scheme

	At 1.7.05 number	Granted number	Number of options during the year Exercised number	Lapsed number	At 30.6.06 number	Exercise price pence	Market price at date of exercise pence	Date from which exercisable	Expiry date
Dave Shemmans	80,000	–	–	–	80,000	267.5	–	22.02.08	21.02.15
Steve Parker	60,000	–	–	–	60,000	267.5	–	22.02.08	21.02.15

The performance criteria attaching to these options require that as a minimum the cumulative growth in the Group's normalised EPS over the next three financial years, from a base point of the average of the Group's normalised EPS figures for the previous two financial years, exceeds that of the Retail Price Index ("RPI") by 3% per annum or more. Options can only be exercised in full if cumulative growth in

the Group's normalised EPS from the base point exceeds the growth in RPI by 6% per annum or more. For performance between 3% per annum and 6% per annum, an option can be exercised based on a sliding scale. If normalised EPS growth fails to exceed that of RPI by at least 3% per annum cumulatively over the three years, the option will lapse.

The 1994 Executive Share Option Scheme

	At 30.6.05 number	Granted number	Number of options during the year Exercised number	Lapsed number	At 30.6.06 number	Exercise price pence	Market price at date of exercise pence	Date from which exercisable	Expiry date
Rodney Westhead	144,000	—	(144,000)	—	—	114.0	285.8		
Andrew Goodburn	10,000	—	(10,000)	—	—	114.0	301.0		
Jeremy Holt	50,000	—	—	—	50,000	381.0	—	25.09.04	24.09.11
Clive Hickman	50,000	—	—	*(50,000)	—	265.0	—		
	65,000	—	—	*(65,000)	—	185.0	—		
Dave Shemmans	45,000	—	—	—	45,000	185.0	—	25.06.07	24.06.14
Steve Parker	100,000	—	—	—	100,000	186.5	—	21.09.07	20.09.14

*These options have lapsed following his resignation on 31 August 2005.

The options granted to Jeremy Holt, as shown above, have not met the performance conditions and have therefore lapsed in full. The performance criteria attaching to subsisting options granted under the 1994 Scheme require that the Group's normalised EPS must increase on average by at least 7.5% per annum (adjusted for inflation), over the three year period after the grant date, before the options may be exercised. If the Group's adjusted EPS performance fails to meet this

target, the period over which performance is measured is extended to four years and if necessary again to five years, in both cases still requiring the average growth in adjusted EPS over the period to exceed 7.5% per annum (adjusted for inflation). If the Group's performance fails to achieve this target after five years, the options will lapse.

The Ricardo plc 2000 Savings Related Share Option Scheme

	At 1.7.05	Granted	Number of options during the year Exercised	Lapsed	At 30.6.06	Exercise price pence	Market price at date of exercise pence	Date from which exercisable	Expiry date
Rodney Westhead	1,619	—	(1,619)	—	—	233.4	285.8	1.12.05	31.05.06
Andrew Goodburn	4,048	—	(4,048)	—	—	233.4	285.8	1.12.05	31.05.06
Clive Hickman	4,048	—	(3,741)	*(307)	—	233.4	284.8	1.12.05	31.05.06
Dave Shemmans	2,814	—	—	—	2,814	233.4	—	1.12.07	31.05.08

*These options have lapsed following his resignation on 31 August 2005.

The mid-market closing price of the Company's shares on 30 June 2006 was 269.25p. The highest price of the Company's shares during the financial year was 318.00p. The lowest price of the Company's shares during the financial year was 258.75p.

Gains made on share option exercises

Gains made on the exercise of share options are calculated by

reference to the difference between the closing mid market price on the date of exercise and the exercise price of the option, disregarding whether such shares were sold or retained on exercise, and is stated before tax. Andrew Goodburn retained all of his shares on exercise. Gains made on share option exercises during the year by Board directors were as follows:

	Gains made on share option exercises £
Rodney Westhead	248,168
Andrew Goodburn	21,219
Clive Hickman	1,921

Directors' interests in shares

Directors' interests in shares, excluding any interests in share options and shares provisionally awarded under the Long Term Incentive Plan, are all beneficial interests and are as follows:

	Ordinary shares	
	At 30 June 2006 Number	At 1 July 2005 Number
Dave Shemmans	960	960
Andrew Goodburn	128,964	114,916
Steve Parker	16,195	10,829
Jeremy Holt	35,622	35,622
Marcus Beresford	20,000	20,000
Ian Percy	—	—
Michael Harper	20,000	20,000
David Hall	—	—*

* at date of appointment.

At 18 September 2006 the interests in shares of the directors still in office were unchanged from those at 30 June 2006.

On behalf of the Board



Michael Harper
Chairman of the Remuneration Committee

18 September 2006

Independent Auditors' Report

Independent Auditors' Report to the Members of Ricardo plc

We have audited the Group and Parent Company financial statements (the "financial statements") of Ricardo plc for the year ended 30 June 2006 which comprise the Consolidated Income Statement, the Consolidated and Parent Company Statements of Recognised Income and Expense, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements and the related notes. These 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.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the 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.

Our responsibility is to audit the 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). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Business Review that is cross referred from the Business Review section of the Directors' Report. We also 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 review whether the Statement of Corporate Governance in practice reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman's Statement, the Business Review, the Statement on Corporate Governance in practice, the Directors' Report and the unaudited part of the Directors' Remuneration Report. We consider the implications for our

report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

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 financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Parent 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 financial statements and the part of the Directors' Remuneration 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 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 30 June 2006 and of its profit and cash flows for the year then ended;
- the Parent Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the Parent Company's affairs as at 30 June 2006 and cash flows for the year then ended;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton

18 September 2006

FINANCIAL STATEMENTS

Consolidated Income Statement
Statements of Recognised Income and Expense
Balance Sheets
Cash Flow Statements
Notes to the Financial Statements

Consolidated Income Statement for the year ended 30 June 2006

Continuing operations	Notes	2006 £m	2005 £m
Revenue	2	173.1	158.1
Operating profit	3	15.8	10.4
Operating profit excluding pensions credit (underlying)		12.1	10.4
Pensions credit	22	3.7	—
Finance income	6	1.4	0.8
Finance costs	6	(2.7)	(2.6)
Profit before taxation		14.5	8.6
Profit before tax excluding pensions credit (underlying)		10.8	8.6
Pensions credit	22	3.7	—
Taxation	7	(2.3)	(1.1)
Profit for the year		12.2	7.5
Profit for the year excluding pensions credit (underlying)		9.6	7.5
Pensions credit	22	2.6	—
Profit attributable to minority interest		0.1	0.1
Profit attributable to equity shareholders		12.1	7.4
Earnings per ordinary share	9		
Basic		24.0p	14.8p
Diluted		23.9p	14.8p

Statements of Recognised Income and Expense for the year ended 30 June 2006

		Group		Company	
	Notes	2006 £m	2005 £m	2006 £m	2005 £m
Currency translation differences on net investment in foreign operations	28	(0.2)	0.2	–	–
Actuarial gains/(losses) on the defined benefit pension scheme	22	6.7	(7.9)	6.7	(7.9)
Tax on actuarial gains/(losses) on the defined benefit pension scheme	7	(2.0)	2.3	(2.0)	2.3
Net income and expense recognised directly in equity		4.5	(5.4)	4.7	(5.6)
Profit for the financial year		12.2	7.5	15.3	(116.6)
Total recognised income and expense for the year		16.7	2.1	20.0	(122.2)
Attributable to minority interest		0.1	0.1	–	–
Attributable to equity shareholders of the parent		16.6	2.0	20.0	(122.2)

Balance Sheets as at 30 June 2006

		Group		Company	
	Notes	2006 £m	2005 £m	2006 £m	2005 £m
Assets					
Non current assets					
Goodwill	11	15.9	15.6	-	-
Other intangible assets	12	1.5	1.0	-	-
Property, plant and equipment	13	45.2	46.7	9.8	10.1
Investments	14	-	-	18.0	21.1
Deferred tax assets	23	8.7	8.0	7.7	7.6
		71.3	71.3	35.5	38.8
Current assets					
Inventories	15	7.0	6.9	-	-
Trade and other receivables	16	47.3	43.1	42.7	40.7
Current taxation		0.2	1.6	0.2	-
Deferred tax assets	23	0.6	4.5	-	3.3
Cash and cash equivalents		49.8	28.8	28.7	22.4
Assets classified as held for sale	10	7.5	2.0	-	-
		112.4	86.9	71.6	66.4
Total assets		183.7	158.2	107.1	105.2
Liabilities					
Current liabilities					
Bank loans and overdrafts	19	(45.0)	(21.5)	(7.6)	(2.1)
Trade and other payables	17	(38.9)	(35.4)	(14.9)	(15.2)
Current tax liabilities	18	(2.5)	(4.9)	-	-
Deferred tax liabilities	23	(0.6)	(0.7)	-	-
Provisions	24	(0.5)	(0.4)	-	-
Liabilities directly associated with assets classified as held for sale	10	(7.5)	(2.0)	-	-
		(95.0)	(64.9)	(22.5)	(17.3)
Net current assets		17.4	22.0	49.1	49.1
Non current liabilities					
Bank loans	19	(10.6)	(18.5)	(8.3)	(15.5)
Retirement benefit obligations	22	(23.6)	(34.7)	(23.6)	(34.7)
Deferred tax liabilities	23	(4.4)	(3.4)	(0.8)	(0.8)
		(38.6)	(56.6)	(32.7)	(51.0)
Total liabilities		(133.6)	(121.5)	(55.2)	(68.3)
Net assets		50.1	36.7	51.9	36.9
Shareholders' equity					
Ordinary shares	25	12.7	12.5	12.7	12.5
Share premium	27	13.3	12.2	13.3	12.2
Other reserves	28	0.6	1.2	-	-
Retained earnings	29	22.9	10.3	25.9	12.2
Total shareholders' equity		49.5	36.2	51.9	36.9
Minority interest in equity	30	0.6	0.5	-	-
Total equity		50.1	36.7	51.9	36.9

The financial statements on pages 63 to 100 were approved by the Board of Directors on 18 September 2006 and signed on its behalf by:

Dave Shemmans, Chief Executive Officer


Andrew Goodburn, Finance Director



Cash Flow Statements for the year ended 30 June 2006

		Group		Company	
	Notes	2006 £m	2005 £m	2006 £m	2005 £m
Cash flows from operating activities					
Cash generated from/(used by) operations	32	20.0	11.2	(2.6)	(19.0)
Interest received	6	1.4	0.8	2.0	0.7
Interest paid	6	(2.7)	(2.6)	(1.2)	(1.3)
Tax (paid)/refunded		(1.4)	0.3	–	0.1
Net cash from operating activities		17.3	9.7	(1.8)	(19.5)
Cash flows from investing activities					
Proceeds of sale of property, plant and equipment		0.3	0.2	–	–
Purchase of intangible assets		(1.1)	(0.9)	–	–
Purchase of property, plant and equipment		(7.3)	(5.4)	(0.1)	(0.1)
Intra group transfers of fixed assets		–	–	0.1	0.2
Net cash (used)/received in investing activities		(8.1)	(6.1)	–	0.1
Cash flows from financing activities					
Net proceeds from issue of ordinary share capital		1.3	0.2	1.3	0.2
Net proceeds from issue of new bank loan		–	15.5	–	15.5
Repayment of borrowings		(0.5)	(17.2)	–	–
Dividends paid to shareholders	8	(4.6)	(4.6)	(4.6)	(4.6)
Dividends paid to minority interests	30	–	(0.1)	–	–
Dividends received from subsidiaries		–	–	12.9	20.6
Net cash (used)/received in financing activities		(3.8)	(6.2)	9.6	31.7
Effects of exchange rate changes		(0.5)	(0.2)	0.6	(0.1)
Net increase/(decrease) in cash and cash equivalents		4.9	(2.8)	8.4	12.2
Cash and cash equivalents at 1 July		7.8	10.6	20.3	8.1
Cash and cash equivalents at 30 June		12.7	7.8	28.7	20.3
At 1 July					
Cash and cash equivalents		28.8	25.5	22.4	13.2
Bank overdrafts		(21.0)	(14.9)	(2.1)	(5.1)
		7.8	10.6	20.3	8.1
At 30 June					
Cash and cash equivalents		49.8	28.8	28.7	22.4
Bank overdrafts	19	(37.1)	(21.0)	–	(2.1)
		12.7	7.8	28.7	20.3

Notes to the Financial Statements

1 Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

These financial statements have been prepared for the first time in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations endorsed by the European Union ("EU") and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

In accordance with EU regulations, the Group adopted IFRS with effect from 1 July 2004 and has restated prior year comparatives to reflect its adoption of IFRS, unless otherwise stated. Prior to the adoption of IFRS, the Group prepared its financial statements in accordance with United Kingdom Generally Accepted Accounting Principles ("UK GAAP"). Disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRS are given in note 39.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain current assets and derivative contracts held for trading.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates, judgements and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates, judgements and assumptions are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates, judgements and assumptions.

The following exemptions permitted by IFRS 1 'First Time Adoption of International Financial Reporting Standards' have been adopted in the initial application of IFRS:

- IFRS 3 'Business Combinations' has been applied prospectively from 1 July 2004. Goodwill arising on acquisitions made prior to this date has been frozen as at 30 June 2004 and is subject to periodic impairment reviews. Goodwill written off to reserves prior to 1998 has not been restated.
- The Group has adopted early the amendment to IAS 19 'Employee Benefits' which is effective for accounting periods beginning on or after 1 January 2006 and has applied the requirements of this amendment in these financial statements.
- The Group adopted IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement' from 1 July 2005. As permitted by IFRS 1 'First Time Adoption of International Financial Reporting Standards', 2005 comparatives have not been restated for these standards. Cumulative foreign currency translation differences on overseas operations are separately recognised from 1 July 2004.
- IFRS 2 'Share Based Payment' has not been applied to share based payments granted before 7 November 2002 but not vested at 1 January 2005.

(b) Basis of consolidation

The consolidated financial statements include the financial statements of the Parent Company and all of its subsidiaries made up to the end of the financial period. Businesses acquired are accounted for as acquisitions with effect from the date control passes. Those disposed of are accounted for up until control passes at the date of disposal. All intra group transactions and balances are eliminated on consolidation. Minority interests are presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity. Minority interests in the profit or loss of the Group are also separately disclosed.

Non current assets are classified as held for sale when a sale within one year is highly probable and are stated at the lower of fair value less cost to sell or the carrying amounts at the date they meet the held for sale criteria.

(c) Revenue

Revenue consists of amounts chargeable to customers for products and services provided and is exclusive of value added tax and other sales taxes.

The Group's professional services revenue is derived principally from work undertaken for customers on long term contracts. Work is undertaken for customers either according to the terms of fixed price contracts or on the basis that time and materials are billed as incurred. With respect to fixed price contracts, revenue is recognised according to the percentages completed after taking into account the total contract value. All losses on fixed price contracts are recognised in the first period they are incurred or foreseen. Revenue and profits from project variations are only recognised when it is expected that they will be recovered from customers. For time and material contracts, revenue and profit is recognised when the right to consideration has been established based on time worked and materials expended.

The corresponding amount for revenue is included within debtors as amounts recoverable on contracts. Advance payments received from customers are included in creditors as payments received in advance and amounts are set off against the value of work undertaken as the contracts progress.

The Group's product revenue is recognised in accordance with IAS 18 'Revenue' and is derived from the sale of licences for its software and related services, which includes maintenance and training services and from the sale of other products. Revenue from software licence arrangements is recognised when a signed contract is obtained and delivery has occurred. Revenue from software leases, maintenance, training and support is recognised over the period of the service provided. Related costs are charged to the income statement as incurred. Revenue from the sale of other products is taken as they are delivered.

(d) Research and development

Internally generated intangible assets are recognised in the case of software products and patents granted when the conditions set out in IAS 38 'Intangible Assets' are met. The amount recognised is the development cost from the point of the decision to develop for commercial sale in the case of software, and in the case of patents from the date of grant, up until the point the intangible asset is readily available for sale/use. Internally generated intangible assets are amortised on a straight-line basis over their estimated useful lives, as outlined in note 1(v).

In all other cases, research and development expenditure is recognised as an expense in the period in which it is incurred.

(e) Leases

The costs of operating leases are charged to the income statement on a straight line basis. Operating lease incentives are included within prepayments and amortised on a straight line basis over the period of the lease.

Assets under finance leases are included at fair value rather than purchase price.

(f) Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due. Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution schemes where the Group's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit scheme.

For defined benefit retirement 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 the income statement and presented in the statement of recognised income and expense. Any gains or losses resulting from settlements or curtailments are recognised in the income statement.

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 obligations recognised in the balance sheet represent the present value of the defined benefit obligations 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 plan.

(g) Share based payments

Equity settled share based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight line basis over the vesting period, based on the Group's estimate of participants eligible to receive shares at the point of vesting.

Fair value is measured by use of a Black Scholes model for share options, and a Monte Carlo model for the Long Term Incentive Plans ("LTIP"). The expected life used in the model is adjusted for the effects of exercise restrictions and behavioural considerations.

(h) Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities acquired. Goodwill arising on overseas acquisitions is treated as a foreign currency asset and revalued at the balance sheet date. Foreign exchange differences arising are taken to the translation reserve and recycled to the income statement when the related subsidiary is sold.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed. On disposal of a

business, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRS is retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 is not reinstated and is not included in determining any subsequent profit or loss on disposal.

(i) Borrowing costs

Interest bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recorded in the income statement over the period of the borrowings on an effective rate basis.

(j) Foreign currency

Transactions

The functional currency of Ricardo plc is pounds sterling. The functional currency of each subsidiary is its local currency. Transactions in currencies other than the functional currency 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 assets and liabilities 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. Gains and losses arising on retranslation and settlements are included in the income statement for the period, except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are required to be recognised directly in equity.

Consolidation

On consolidation, the assets and liabilities of overseas operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates of the period unless exchange rates fluctuate significantly. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. On disposal of an operation, such translation differences are recognised as income or expense in the period in which the operation is disposed of.

Goodwill and fair value adjustments

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. Foreign exchange differences arising are taken to the translation reserve and recycled through the income statement when the related business is sold. The Group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of transition to IFRS as sterling denominated assets and liabilities.

Derivative financial instruments

Derivative financial instruments are initially recognised and measured at fair value on the date a derivative contract is entered into and subsequently measured at fair value. The gain or loss on re-measurement is taken to the income statement except where the derivative is designated as a cash flow hedging instrument or a hedge of a net investment in a foreign entity. The accounting treatment of derivatives classified as hedges depends on their designation, which

occurs on the date that the derivative contract is committed to. The Group designates derivatives as:

- A hedge of the fair value of an asset or liability ('fair value hedge')
- A hedge of the income/cost of a highly probable forecasted transaction or commitment ('cash flow hedge')
- A hedge of a net investment in a foreign entity ('net investment hedge').

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document in advance the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an on-going basis. This effectiveness testing is re-performed at each period end to ensure that the hedge remains highly effective.

Gains or losses on fair value hedges that are highly effective are recorded in the income statement with the gain or loss on the hedged item attributable to the hedged risk.

Gains or losses on cash flow hedges that are highly effective are recognised in equity. Where the forecast transaction results in a financial asset or liability only gains or losses previously recognised in equity are reclassified to the income statement in the same period as the asset or liability affects the income statement. Where the forecasted transaction or commitment results in a non-financial asset or a liability, then any gains or losses previously deferred in equity are included in the cost of the related asset or liability. If the forecasted transaction or commitment results in future income or expenditure, gains or losses deferred in equity are transferred to the income statement in the same period as the underlying income or expenditure. The ineffective portions of the gain or loss on the hedging instrument are recognised immediately in the income statement.

Where the Group hedges net investments in foreign entities through currency borrowings and those borrowings qualify for hedge accounting, the gains or losses on the translation of the borrowings are recognised in equity. If the Group uses derivatives as the hedging instrument, the effective portion of the hedge is recognised in equity. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

For the ineffective portion of any hedges and any transactions that do not qualify for hedge accounting, any change in assets or liabilities is recognised immediately in the income statement. Where a hedge no longer meets the effectiveness criteria, any gains or losses previously deferred in equity are only transferred to the income statement when the committed or forecasted transaction is recognised in the income statement. Where hedge accounting has been applied to a cash flow hedge for a forecasted or committed transaction that is no longer expected to occur, then the cumulative gain or loss that has been recorded in equity is transferred to the income statement. When a hedging instrument expires or is sold, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement.

(k) Fair value estimation

The fair values of forward currency contracts are based on market forward exchange rates at the balance sheet date.

The fair values of short-term deposits, loans and overdrafts with a maturity of less than one year are assumed to approximate to their book values. The fair value of bank loans and other loans due in more than one year is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

(l) Investments

Investments are stated at cost less any impairment in value.

(m) Property, Plant and Equipment

Freehold land is not depreciated, but is reviewed for impairment on an annual basis. Freehold buildings, plant and equipment are held at cost less accumulated depreciation and any recognised impairment losses. The cost of an item of property, plant and equipment is the purchase price and any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(n) Assets held for sale

Non-current assets or disposal groups that meet the conditions to be classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

(o) Inventories

Inventories are stated at the lower of cost, including attributable overheads, and net realisable value. Work in progress is stated at cost, including attributable overheads, less any foreseeable losses and progress payments receivable. Pre production and development costs relating to specific contracts are included in work in progress to the extent to which they are recoverable.

(p) Trade receivables

Trade receivables are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

(q) Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and loans with a maturity of three months or less. Bank overdrafts that are repayable on demand are included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

(r) Provisions

A provision is required when the Group has a present legal or constructive obligation at the balance sheet date as a result of a past event, and it is probable that settlement will be required of an amount that can be reliably estimated. Provisions for warranty costs are recognised at the date of sale of the relevant products, at the directors' best estimate of the expenditure required to settle the Group's liability. Provisions for onerous contracts are recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

(s) Government grants

Government grants are recognised when there is reasonable assurance that the entity will comply with the relevant conditions and the grant will be received. Grants are recognised as income on a systematic basis to match the related costs.

(t) Taxation

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 that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

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

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

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

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

(u) Dividends

Dividends are recognised as a liability in the period in which they are fully authorised.

(v) Amortisation and depreciation

Depreciation (or amortisation in the case of intangible assets) is provided to write off the value (being cost less estimated residual value) of tangible fixed assets and computer software included in other intangible assets over their estimated useful lives as follows:

Intangible Assets	– Between 2 and 10 years
Freehold buildings	– Between 25 and 50 years
Long and short leasehold property	– Over the term of the lease
Plant and machinery	– Between 4 and 10 years
Fixtures, fittings and equipment	– Between 2 and 10 years

Freehold land is not depreciated.

(w) Impairment of tangible and intangible assets excluding goodwill

Intangible assets are measured initially at cost, in the form of the purchase price plus directly attributable costs of preparing the asset for its intended use.

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any

indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of any impairment loss. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash generating unit to which the asset belongs. Intangible assets with indefinite useful lives are tested for impairment annually and whenever there is an indication that the asset may be impaired.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset or cash generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash generating unit is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset or cash generating unit is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset or cash generating unit in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

(x) Impact of standards not yet effective

The International Accounting Standards Board ("IASB") and IFRIC have issued a number of international financial reporting standards and interpretations which are effective for future accounting periods of Ricardo plc. The directors do not anticipate that the adoption of any of these would make a material impact on these financial statements.

(y) Underlying results

Underlying results such as underlying gross margin, operating profit, profit before tax, profit for the year and earnings per share exclude the impact of exceptional one off profits and losses such as those arising from pensions curtailments, exceptional levels of redundancies and impairments.

2 Segmental reporting

Business Segments

Continuing operations – revenue and results

	Technical Consulting		Strategic Consulting		Total	
	2006	2005	2006	2005	2006	2005
	£m	£m	£m	£m	£m	£m
Revenue earned	159.2	149.2	13.9	8.9	173.1	158.1
Adjustment for inter-segmental revenue	(3.8)	(2.5)	3.8	2.5	–	–
Revenue from third parties	155.4	146.7	17.7	11.4	173.1	158.1
Inter-segmental revenue is charged at prevailing market prices.						
Segment result (before pensions credit)	9.5	8.6	2.6	1.8	12.1	10.4
Pensions credit					3.7	–
Operating profit					15.8	10.4
Finance income					1.4	0.8
Finance costs					(2.7)	(2.6)
Profit before tax					14.5	8.6
Tax					(2.3)	(1.1)
Profit for the year					12.2	7.5

Continuing operations – assets & liabilities

	Technical Consulting		Strategic Consulting		Total	
	2006	2005	2006	2005	2006	2005
	£m	£m	£m	£m	£m	£m
Segment assets	174.0	141.7	0.2	2.4	174.2	144.1
Unallocated assets					9.5	14.1
Consolidated total assets					183.7	158.2
Segment liabilities	121.6	111.6	4.5	0.9	126.1	112.5
Unallocated liabilities					7.5	9.0
Consolidated total liabilities					133.6	121.5
Capital expenditure – Intangible assets	1.1	0.9	–	–	1.1	0.9
Capital expenditure – Property, plant and equipment	7.3	5.4	–	–	7.3	5.4
Depreciation and amortisation	9.0	9.3	–	–	9.0	9.3

Discontinued operations

Ricardo (2010) Consultants Ltd, which provides technical consulting services, is expected to be sold for £1 within twelve months of the balance sheet date in accordance with a contract with Shanghai Automotive Industry Corporation (note 10).

Geographical Segments

Continuing operations by destination

	Revenue	
	2006	2005
	£m	£m
Europe	84.8	91.3
North America	49.3	42.2
Asia	35.4	22.8
Rest of the World	3.6	1.8
	173.1	158.1

Continuing operations by location

	Capital Spend		Assets	
	2006	2005	2006	2005
	£m	£m	£m	£m
UK	3.6	3.7	125.1	95.5
North America	1.4	1.7	20.0	18.3
Germany	3.1	0.7	27.9	29.6
Rest of the World	0.3	0.2	1.2	0.7
	8.4	6.3	174.2	144.1
Unallocated assets			9.5	14.1
			183.7	158.2

3 Operating Profit

	2006 £m	2005 £m
Revenue	173.1	158.1
Cost of sales	(117.7)	(111.4)
Cost of sales excluding pension credit (underlying)	(119.8)	(111.4)
Pensions credit	2.1	–
Gross profit	55.4	46.7
Gross profit excluding pension credit (underlying)	53.3	46.7
Pensions credit	2.1	–
Administration expenses	(39.6)	(36.3)
Administration expenses excluding pension credit (underlying)	(41.2)	(36.3)
Pensions credit	1.6	–
Operating profit	15.8	10.4
Operating profit excluding pension credit (underlying)	12.1	10.4
Pensions credit	3.7	–

4 Profit before tax

	2006 £m	2005 £m
The following items have been charged/(credited) in arriving at operating profit:		
Amortisation of intangible assets recognised as expense in cost of sales	0.6	0.6
Depreciation of property, plant and equipment:		
– recognised as an expense in cost of sales	6.5	6.2
– recognised as an expense in administration expenses	1.9	2.5
Inventories		
– consumed and recognised as expense in cost of sales	26.5	18.6
Other operating lease rentals payable		
– plant and machinery	0.6	0.8
– property	3.2	3.2
Repairs and maintenance on property, plant and equipment	2.1	2.8
Research and development expenditure	4.5	3.9
Trade receivables impairment	0.1	0.1
Exchange differences on foreign currency borrowings	0.1	(0.1)
Pensions credit	(3.7)	–
Profit on disposal of property plant and equipment	–	(0.1)
	2006 £m	2005 £m
During the year the Group obtained the following services from the Group's auditors and network firms:		
– statutory audit services for the Group (Parent Company £0.1m: 2005 £0.1m)	0.3	0.3
– other assurance services – IFRS conversion review work	0.1	–
– other services paid or payable to the auditors in the UK	–	0.1
	0.4	0.4

5 Employees

	2006 £m	2005 £m
Staff costs for the Group during the year (excluding pensions credit)		
Wages and salaries	67.1	60.2
Social security costs	8.5	8.4
Other pension costs (note 22)	2.9	2.3
	78.5	70.9

	2006 Number	2005 Number
Average number of employees (including executive directors) during the year		
Management, administration and sales	209	204
Production and engineering staff	1,442	1,420
	1,651	1,624

	2006 £m	2005 £m
Key Management Compensation		
Salaries and short-term employee benefits	2.5	2.4
Post-employment benefits	0.3	0.5
Termination benefits	0.3	0.2
Share based payments	0.2	0.1
	3.5	3.2

The key management personnel are the board of directors and the Managing Directors of the German business. Details of the directors' remuneration, pensions contributions and share based payments are provided in the Directors' Remuneration Report.

6 Finance income and costs

	2006 £m	2005 £m
Finance income		
Bank interest receivable	1.4	0.8
	1.4	0.8
Finance costs		
Interest payable on bank borrowings	2.0	1.6
Defined benefit pension scheme net finance costs (note 22)	0.7	1.0
	2.7	2.6

7 Taxation

	2006 £m	2005 £m
Analysis of charge in the year		
Current tax		
UK corporation tax at 30%	1.1	1.0
Adjustments in respect of prior years	(2.0)	-
Total UK tax	(0.9)	1.0
Foreign corporation tax	1.1	1.1
Total current tax	0.2	2.1
Deferred tax (note 23)		
Charge/(credit) for year excluding tax on pensions credit	0.7	(0.5)
Tax charge on pensions credit	1.1	-
Adjustment in respect of prior years	0.3	(0.5)
Total deferred tax	2.1	(1.0)
Taxation	2.3	1.1
Taxation excluding tax charge on pensions credit	1.2	1.1
Tax charge on pensions credit	1.1	-
Tax on items charged to equity		
Deferred tax on movement in defined benefit pension scheme obligations	2.0	(2.3)
Total current tax charge	0.2	2.1
Total deferred tax charge/(credit)	4.1	(3.3)

The tax charge for the year is lower than the standard rate of corporation tax in the UK. The differences are set out below:

	2006		2005	
	%	£m	%	£m
Profit for the year before tax		14.5		8.6
Profit for the year multiplied by rate of corporation tax in the UK	30.0	4.4	30.0	2.6
Effects of:				
Losses not recognised/(utilised)	0.8		(6.7)	
Expenses not deductible for tax purposes	1.4		1.7	
Government tax incentives	(8.8)		(16.4)	
Irrecoverable overseas tax	6.4		8.6	
Adjustments to taxation in respect of prior years	(11.9)		(5.7)	
Differences in tax rate/other	(2.0)		1.3	
Total taxation	15.9	2.3	12.8	1.1

8 Dividends

	2006 £m	2005 £m
Final paid 6.3p per share (2005 : 6.3p)	3.2	3.2
Interim paid 2.7p per share (2005 : 2.7p)	1.4	1.4
Equity dividends paid	4.6	4.6
Dividend paid to minority shareholders	-	0.1
Total dividend paid	4.6	4.7

In addition, the directors are proposing a final dividend in respect of the financial year ended 30 June 2006 of 6.7p per share which will absorb £3.4m of retained profits. It will be paid on 24 November 2006 to shareholders who are on the register of members at close of business on 27 October 2006.

9 Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of shares outstanding during the year, excluding those held in the ESOP (note 26) and those held by the LTIP which are treated as cancelled for the purposes of the calculation.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company has one class of dilutive potential ordinary shares: those options granted to employees where the exercise price is less than the market price of the Company's ordinary shares during the year. Where it is not possible to determine whether or not the performance criteria for the award to vest have been met until the end of the performance period, the shares are excluded from the calculation.

Reconciliations of the earnings and the weighted average number of shares used in the calculations are set out below.

Continuing Operations	Earnings £m	2006 Number* of shares millions	Per Share amount pence	Earnings £m	2005 Number* of shares millions	Per Share amount pence
Basic EPS						
Profit attributable to ordinary shareholders	12.1	50.4	24.0	7.4	49.9	14.8
Effect of dilutive securities: Options		0.1			0.1	
Diluted EPS	12.1	50.5	23.9	7.4	50.0	14.8

* weighted average

The above earnings per share is significantly affected by a pensions credit of £3.7m (£2.6m net of tax) being included in earnings. The table below therefore shows underlying basic and diluted earnings per share excluding this impact.

Continuing Operations	Underlying Earnings £m	2006 Number* of shares millions	Per Share amount pence	Underlying Earnings £m	2005 Number* of shares millions	Per Share amount pence
Basic underlying EPS						
Profit attributable to ordinary shareholders excluding pensions credit	9.5	50.4	18.8	7.4	49.9	14.8
Effect of dilutive securities: Options		0.1			0.1	
Diluted underlying EPS	9.5	50.5	18.8	7.4	50.0	14.8

* weighted average

10 Ricardo (2010) Consultants Ltd ("Ricardo 2010")

Ricardo 2010 is a wholly-owned subsidiary created in May 2005 under an agreement with Shanghai Automotive Industry Corporation ("SAIC") and provides technical consulting services. Under the agreement SAIC has an option to acquire Ricardo 2010 for £1 by giving three months notice from 1 July 2006 onwards. This option is fully expected to be exercised within the new financial year ending 30 June 2007. Therefore Ricardo 2010 has been classified as an asset held for sale and a discontinued operation under IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'. No profit or loss on disposal is anticipated. In accordance with IFRS 5 the aggregate assets and liabilities of Ricardo 2010 are separately disclosed on the face of the balance sheet under assets classified as held for sale and liabilities directly associated with assets classified as held for sale.

The results of Ricardo 2010 for the year were as follows:

	2006 £m	2005 £m
Revenue from third parties	23.3	1.8
Operating profit	0.5	-
Finance costs	(0.1)	-
Profit before taxation	0.4	-
Taxation	(0.4)	-
Profit for the year	-	-
Earnings per share from discontinued activities	-	-

Ricardo 2010's revenue includes invoicing to SAIC in respect of the payroll cost of the Ricardo 2010 engineering team, fees charged by Ricardo UK for facilities, management and administration and also engineering projects subcontracted to third parties including Ricardo UK.

	2006 £m	2005 £m
Deferred tax assets	0.2	-
Trade and other receivables	7.3	2.0
Total assets classified as held for sale	7.5	2.0
Bank overdrafts	(3.2)	-
Trade and other payables	(4.1)	(2.0)
Deferred tax liabilities	(0.2)	-
Total liabilities associated with assets classified as held for sale	(7.5)	(2.0)
Net assets	-	-

	2006 £m	2005 £m
Cash flows from operating activities		
Operating profit	0.5	-
Movement in trade and other receivables	(5.3)	(2.0)
Movement in trade and other payables	2.1	2.0
Interest paid	(0.1)	-
Tax paid	(0.4)	-
Net cash received/(used) in operating activities	(3.2)	-
Net cash received/(used) in investing activities	-	-
Net cash received/(used) in financing activities	-	-
Cash and cash equivalents at 30 June	(3.2)	-

11 Goodwill

Group	£m
Deemed cost at 1 July 2004, being carrying amount on transition to IFRS	16.2
Reduction in Tarragon goodwill (see note below)	(0.6)
At 30 June 2005	15.6
Exchange adjustments	0.3
At 30 June 2006	15.9

The goodwill relating to the purchase of Tarragon Embedded Technology Limited was reduced in 2005 to reflect the reduction in deferred consideration due to certain performance criteria not being met.

£13.2m of the net book amounts at 30 June 2006 (2005: £12.9m) relates to the German business. The recoverable amounts were based on value in use. The key assumptions in the value in use calculations for the German business are those regarding the discount rates and growth rates. Management estimated the discount rate at 8.3% (2005: 8.0%) using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the German business. The growth rates are based on cash flow forecasts derived from the most recent financial budgets approved by management for the next five years, which assume that the German business will return to profitability in the new financial year, due to the implementation of Ricardo's strategy and a focus on growth areas in the German automotive marketplace. Growth rates for the sixth and following years at 3% (2005: 3%) are based on the estimated nominal Gross Domestic Product for the market in which the German business operates.

12 Other intangible assets

Group	Computer Software £m
Cost	
At 1 July 2004	5.1
Additions	0.9
At 30 June 2005	6.0
Additions	1.1
At 30 June 2006	7.1
Amortisation	
At 1 July 2004	4.4
Charge for the year	0.6
At 30 June 2005	5.0
Charge for the year	0.6
At 30 June 2006	5.6
Net book amounts	
At 30 June 2006	1.5
At 30 June 2005	1.0
At 30 June 2004	0.7

Computer software includes software capitalised relating to the recently developed software products FEARCE, SABR and ISIS.

13 Property, plant and equipment

Group	Land and Buildings Freehold £m	Short leasehold £m	Plant and machinery £m	Fixtures, fittings and equipment £m	Total £m
Cost					
At 1 July 2004	10.6	6.7	70.8	15.4	103.5
Additions	—	0.1	3.6	1.7	5.4
Disposals	—	—	(0.5)	(0.6)	(1.1)
Foreign exchange adjustment	—	—	0.2	—	0.2
At 30 June 2005	10.6	6.8	74.1	16.5	108.0
Additions	0.1	0.3	3.3	3.6	7.3
Disposals	—	—	—	(0.3)	(0.3)
Foreign exchange adjustment	0.1	—	(0.5)	0.2	(0.2)
At 30 June 2006	10.8	7.1	76.9	20.0	114.8
Depreciation					
At 1 July 2004	1.2	0.7	40.1	11.6	53.6
Charge for the year	0.2	0.4	6.1	2.0	8.7
Disposals	—	—	(0.4)	(0.6)	(1.0)
At 30 June 2005	1.4	1.1	45.8	13.0	61.3
Charge for the year	0.2	0.4	6.2	1.6	8.4
Foreign exchange adjustment	—	—	(0.3)	0.2	(0.1)
At 30 June 2006	1.6	1.5	51.7	14.8	69.6
Net book amounts					
At 30 June 2006	9.2	5.6	25.2	5.2	45.2
At 30 June 2005	9.2	5.7	28.3	3.5	46.7
At 30 June 2004	9.4	6.0	30.7	3.8	49.9

Company	Land and Buildings Freehold £m	Short leasehold £m	Fixtures, fittings and equipment £m	Total £m
Cost				
At 1 July 2004	5.6	5.9	0.3	11.8
Additions	—	0.1	—	0.1
Intra Group transfer	—	—	(0.2)	(0.2)
At 30 June 2005	5.6	6.0	0.1	11.7
Intra Group transfer	—	—	(0.1)	(0.1)
Additions	—	0.1	—	0.1
At 30 June 2006	5.6	6.1	—	11.7
Depreciation				
At 1 July 2004	1.0	0.3	—	1.3
Charge for the year	—	0.3	—	0.3
At 30 June 2005	1.0	0.6	—	1.6
Charge for the year	—	0.3	—	0.3
At 30 June 2006	1.0	0.9	—	1.9
Net book amounts				
At 30 June 2006	4.6	5.2	—	9.8
At 30 June 2005	4.6	5.4	0.1	10.1
At 30 June 2004	4.6	5.6	0.3	10.5

The gross carrying amounts of property, plant and equipment are measured using a historic cost basis.

14 Investments

Company	2006		2005	
	Unlisted trade investments £m	Shares in subsidiaries £m	Unlisted trade investments £m	Shares in subsidiaries £m
Cost at 1 July	0.2	36.5	0.2	30.8
Investment in subsidiaries	–	–	–	6.3
Disposals	(0.2)	(3.1)	–	–
Reduction in deferred consideration	–	–	–	(0.6)
Cost at 30 June	–	33.4	0.2	36.5
Provisions at 1 July	0.2	15.4	0.2	15.4
Disposals	(0.2)	–	–	–
Provisions at 30 June	–	15.4	0.2	15.4
Net book value at 30 June	–	18.0	–	21.1
Net book value at 1 July	–	21.1	–	15.4

During the year the Tarragon business was sold to Ricardo UK Limited for £3.1m and SRH Systems Limited was sold to the Schenck Group for £0.2m.

15 Inventories

Group	2006 £m	2005 £m
Raw materials and consumables	6.3	3.4
Work in progress	0.7	3.5
	7.0	6.9

In respect of contracts in progress at the year end the aggregate amount of costs incurred and recognised profits (less recognised losses) to date was £173.0m (2005: £153.9m). Progress billings in respect of this amount to £165.6m (2005: £153.4m). Contract revenue in the year for contracts designated under IAS 11 'Construction Contracts' as construction contracts amounted to £139.1m (2005: £124.5m).

16 Trade and other receivables

	Group		Company	
	2006 £m	2005 £m	2006 £m	2005 £m
Trade receivables	26.4	26.8	–	0.1
Less : provision for impairment of receivables	(0.2)	(0.1)	–	–
Trade receivables – net	26.2	26.7	–	0.1
Amounts recoverable on contracts	17.0	13.2	–	–
Amounts owed by Group undertakings	–	–	42.0	40.1
Prepayments and accrued income	2.4	2.4	0.2	0.2
Other receivables	1.7	0.8	0.5	0.3
	47.3	43.1	42.7	40.7

Concentrations of credit risk with respect to trade receivables are limited due to the Group's customer base being large and unrelated. Due to this, the directors believe there is no further credit risk provision required in excess of any normal provision for doubtful receivables.

17 Trade and other payables

	Group		Company	
	2006	2005	2006	2005
	£m	£m	£m	£m
Trade payables	11.0	7.4	0.7	0.3
Other tax and social security payable	1.5	1.8	0.1	0.2
Amounts owed to Group undertakings	—	—	11.1	12.1
Accruals	15.0	12.6	1.3	0.5
Payments received in advance	8.4	10.9	—	—
Other payables	3.0	2.7	1.7	2.1
	38.9	35.4	14.9	15.2

18 Current tax liabilities

Group	2006	2005
	£m	£m
UK corporation tax	1.6	2.9
Overseas taxes	0.9	2.0
	2.5	4.9

19 Financial liabilities – borrowings

	Group		Company	
	2006	2005	2006	2005
	£m	£m	£m	£m
Bank overdrafts	37.1	21.0	—	2.1
Current bank loans	7.9	0.5	7.6	—
Total current borrowings	45.0	21.5	7.6	2.1
Maturity of non current debt (bank loans):	2006	2005	2006	2005
	£m	£m	£m	£m
Between one and two years	2.4	7.8	2.1	5.4
Between two and five years	7.5	6.8	6.2	—
In five years or more	0.7	3.9	—	10.1
	10.6	18.5	8.3	15.5

The bank loans are denominated in Euros and Swiss Francs. There are both variable and fixed rate Euro and Swiss Franc loans. The variable interest rates vary from 0.7% and 0.85% above Euribor to 0.8% above LIBOR. There are also two Euro loans which attract interest at a variable rate, which are normally fixed monthly, and are currently 3.9% and 4.85%. There are fixed rate loans which are denominated both in Euros and Swiss Francs. Interest rates on these loans vary from 2.05% to 5.85%. Loan balances include £4.8m (2005: £4.5m) of loans in respect of Ricardo GmbH which are secured on buildings belonging to the Company.

The Group has a banking facility with a net overdraft limit and on which interest is charged on the net overdraft balance.

20 Fair value of financial assets and liabilities

The following are the book and fair values of financial assets and liabilities.

Group	2006		2005	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Cash at bank and in hand	49.8	49.8	28.8	28.8
Bank overdrafts	(37.1)	(37.1)	(21.0)	(21.0)
Loans repayable within one year	(7.9)	(7.9)	(0.5)	(0.5)
Loans repayable after more than one year	(10.6)	(10.6)	(18.5)	(18.5)
Trade receivables	26.2	26.2	26.7	26.7
Trade payables	(11.0)	(11.0)	(7.4)	(7.4)
Derivative Liabilities	-	(0.1)	-	-
Deferred consideration	-	-	(0.1)	(0.1)
	9.4	9.3	8.0	8.0

Company	2006		2005	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Cash at bank and in hand	28.7	28.7	22.4	22.4
Bank overdrafts	-	-	(2.1)	(2.1)
Loans repayable within one year	(7.6)	(7.6)	-	-
Loans repayable after more than one year	(8.3)	(8.3)	(15.5)	(15.5)
Trade receivables	-	-	0.1	0.1
Trade payables	(0.7)	(0.7)	(0.3)	(0.3)
	12.1	12.1	4.6	4.6

Summary of methods and assumptions

Short term borrowing and deposits

The fair value of short term deposits, loans and overdrafts approximates to the carrying amount because of the short maturity of these instruments

Long term borrowings

The fair value of bank loans approximates to the carrying value in the balance sheet as they are mainly floating rate loans where payments are reset to market rates at regular intervals

21 Financial risks

Objectives, policies and strategies

The financial risks faced by the Group comprise interest rate risk, liquidity risk, credit risk and foreign currency exchange rate risk. The Board reviews and agrees policies for managing each of these risks.

The Group's financial instruments comprise floating rate borrowings, the main purpose of which is to raise finance for the Group's operations and the use of forward foreign exchange contracts to manage currency risks.

Interest rate risk

The Group does not consider interest rate risk as significant and the current policy is to maintain its borrowings at floating rates where possible although the acquisition in 2003 of the Prototechnik-IFT group of companies resulted in some fixed rate liabilities being acquired (18.4% of total borrowings (2005: 15.2%)). This policy is kept under regular review by the Board.

Financial assets and liabilities by interest type:

	2006 £m	2005 £m
Floating rate financial liabilities	(38.2)	(21.0)
No interest financial liabilities	(11.1)	(7.5)
Fixed rate financial liabilities	(17.4)	(19.0)
Floating rate financial assets	49.8	28.8
No interest financial assets	26.2	26.7
Total	9.3	8.0

Liquidity risk

As regards liquidity, the Group's policy has throughout the year been to maintain a mix of short and medium term borrowings with its bankers. Short term flexibility is provided by overdraft facilities. Details of the year end position, which is in accordance with this policy, are given in note 19 to the financial statements. It is, in addition, the Group's policy to maintain undrawn committed borrowing facilities in order to provide flexibility in the management of the Group's liquidity. At the year end, the Group had committed facilities of £37.0m (2005: £29.7m) with its banks, 37.1% (2005: 39.5%) of which, net of credit balances where appropriate, was drawn down. These facilities are subject to periodic review.

Credit risk

The Group is exposed to credit risk primarily in respect of its trade receivables, which are stated net of provision for estimated doubtful receivables. Exposure to this risk is mitigated by careful evaluation of the granting of credit and credit insurance where practicable.

Foreign currency exchange rate risk

The Group faces currency exposures on trading transactions undertaken by its subsidiaries in foreign currencies, and on the translation of profits earned in and net assets of overseas subsidiaries, primarily in the US and in Germany.

The Group hedges a proportion of transactional exposures relating to its foreign currency exposures on contracts by taking out forward foreign exchange contracts or other derivative financial instruments. The decision to hedge is influenced by the size and expected timing of the exposure, the certainty of it arising and the current exchange rate. At 30 June 2005 and 2006 there were no such outstanding forward foreign exchange contracts.

The Group hedges a proportion of forecast profits from its US and German businesses by taking out forward foreign exchange contracts or other derivative financial instruments. The decision to hedge is influenced by the size and expected timing of the exposure, the certainty of it arising and the current exchange rate. At 30 June 2005 and 2006 there were no such outstanding forward foreign exchange contracts.

The Group has financed its net investment in the German business using Euro denominated borrowings to which hedge accounting has been applied.

Embedded Derivatives

In accordance with IAS 39, 'Financial Instruments: Recognition and Measurement', management have reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. There are some contracts within Ricardo UK denominated in Euros and US\$ which fail to meet the requirements outlined by IAS 39, and so the derivative related to the contract currency is accounted for separately to the rest of the contract. As at 30 June 2006, the fair value of this embedded derivative was a liability of £0.1m. This derivative is recorded at fair value based on discounted future cash flows with gains and losses passing through the income statement. Amounts recorded in the income statement are shown below:

Group	2006 £m	2005 £m
Gain/(loss) in the income statement	0.3	(0.4)

22 Retirement benefit obligations**Group and Company**

The Group operates various defined contribution pension schemes, the assets of which are held in separately administered funds. The Group also operates a defined benefit scheme, the Ricardo Group Pension Fund ("RGPF"). The scheme is closed to new entrants. The pension costs relating to the RGPF are assessed in accordance with the advice of Watson Wyatt Limited, qualified actuaries, using the Projected Unit Credit method.

The latest triennial valuation of the RGPF was at 5 April 2005. At that date, the assets of the fund had a market value of £47 million and were sufficient to cover 66% of the benefits that had accrued to members, after allowing for expected future increases in earnings. On the alternative minimum funding requirement valuation basis, which was required under the Pensions Act 1995 as part of the triennial valuation of the scheme, the ratio of assets to liabilities was 86%. The next triennial valuation is scheduled to be carried out as at a date no later than 5 April 2008. The principal assumptions made by the actuaries in 2005 were that investment returns in the long term would comprise 4.9% per annum post retirement and 7.9% pre retirement. Pensionable salaries would be capped to future price inflation and therefore rise by 2.7% per annum. Pensions would rise at 3.25% per annum in respect of benefits accrued prior to 1 July 2002 and 2.7% per annum in respect of benefits accrued after 30 June 2002. It was assumed that future price inflation would rise at a rate of 2.7% per annum.

The capping of pensionable salaries to future price inflation has led to a credit to the income statement in the year of £3.7m (£2.6m net of tax). Current contribution rates expected to be payable by the Company for the foreseeable future are 15.2% of pensionable salaries for active members plus a monthly lump sum increased to £277,000 to make good previous deficits over a nine year period.

IAS 19 'Employee Benefits' valuations were completed as at 30 June 2005 and 30 June 2006 by Watson Wyatt LLP, qualified actuaries. The major assumptions made were:

	At 30 June 2006	At 30 June 2005
Rate of increase in pensionable salaries	2.9%	4.0%
Rate of increase in pensions in payment		
Pre 1 July 2002 accrual	3.0%	3.0%
Post 1 July 2002 accrual	2.9%	2.7%
Rate of increase in pension in deferment	2.9%	2.7%
Discount rate	5.25%	5.0%
Inflation	2.9%	2.7%
Expected return on plan assets	7.2%	7.1%

The expected return on plan assets is based on market expectation at the beginning of the period for returns over the entire life of the benefit obligation.

The assets of the scheme and the expected rate of return were:

	Long term rate of return expected at 30 June 2006	Value at 30 June 2006 £m	Long term rate of return expected at 30 June 2005	Value at 30 June 2005 £m
Equities	8.1%	41.5	8.0%	35.8
Bonds	4.8%	12.0	4.5%	10.5
Cash	3.9%	0.5	3.7%	0.3
Property	6.5%	3.5	6.3%	2.8
Total assets	7.2%	57.5	7.1%	49.4

The movements in the present value of retirement benefit obligations were as follows:

	Obligations £m	2006 Assets £m	Net total £m	Obligations £m	2005 Assets £m	Net total £m
At 1 July	(84.1)	49.4	(34.7)	(69.2)	41.9	(27.3)
Current service cost	(1.4)	—	(1.4)	(0.9)	—	(0.9)
Past service cost	(0.1)	—	(0.1)	(0.1)	—	(0.1)
Expected return/(interest cost)	(4.1)	3.4	(0.7)	(4.0)	3.0	(1.0)
Credit/(charge) excluding pensions credit	(5.6)	3.4	(2.2)	(5.0)	3.0	(2.0)
Pensions credit	3.7	—	3.7	—	—	—
Credit/(charge) to the income statement	(1.9)	3.4	1.5	(5.0)	3.0	(2.0)
Experience gains and losses charged/(credited) to the Statement of Recognised Income and Expense	2.8	3.9	6.7	(11.8)	3.9	(7.9)
	0.9	7.3	8.2	(16.8)	6.9	(9.9)
Contributions from sponsoring companies	—	2.9	2.9	—	2.5	2.5
Contributions from scheme members	(0.3)	0.3	—	(0.4)	0.4	—
Benefits paid	2.4	(2.4)	—	2.3	(2.3)	—
Total movements	3.0	8.1	11.1	(14.9)	7.5	(7.4)
At 30 June	(81.1)	57.5	(23.6)	(84.1)	49.4	(34.7)

Cumulative actuarial gains and losses recognised in equity are as follows:

	2006 £m	2005 £m
At 1 July	(7.9)	—
Net actuarial gains/(losses) recognised in the year	6.7	(7.9)
At 30 June	(1.2)	(7.9)

The five year history of experience adjustments is as follows:

	2006 £m	2005 £m	2004 £m	2003 £m	2002 £m
Present value of defined benefit obligations	(81.1)	(84.1)	(69.2)	(70.4)	(62.1)
Fair value of scheme assets	57.5	49.4	41.9	38.6	39.5
Deficit in the scheme	(23.6)	(34.7)	(27.3)	(31.8)	(22.6)
Experience adjustments on scheme liabilities					
Amount (£m)	2.8	(11.8)	0.3	0.5	(0.8)
Percentage of scheme liabilities (%)	3.5%	(14.0%)	0.4%	0.7%	(1.3%)
Experience adjustments on scheme assets					
Amounts (£m)	3.9	3.9	1.4	(4.2)	(9.7)
Percentage of scheme assets (%)	6.8%	7.9%	3.3%	(10.9%)	(24.5%)

Note that historical data for 2002, 2003 and 2004 is as stated under UK GAAP, FRS 17 'Retirement Benefits'.

Amounts charged in the income statement in respect of pensions (excluding the pensions credit) are as follows:

	2006 £m	2005 £m
In respect of defined contribution schemes	1.4	1.3
In respect of defined benefit schemes	2.2	2.0
	3.6	3.3
Included within:		
Staff costs	2.9	2.3
Finance costs	0.7	1.0
	3.6	3.3

23 Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method using the effective rate of tax in each relevant territory. The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior years.

Group	Accelerated capital allowances £m	Retirement benefit obligations £m	Tax losses £m	Unrealised capital gains £m	Other £m	Total £m
At 1 July 2004	(5.1)	8.1	1.5	–	0.6	5.1
(Charged)/credited to the income statement	1.2	(0.1)	0.6	(0.8)	0.1	1.0
(Charged)/credited to Statement of Recognised Income and Expense	–	2.3	–	–	–	2.3
At 30 June 2005	(3.9)	10.3	2.1	(0.8)	0.7	8.4
(Charged)/credited to the income statement	(1.4)	(1.1)	(0.4)	–	0.8	(2.1)
(Charged)/credited to Statement of Recognised Income and Expense	–	(2.0)	–	–	–	(2.0)
At 30 June 2006	(5.3)	7.2	1.7	(0.8)	1.5	4.3

The following is the analysis of the Group deferred tax balances for financial reporting purposes.

	2006 £m	2005 £m
Deferred tax assets		
Current	0.6	4.5
Non-current	8.7	8.0
	9.3	12.5
Deferred tax liabilities		
Current	(0.6)	(0.7)
Non-current	(4.4)	(3.4)
	(5.0)	(4.1)
Net deferred tax asset	4.3	8.4

Company	Accelerated capital allowances £m	Retirement benefit obligations £m	Unrealised capital gains £m	Tax losses £m	Other £m	Total £m
At 1 July 2004	–	8.1	–	–	0.3	8.4
(Charged)/credited to the income statement	–	–	(0.8)	–	0.2	(0.6)
(Charged)/credited to Statement of Recognised Income and Expense	–	2.3	–	–	–	2.3
At 30 June 2005	–	10.4	(0.8)	–	0.5	10.1
(Charged)/credited to the income statement	(0.1)	(1.3)	–	0.1	0.1	(1.2)
(Charged)/credited to Statement of Recognised Income and Expense	–	(2.0)	–	–	–	(2.0)
At 30 June 2006	(0.1)	7.1	(0.8)	0.1	0.6	6.9

The following is the analysis of the Company deferred tax balances for financial reporting purposes.

	2006 £m	2005 £m
Deferred tax assets		
Current	–	3.3
Non-current	7.7	7.6
	7.7	10.9
Deferred tax liabilities		
Current	–	–
Non-current	(0.8)	(0.8)
	(0.8)	(0.8)
Net deferred tax asset	6.9	10.1

Deferred tax assets have been recognised in respect of tax losses and other temporary differences giving rise to deferred tax assets where it is probable that these assets will be recovered. At the balance sheet date there were no temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised (2005: nil). No liability would be recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

24 Provisions

Group	Short term warranty provision £m
At 1 July 2005	0.4
Charged to profit and loss account	0.1
At 30 June 2006	0.5

The warranty provision reflects the directors' best estimate of the cost needed to fulfil its warranty obligations within a number of contracts. This is expected to unwind over the life of the products to which they relate, which is expected to be a period of less than five years.

25 Called up share capital

	Group and Company 2006 £m	2005 £m
Authorised 80,000,000 (2005: 59,760,000) Ordinary shares of 25p each	20.0	14.9
Allotted, called up and fully paid		
At 1 July 2005 – 50,018,275 shares (2004 : 49,898,276)	12.5	12.5
Allotted under share option schemes – 664,566 shares (2005 : 119,999)	0.2	–
Allotted under LTIP scheme – 15,892 shares (2005: nil)	–	–
At 30 June 2006 – 50,698,733 shares (2005 : 50,018,275)	12.7	12.5

The consideration received for shares allotted under the share option schemes and LTIP during the year ended 30 June 2006 was £1.3m (2005: £0.2m).

Potential issues of shares

The Company currently has two HMRC-approved employee share option schemes under which options to subscribe for shares may be granted; the 2004 Ricardo plc Executive Share Option Plan (the "2004 Plan") and the Ricardo plc 2000 Savings Related Share Option Scheme (the "SAYE Scheme"). During the year ended 30 June 2006 options over 169,000 shares were exercised and 115,000 options lapsed under the previous 1994 Share Option Scheme (the "1994 Scheme"). Options over 27,761 shares were also granted under the 2004 Plan with an exercise price of 307p and which are exercisable until 27 February 2016. No options were granted under the SAYE Scheme. Under this scheme options over 495,566 shares were exercised and 45,137 options lapsed during the year.

The number of shares subject to options, the periods in which they were granted and the periods in which they may be exercised are given below:

Calendar year of grant	Scheme	Exercise prices Pence	Exercise Period	2006 Numbers	2005 Numbers
1996	1994 Scheme	114.0	1999-2006	–	169,000
2000	SAYE Scheme	416.0	2004-2008	883	15,660
2001	1994 Scheme	381.0	2004-2011	50,000	50,000
2002	SAYE Scheme	233.4	2005-2010	165,106	691,032
2003	1994 Scheme	265.0	2006-2013	–	50,000
2004	1994 Scheme	185.0	2007-2014	45,000	110,000
2004	1994 Scheme	186.5	2007-2014	100,000	100,000
2005	2004 Plan	267.5	2008-2015	140,000	140,000
2006	2004 Plan	307.0	2009-2016	27,761	–
				528,750	1,325,692

Under the Group's LTIP, awards may be made to beneficiaries under the scheme which may result in the issue of up to 1,107,379 ordinary shares by 30 June 2008.

26 Share based payments

Equity-settled Executive Share Options

The Group plans include the 2004 Plan and the 1994 Scheme, which are described in the Directors' Remuneration Report and provide for an exercise price equal to the average quoted market price of the Company's shares on the date of grant. The vesting period is generally three years. If the options remain unexercised after a period of 10 years from the date of grant, the options expire. Furthermore, options are forfeited if the employee leaves the Group before the options vest.

Movements in Executive Share Options were as follows:

	2006		2005	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of year	619,000	207p	506,000	190p
Granted during the year	27,761	307p	240,000	234p
Forfeited during the year	(115,000)	220p	(50,000)	265p
Exercised during the year	(169,000)	114p	(77,000)	144p
Outstanding at the end of the year	362,761	254p	619,000	207p
Exercisable at the end of the year	–	–	169,000	114p

The weighted average share price at the date of exercise for share options exercised during the year was 288p. The options outstanding at 30 June 2006 had a weighted average exercise of 254p and a weighted average remaining contractual life of 8.1 years.

For those options granted after 7 November 2002 for which the performance criteria are expected to be met, the Black Scholes model has been used to calculate the charge to the income statement. The inputs into the model are as follows:

	2006	2005
Number of employees	3	2
Shares under option	267,761	240,000
Weighted average option price	nil	nil
Weighted average exercise price	241p	234p
Expected volatility	32%	32%
Expected life from date of grant	5 yrs	5 yrs
Risk free rate	4%	4%
Dividend yield	3.7%	3.7%
Possibility of ceasing employment before vesting	nil	nil
Expectations of meeting performance criteria	98%	99%
Weighted average fair value per option	58p	55p

Expected volatility was determined by calculating the historical volatility of the Company's share price over the five years preceding the date of grant. The expected life used in the model is based on management's best estimate, taking into account the effects of non-transferability, exercise restrictions, and behavioural considerations.

LTIP

The current LTIP is described in the Directors' Remuneration Report. Awards are forfeited if the employee leaves the Group before the awards are given.

	2006 Shares allocated	2005 Shares allocated
Outstanding at beginning of year	798,864	662,523
Provisionally awarded during the year	351,182	509,372
Forfeited during the year	(34,657)	(116,520)
Expired during the year	(289,492)	(256,511)
Vested during the year	(15,892)	-
Outstanding at the end of the year	810,005	798,864

For the LTIP plan cycles where the performance criteria are based on the Group's adjusted EPS performance relative to the comparator group, no shares are expected to vest.

For the LTIP plan cycles where the performance criteria are based on the Group's Total Shareholder Return ("TSR") performance relative to the comparator group, as the TSR is dependent on the future market price of shares, the charge to the income statement has been calculated using the Monte Carlo model, using the following assumptions for the plan cycles commencing in these years:

	2006	2005
Number of employees	42	34
Number of shares provisionally awarded	351,182	509,372
Weighted average share price of date of award	301p	187p
Expected volatility	37%	37%
Expected life	2.5 yrs	2.5 yrs
Risk free rate	4.3%	4.5%
Dividend yield	3.7%	3.7%
Possibility of ceasing employment before vesting	10%	10%
Fair value per LTIP as a % of a share at date of award	44%	55%

Both of the above plan cycles were outstanding at the year end.

Expected volatility was determined by calculating the historical volatility of the Company's share price over the three financial years preceding the date of the award.

The Group recognised total expenses of £0.3m and £0.1m related to equity-settled share-based payment transactions in 2006 and 2005 respectively.

SAYE Scheme

No options have been granted under this scheme since 7 November 2002 and therefore no charge is required under IFRS 2.

27 Share premium account

	Group and Company £m
At 1 July 2004	12.0
Arising on shares issued in 2005	0.2
At 30 June 2005	12.2
Arising on shares issued in 2006	1.1
At 30 June 2006	13.3

28 Other reserves

Group	Hedging Reserve £m	Merger Reserve £m	Translation reserve £m	Total £m
At 1 July 2004	—	1.0	—	1.0
Movement in year	—	—	—	—
Exchange adjustments net of tax	—	—	0.2	0.2
At 30 June 2005	—	1.0	0.2	1.2
Movement in year	(0.4)	—	—	(0.4)
Exchange adjustments net of tax	—	—	(0.2)	(0.2)
At 30 June 2006	(0.4)	1.0	—	0.6

29 Retained earnings

Group	£m
At 1 July 2004	13.0
Profit for the year	7.4
Recognised actuarial losses, net of deferred tax	(5.6)
Dividends paid	(4.6)
Value of employee service	0.1
At 30 June 2005	10.3
Profit for the year	12.1
Recognised actuarial gains, net of deferred tax	4.7
Dividends paid	(4.6)
Value of employee service	0.4
At 30 June 2006	22.9

The cumulative goodwill relating to acquisitions made prior to 1998, which has been eliminated against reserves, is £12.1m (2005: £12.1m).

Company	£m
At 1 July 2004	138.8
Loss for the year	(116.5)
Recognised actuarial losses, net of deferred tax	(5.6)
Dividends paid	(4.6)
Value of employee service	0.1
At 30 June 2005	12.2
Profit for the year	13.3
Recognised actuarial losses, net of deferred tax	4.7
Dividends paid	(4.6)
Value of employee service	0.3
At 30 June 2006	25.9

30 Minority Interests

Group	£m
At 1 July 2004	0.5
Share of net profit	0.1
Dividend paid to minority shareholder	(0.1)
At 30 June 2005	0.5
Share of net profit	0.1
At 30 June 2006	0.6

31 Company Reserves

The Company has not presented its own income statement as permitted by Section 230 of the Companies Act 1985.

The Company's distributable reserves at 30 June 2006 are £18.1m (2005: £4.4m).

32 Cash flow from operating activities

Group	2006 £m	2005 £m
Continuing operations		
Profit from operations before pensions credit	12.1	10.4
Adjustments for:		
Share based payments adjustment	0.3	0.1
Depreciation and amortisation	9.0	9.3
Operating cash flows before movements in working capital	21.4	19.8
(Increase)/decrease in inventory	-	(0.6)
(Increase)/decrease in trade and other receivables	(4.3)	(10.5)
Increase/(decrease) in payables	3.5	2.9
Increase/(decrease) in provisions	0.1	0.1
Pension payments in excess of pension costs	(0.7)	(0.5)
Cash generated by operations	20.0	11.2
Company		
Continuing operations		
Loss from operations before pensions credit	(0.9)	(136.3)
Adjustments for:		
Share based payments adjustment	0.3	0.1
Depreciation	0.3	0.3
Operating cash flows before movements in working capital	(0.3)	(135.9)
(Increase)/decrease in trade and other receivables	(0.3)	123.1
(Increase)/decrease in inter company balances	(1.9)	(5.7)
Increase/(decrease) in payables	0.6	0.2
Increase/(decrease) in provisions	-	(0.2)
Pension payments in excess of pension costs	(0.7)	(0.5)
Cash used by operations	(2.6)	(19.0)

33 Operating leases

Group	2006 £m	2005 £m
Total commitments under non-cancellable operating leases expiring:		
Within one year	1.1	0.3
Between one and five years	1.2	1.8
After five years	26.0	29.6
	28.3	31.7

34 Contingent Liabilities

The directors are not aware of any contingent liabilities which require separate disclosure under IAS 10 'Events after the Balance Sheet Date'.

35 Capital commitments

Group	2006 £m	2005 £m
Contracts placed for future capital expenditure not provided for in the financial statements	0.4	0.8

36 Related party transactions

During the year the Company paid administrative expenses of £0.2m (2005: £0.1m) on behalf of the Group's pension schemes.

37 Post balance sheet events

There have been no events between the balance sheet date and the date of authorisation of the financial statements that qualify as post balance sheet events under IAS 10 'Events after the Balance Sheet Date'.

38 Principal operating subsidiaries

Each subsidiary company operates principally in the country in which it is incorporated, and undertakes technology and strategic consulting.

The Company owns directly(*), or indirectly, 100% of the issued share capital of the following principal operating subsidiaries which are included in the consolidated accounts:

Incorporated in Great Britain
(and registered in England and Wales)
Ricardo UK Limited*
Ricardo (2010) Consultants Limited

Incorporated in the USA
Ricardo, Inc.*

Incorporated in Germany
Ricardo GmbH
Ricardo Deutschland GmbH
Ricardo Strategic Consulting GmbH

Incorporated in the Czech Republic
Ricardo Prague S.R.O.

Incorporated in Japan
Ricardo Japan K.K.*

Ricardo, Inc. owns a 55% share in Ricardo MEDA Technical Services, LLC.

39 Reconciliation of net assets and profit under UK GAAP to IFRS

Ricardo plc reported under UK GAAP in its previously published financial statements for the year ended 30 June 2005. The analysis below shows a reconciliation of net assets and profit as reported under UK GAAP at 30 June 2005 to the revised numbers under IFRS as reported in these financial statements. In addition there is a reconciliation of net assets under UK GAAP to IFRS at the transition date for the Company, being 1 July 2004.

Reconciliation of equity of the Group at 1 July 2004

	Note	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Non current assets				
Goodwill		16.2	–	16.2
Other intangible assets	39 a) 1	–	0.7	0.7
Property, plant and equipment	39 a) 2	50.9	(1.0)	49.9
Deferred tax asset	39 a) 3	–	9.9	9.9
		67.1	9.6	76.7
Current assets				
Inventories		6.3	–	6.3
Trade and other receivables	39 a) 4	34.1	(1.3)	32.8
Current tax assets		2.4	0.1	2.5
Cash and cash equivalents		11.1	–	11.1
		53.9	(1.2)	52.7
Total assets		121.0	8.4	129.4
Current liabilities				
Trade and other payables	39 a) 5	(33.0)	(0.1)	(33.1)
Tax liabilities		(3.5)	–	(3.5)
Bank overdrafts and loans		(16.6)	–	(16.6)
Proposed final dividend	39 a) 6	(3.1)	3.1	–
		(56.2)	3.0	(53.2)
Net current liabilities		(2.3)	1.8	(0.5)
Non current liabilities				
Bank loans		(4.8)	–	(4.8)
Retirement benefit obligations	39 a) 7	–	(27.3)	(27.3)
Deferred tax liabilities	39 a) 8	(3.5)	(1.3)	(4.8)
Long term provisions		(0.3)	–	(0.3)
		(8.6)	(28.6)	(37.2)
Total liabilities		(64.8)	(25.6)	(90.4)
Net assets		56.2	(17.2)	39.0
Equity				
Share capital		12.5	–	12.5
Share premium		12.0	–	12.0
Other reserves		1.0	–	1.0
Retained earnings	39 a) 9	30.2	(17.2)	13.0
Total shareholders' equity		55.7	(17.2)	38.5
Minority interest in equity		0.5	–	0.5
Total equity		56.2	(17.2)	39.0

Reconciliation of profit of the Group for year ended 30 June 2005

	Note	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Continuing operations				
Revenue	39 b) 10	159.9	(1.8)	158.1
Cost of sales	39 b) 11	(113.2)	1.8	(111.4)
Gross profit		46.7	—	46.7
Administrative expenses	39 b) 12	(38.5)	2.2	(36.3)
Profit from operations		8.2	2.2	10.4
Net finance expense	39 b) 13	(0.8)	(1.0)	(1.8)
Profit before tax		7.4	1.2	8.6
Tax	39 b) 14	(0.2)	(0.9)	(1.1)
Profit for the year		7.2	0.3	7.5
Profit attributable to minority interest		0.1	—	0.1
Profit attributable to equity shareholders		7.1	0.3	7.4
		7.2	0.3	7.5

Reconciliation of recognised income and expense of the Group for the year ended 30 June 2005

	Note	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Actuarial losses	39 b) 15	—	(7.9)	(7.9)
Net exchange adjustments		0.2	—	0.2
Tax on items taken directly to equity	39 b) 16	—	2.3	2.3
Net income recognised directly in equity		0.2	(5.6)	(5.4)
Profit for the period		7.2	0.3	7.5
Total recognised income and expense for the year		7.4	(5.3)	2.1

Reconciliation of equity of the Group at 30 June 2005

	Note	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Non current assets				
Goodwill	39 c) 17	14.6	1.0	15.6
Intangible assets	39 c) 18	–	1.0	1.0
Property, plant and equipment	39 c) 19	47.9	(1.2)	46.7
Deferred tax assets	39 c) 20	–	8.0	8.0
		62.5	8.8	71.3
Current assets				
Inventories		6.9	–	6.9
Trade and other receivables	39 c) 21	45.0	(1.9)	43.1
Current tax assets		1.6	–	1.6
Deferred tax assets	39 c) 20	–	4.5	4.5
Cash and cash equivalents	39 c) 22	8.8	20.0	28.8
Assets classified as held for sale	39 c) 23	–	2.0	2.0
		62.3	24.6	86.9
Total assets		124.8	33.4	158.2
Current liabilities				
Bank overdraft and loans	39 c) 24	(1.5)	(20.0)	(21.5)
Trade and other payables	39 c) 25	(35.4)	–	(35.4)
Current tax liabilities		(4.9)	–	(4.9)
Deferred tax liabilities	39 c) 20	–	(0.7)	(0.7)
Provisions	39 c) 26	–	(0.4)	(0.4)
Liabilities directly associated with assets classified as held for sale	39 c) 23	–	(2.0)	(2.0)
Proposed final dividend	39 c) 27	(3.2)	3.2	–
		(45.0)	(19.9)	(64.9)
Net current assets		17.3	4.7	22.0
Non current liabilities				
Bank loans		(18.5)	–	(18.5)
Retirement benefit obligations	39 c) 28	–	(34.7)	(34.7)
Deferred tax liabilities	39 c) 29	(1.8)	(1.6)	(3.4)
Long term provisions	39 c) 30	(0.2)	0.2	–
		(20.5)	(36.1)	(56.6)
Total liabilities		(65.5)	(56.0)	(121.5)
Net assets		59.3	(22.6)	36.7
Equity				
Share capital		12.5	–	12.5
Share premium		12.2	–	12.2
Other reserves	39 c) 31	1.1	0.1	1.2
Retained earnings	39 c) 32	33.0	(22.7)	10.3
Total shareholders' equity		58.8	(22.6)	36.2
Minority interest in equity		0.5	–	0.5
Total equity		59.3	(22.6)	36.7

Explanations of reconciling items from UK GAAP to IFRS

a) Explanation of effects of IFRS on the Group balance sheet at 1 July 2004

	£m
Note	
a) 1 Re-classification of non current assets	0.7
a) 2 Re-classification of non current assets	(1.0)
a) 3 Gross up deferred tax debit and credit balances	9.9
a) 4 Write back SSAP 24 debtor	(1.3)
a) 5 Employee benefit adjustment	(0.1)
a) 6 Proposed dividends no longer accrued	3.1
a) 7 Recognise retirement benefit obligations	(27.3)
a) 8 Deferred tax movements on adjustments above	
Write back SSAP 24 debtor	0.4
Retirement benefit obligations	8.2
Gross up deferred tax debit and credit balances	(9.9)
	(1.3)
a) 9 Effect on reserves of adjustments above (net of tax)	
Proposed dividend no longer accrued	3.1
Lease reverse premium	(0.1)
SSAP 24 debtor write back	(0.9)
Retirement benefit obligations	(19.1)
Employee benefit adjustment	(0.2)
	(17.2)

b) Reconciliation of profit and recognised income and expense of the Group for the year ended 30 June 2005

	£m
Note	
Profit after tax per UK GAAP accounts	7.2
b) 10 Ricardo 2010 IFRS 5 adjustment	(1.8)
b) 11 Ricardo 2010 IFRS 5 adjustment	1.8
b) 12 Reverse goodwill amortisation	1.0
Current year adjustment to retirement benefit obligations	1.5
SSAP 24 debtor write back	(0.6)
Impact of deferral of IFRS 2 bonuses	0.2
Capitalisation of software development costs in line with IAS 38	0.1
	2.2
b) 13 Finance cost of defined benefit pension scheme	(1.0)
b) 14 Deferred tax adjustments	
Pension scheme adjustment	(0.1)
SSAP 24 debtor write back	0.2
Provide for rolled over capital gain	(0.8)
Deferral of IFRS 2 bonuses and IAS 38 capitalised development costs	(0.2)
	(0.9)
Profit after tax under IFRS	7.5
b) 15 Recognise defined pension scheme net actuarial loss	(7.9)
b) 16 Deferred tax relief on retirement benefit obligations	2.3

c) Explanation of effects of IFRS on the Group balance sheet at 30 June 2005

	£m
Note	
c) 17 Reverse goodwill amortisation	1.0
c) 18 Re-classification of non current assets	1.0
c) 19 Re-classification of non current assets	(1.2)
c) 20 Gross up non current deferred tax asset	8.0
Gross up current deferred tax asset	4.5
Gross up current deferred tax liabilities	(0.7)
	11.8
c) 21 SSAP 24 debtor write back	(1.9)
c) 22 Grossing up of offsetting cash/overdraft balances per IAS 32	20.0
c) 23 Grossing up of Ricardo 2010 assets as assets classified as held for sale	2.0
Grossing up of Ricardo 2010 liabilities as liabilities associated with assets classified as held for sale	(2.0)
c) 24 Grossing up of offsetting cash/overdraft balances per IAS 32	(20.0)
c) 25 Lease reverse premium	(0.1)
Adjustment re share based payments	(0.1)
Adjustment re employee benefit	(0.2)
Transfer warranties to provisions	0.4
	-
c) 26 Transfer warranties from short term creditors to provisions	(0.4)
c) 27 Proposed dividend no longer accrued	3.2
c) 28 Provision for retirement benefit obligations	(34.7)
c) 29 Deferred tax (charge) / relief on	
Retirement benefit pension scheme deficit	10.4
SSAP 24 debtor write back	0.6
On employee benefit adjustment	0.1
On translation reserve	(0.1)
Gross up deferred tax debit and credit balances	(11.8)
Rolled over gain	(0.8)
	(1.6)
c) 30 Reclassification of provisions	0.2
c) 31 Transfer from retained profits, net of deferred tax	0.1
c) 32 Adjustments, net of tax	
Include retirement benefit pension obligations and other employee-related matters	(24.5)
SSAP 24 debtor write back	(1.3)
Reversal of goodwill amortisation	1.0
Proposed dividend no longer accrued	3.2
Transfer to translation reserve	(0.2)
Lease reverse premium	(0.1)
Deferred tax on rolled over gain	(0.8)
Net effect of IFRS adjustments	(22.7)

d) Explanation of effects of IFRS on the 2005 Group cash flow statement

The impact on the cash flow is minimal as the conversion from UK GAAP to IFRS comprises non-cash adjustments. There are changes to the order in which items are presented, but these have no overall impact. The IFRS adjustments are mainly reflected between the different categories of working capital.

Reconciliation of the Company net assets and profit under UK GAAP to IFRS

The Company has reported under UK GAAP in its previously published financial statements for the year ended 30 June 2005. The analysis below shows a reconciliation of net assets profit as reported under UK GAAP at 30 June 2005 to the revised numbers under IFRS as reported in these financial statements. In addition there is a reconciliation of net assets under GAAP to IFRS at the transition date for this company, being 1 July 2004.

Reconciliation of equity of the Company at 1 July 2004

	Note	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Non current assets				
Property, plant and equipment		10.5	–	10.5
Investment in subsidiaries	39 e) 1	20.3	(4.9)	15.4
Deferred tax asset	39 e) 2	–	8.6	8.6
		30.8	3.7	34.5
Current assets				
Trade and other receivables	39 e) 3	164.6	(1.2)	163.4
Current tax assets		0.1	–	0.1
Cash and cash equivalents		13.2	–	13.2
		177.9	(1.2)	176.7
Total assets		208.7	2.5	211.2
Current liabilities				
Trade and other payables	39 e) 4	(15.0)	(0.1)	(15.1)
Bank overdrafts and loans		(5.1)	–	(5.1)
Proposed final dividend	39 e) 5	(3.1)	3.1	–
		(23.2)	3.0	(20.2)
Net current assets		154.7	1.8	156.5
Non current liabilities				
Retirement benefit obligations	39 e) 6	–	(27.3)	(27.3)
Long term provisions		(0.2)	–	(0.2)
Deferred tax liability		(0.2)	–	(0.2)
		(0.4)	(27.3)	(27.7)
Total liabilities		(23.6)	(24.3)	(47.9)
Net assets		185.1	(21.8)	163.3
Equity				
Share capital		12.5	–	12.5
Share premium account		12.0	–	12.0
Retained earnings	39 e) 7	160.6	(21.8)	138.8
Total equity		185.1	(21.8)	163.3

Reconciliation of recognised income and expense of the Company for the year ended 30 June 2005

	Note	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Actuarial losses	39 f) 8	–	(7.9)	(7.9)
Tax on items taken directly to equity	39 f) 9	–	2.3	2.3
Net income recognised directly in equity		–	(5.6)	(5.6)
Loss for the period	39 f) 10	(116.0)	(0.6)	(116.6)
Total recognised income and expense for the year		(116.0)	(6.2)	(122.2)

Reconciliation of equity of the Company at 30 June 2005

	Note	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Non current assets				
Property, plant and equipment		10.1	–	10.1
Investment in subsidiaries	39 g) 11	26.0	(4.9)	21.1
Deferred tax asset	39 g) 12	–	7.6	7.6
		36.1	2.7	38.8
Current assets				
Trade and other receivables	39 g) 13	42.5	(1.8)	40.7
Deferred tax assets	39 g) 14	–	3.3	3.3
Cash and cash equivalents		22.4	–	22.4
		64.9	1.5	66.4
Total assets		101.0	4.2	105.2
Current liabilities				
Bank overdrafts and loans		(2.1)	–	(2.1)
Trade and other payables	39 g) 15	(15.1)	(0.1)	(15.2)
Proposed final dividend	39 g) 16	(3.2)	3.2	–
		(20.4)	3.1	(17.3)
Net current assets		44.5	4.6	49.1
Non current liabilities				
Bank loans		(15.5)	–	(15.5)
Retirement benefit obligations	39 g) 17	–	(34.7)	(34.7)
Deferred tax liabilities	39 g) 18	(0.1)	(0.7)	(0.8)
		(15.6)	(35.4)	(51.0)
Total liabilities		(36.0)	(32.3)	(68.3)
Net assets		65.0	(28.1)	36.9
Equity				
Share capital		12.5	–	12.5
Share premium		12.2	–	12.2
Other reserves	39 g) 19	0.2	(0.2)	–
Retained earnings	39 g) 20	40.1	(27.9)	12.2
Total equity		65.0	(28.1)	36.9

Explanations of reconciling items from UK GAAP to IFRS for the Company
e) Explanation of effects of IFRS on the Company balance sheet at 1 July 2004

	£m
Note	
e) 1 Provision for investment in Ricardo MTC Ltd	(4.9)
e) 2 Deferred tax movements on adjustments below	
SSAP 24 debtor write back	0.4
Retirement benefit obligations	8.2
	8.6
e) 3 SSAP 24 debtor write back	(1.2)
e) 4 Lease reverse premium	(0.1)
e) 5 Proposed dividend no longer accrued	3.1
e) 6 Recognise retirement benefit obligations	(27.3)
e) 7 Effect on reserves of adjustments above (net of tax)	
Proposed dividend no longer accrued	3.1
Lease reverse premium	(0.1)
SSAP 24 debtor write back	(0.8)
Retirement benefit obligations	(19.1)
Provision for investment in Ricardo MTC Ltd	(4.9)
	(21.8)

f) Reconciliation of recognised income and expense of the Company for the year ended 30 June 2005

	£m
Note	
f) 8 Recognise retirement benefit net obligations	(7.9)
f) 9 Deferred tax relief on retirement benefit obligations	2.3
f) 10 Effect on income statement of adjustments above (net of tax)	
SSAP 24 debtor write back	(0.4)
Retirement benefit obligations – income statement elements	0.6
Provide for rolled over capital gain	(0.8)
	(0.6)

g) Explanation of effects of IFRS on the Company balance sheet at 30 June 2005

	£m
Note	
g) 11 Provision for investment in Ricardo MTC Ltd	(4.9)
g) 12 Gross up deferred tax assets and liabilities	7.6
g) 13 SSAP 24 debtor write back	(1.8)
g) 14 Gross up deferred tax assets and liabilities	3.3
g) 15 Lease reverse premium	(0.1)
g) 16 Proposed dividend no longer accrued	3.2
g) 17 Provision for retirement benefit obligations	(34.7)
g) 18 Deferred tax (charge) / relief on	
Retirement benefit obligations	10.4
SSAP 24 debtor write back	0.6
Gross up deferred tax debit and credit balances	(10.9)
Rolled over gain	(0.8)
	(0.7)
g) 19 Transfer to retained profits	(0.2)
g) 20 Adjustments, net of tax	
Include retirement benefit pension scheme obligations and other employee-related matters	(24.3)
SSAP 24 debtor write back	(1.3)
Proposed dividend no longer accrued	3.2
Deferred tax on rolled over gain	(0.8)
Transfer of other reserves to retained profits	0.2
Provision for investment in Ricardo MTC Ltd	(4.9)
Net effect of IFRS adjustments	(27.9)

h) Explanation of effects of IFRS on the 2005 Company cash flow statement

The impact on the cash flow is minimal as the conversion from UK GAAP to IFRS comprises non-cash adjustments. There are changes to the order in which items are presented, but these have no overall impact. The IFRS adjustments are mainly reflected between the different categories of working capital.

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