FLIR Systems Limited

Directors' report and financial statements

Registered number 1320288

31 December 2006

28.10.07

227

Contents

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2006

Principal activities

The principal activity of the company during the year continued to be the sale of infrared systems and thermographic equipment

Business review

2006 was a year of strong growth within the UK business of FLIR Systems, with revenues increasing by 19% on the previous year The Gross Margin was down by 1%, although on this higher level of sales it produced an additional £861k contribution to operating expenses Operating Expenses were kept broadly in line with the previous year and therefore Operating Profit grew by just under £1m compared to 2005

Due to the continued strong performance of the company and its growing cash reserves, the board recommended the payment of an Interim Dividend during the year of £1 6m

During the year the company successfully launched two products that are significant to its ongoing business prospects The InfraCAM™® product was launched in the UK in February 2006 and represents the latest low-end, volume market offering in FLIR Systems' market leading Thermography product range Orders for the InfraCAM have been strong during 2006 and contributed significantly to the growth in revenue of the UK Thermography business in the year

In addition, the Government Systems business was buoyed by significant orders for its new StarSAFIRE HD airborne product, the latest generation in the StarSAFIRE family This variant offers a complete digital architecture for maximum image clarity as well as improved six axis stabilisation

The company's Order Backlog grew in line with its 2006 revenue growth, positioning the company well to continue this growth into 2007

Review of the Principal Risks and Uncertainties facing the Business

A comprehensive schedule of the risks facing the business is identified within the 10-K filing of the US Parent FLIR Systems Inc (NASDAQ FLIR) Of those identified the following have the potential to have a disproportionate affect on the UK business

- Foreign exchange fluctuations – a significant proportion of the company s costs and revenues are dominated in foreign currencies (mainly Euro and USD), as such the company is at risk to fluctuations in these currencies Where possible the company endeavours to minimise this risk by matching in and out flows of these currencies During 2006 the company had a gain on foreign currency of £138k (2005 £55k)
- The ability to secure export licenses – a large percentage of the revenue generated in the UK business is from product that is subject to the Export License controls of various countries' governments A significant change in the landscape for granting Export Licenses for these products would have a corresponding impact on the UK business

Research and development

In the year to 31 December 2006, expenditure on research and development totalled £8,231 (2005 £48,026)

Dividends

Dividends paid during the year comprise an interim dividend of £1,600,000 in respect of the year ended 31 December 2006 *(2005 £nil)*

Directors' report *(continued)*

Directors and directors' interests

The directors who held office during the year were as follows

A Almerfors
A Stensson

Disclosure of information to auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware, and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG LLP as auditors of the company is to be proposed at the forthcoming Annual General Meeting

By order of the board

Craig J Cooper
Company Secretary

2 Kings Hill Avenue
Kings Hill
West Malling
Kent
ME19 4AQ

24 September 2007

Statement of directors' responsibilities in respect of the Directors' Report and the financial statements

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice)

The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period

In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985 They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect 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 UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

KPMG

KPMG LLP
8 Salisbury Square
London
EC4Y 8BB
United Kingdom

Independent auditors' report to the members of FLIR Systems Limited

We have audited the financial statements of FLIR Systems Limited for the year ended 31 December 2006 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes These financial statements have been prepared under the accounting policies set out therein

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 3

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985 We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements

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

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it

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 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 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 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

Independent auditors' report to the members of FLIR Systems Limited *(continued)*

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements

KPMG LLP

KPMG LLP
Chartered Accountants
Registered Auditor

25 october 2007

Profit and loss account
for the year ended 31 December 2006

	Note	2006 £	Restated 2005 £
Turnover	2	**25,062,289**	21,011,695
Cost of sales		**(18,358,428)**	(15,168,826)
Gross profit		**6,703,861**	5,842,869
Operating expenses		**(3,547,946)**	(3,591,415)
Operating profit		**3,155,915**	2,251,454
Interest receivable	6	**411,323**	359,507
Profit on ordinary activities before taxation	3	**3,567,238**	2,610,961
Tax on profit on ordinary activities	7	**(1,211,691)**	(686,610)
Profit for the financial year	15, 16	**2,355,547**	1,924,351

All of the above results are derived from continuing operations

A statement of total recognised gains and losses has not been included as part of these financial statements as the company made no gains or losses in the period other than disclosed above in the profit and loss account

A note on historical gains and losses has not been included as part of the financial statements as the results as disclosed in the profit and loss account are prepared on an unmodified historical cost basis

Balance sheet
at 31 December 2006

	Note		2006		2005
		£	£	£	£
Fixed assets					
Tangible assets	*9*		**837,948**		632,393
Current assets					
Stocks	*10*	**1,666,920**		1,626,173	
Debtors	*11*	**9,195,636**		10,685,503	
Cash at bank and in hand		**1,318,238**		1,492,228	
Liquid resources		**8,788,260**		7,353,852	
		20,969,054		21,157,756	
Creditors amounts falling due within one year	*12*	**(11,540,046)**		(12,547,952)	
Net current assets			**9,429,008**		8,609,804
Total assets less current liabilities			**10,266,956**		9,242,197
Creditors amounts falling due after more than one year	*13*		**(114,567)**		-
Net assets			**10,152,389**		9,242,197
Capital and reserves					
Called up share capital	*14*		**465,000**		465,000
Capital reserve	*15*		**250,000**		250,000
Profit and loss account	*16*		**9,437,389**		8,527,197
Shareholders' funds	*16*		**10,152,389**		9,242,197

These financial statements were approved by the board of directors on 21st September 2007 and were signed on its behalf by

A Stensson
Director

Statement of total recognised gains and losses
for the year ended 31 December 2006

	2006 £	Restated 2005 £
Profit for the financial year	**2,355,547**	1,924,351
Total recognised gains and losses relating to the financial year	**2,355,547**	1,924,351
Prior year adjustment in respect of share based payments	**77,222**	-
Total recognised gains since last annual report	**2,432,769**	1,924,351

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements

In these financial statements the following new standards have been adopted for the first time

- - FRS 20 'Share-based Payment'

This standard has had the following effects on the financial statements

2006 the financial statements reflect a chare based payments charge of £154,645 in the profit and loss account A corresponding credit was recorded in equity

2005 The financial statements have been restated to reflect a share based payments charge of £77,222 in the profit and loss account A corresponding credit was recorded in equity

The corresponding amounts in these financial statements are restated in accordance with the new policies

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards under the historical cost accounting rules

Under Financial Reporting Standard 1 the company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements

As the company is a wholly owned subsidiary of FLIR Systems Inc the company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the group or investees of the group qualifying as related parties The consolidated financial statements of FLIR Systems Inc , within which this company is included, can be obtained from the address given in note 21

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction Monetary assets and liabilities denominated in foreign currencies are translated using the contracted rate or the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account

Leases

Assets acquired under finance leases are capitalised and the outstanding future lease obligations are shown in creditors Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease

Post-retirement benefits

The company operates a defined contribution pension scheme

The assets of the defined contribution scheme are held separately from those of the company in an independently administered fund The amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting period

The company provides no other post retirement benefits to its employees

Notes *(continued)*

1 Accounting policies *(continued)*

Share based payments

The share option programmes allow employees to acquire shares of the Parent Company The fair value of options granted after 7 November 2002 and those not yet vested as at the effective date of FRS 20 is recognised as an employee expense with a corresponding increase in equity The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options The fair value of the options granted is measured using an option pricing model, taking into account the terms and conditions upon which the options were granted The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to share prices not achieving the threshold for vesting

Research and development expenditure

Expenditure on research and development is written off to the profit and loss account in the year in which it is incurred

Stocks and long term contracts

Stocks are stated at the lower of cost and net realisable value Cost is determined on a first in first out basis Where necessary, provision is made for obsolete and slow moving stock

Contracts in progress are accounted for in accordance with the requirements of the Statement of Standard Accounting Practice no 9 (Revised) Once the outcome of a contract can be assessed with reasonable certainty, an amount of profit appropriate to the value of work completed is recognised Provision is made for foreseeable losses immediately the contract is assessed as being unprofitable and is disclosed in the accounts under creditors Where appropriate, payments received and receivable are disclosed in the accounts under debtors

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19

Turnover

Turnover represents the total net sales to customers excluding value added tax Sales are recognised upon delivery of the goods, unless the terms of the sale specify acceptance or other procedures in which case the sale is recognised once those procedures have been completed

Tangible fixed assets and depreciation

The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values on a straight-line basis over the expected economic lives of the assets concerned as follows

Short leasehold land and buildings	-	Over the term of the lease
Fixtures, fittings, tools and equipment	-	15% - 25% per annum
Computer hardware/software	-	33% per annum

Notes *(continued)*

1 Accounting policies *(continued)*

Liquid resources

Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market Liquid resources comprise government securities and investments in money market managed funds

2 Analysis of turnover

By geographical market	**2006** **£**	2005 £
Europe	**24,444,789**	20,945,217
United States of America	**387,155**	3,920
Rest of world	**230,345**	62,558
	25,062,289	21,011,695

3 Profit on ordinary activities before taxation

	2006 **£**	2005 £
Profit on ordinary activities before taxation is stated after charging/(crediting)		
Depreciation	**454,015**	360,577
Operating lease rentals		
- land and buildings	**261,249**	242,027
- vehicles	**171,039**	159,628
Exchange gains	**(137,971)**	(55,150)
Research and development	**8,231**	48,026

	2006 **£**	2005 £
Auditors' remuneration		
- Audit of these financial statements	**32,500**	31,800
Amounts receivable by the auditors and their associates in respect of		
- All other services	**34,937**	32,585

4 Remuneration of directors

The directors receive no remuneration in respect of their services to the company

No director is a member of either the defined benefit or the money purchase pension schemes

Notes *(continued)*

5 Staff numbers and costs

The average monthly number of persons employed by the company during the year was

	Number of employees	
	2006	2005
Administrative and selling	**51**	50

The aggregate payroll costs of these persons were as follows

	2006 £	restated 2005 £
Wages and salaries	**1,988,552**	1,885,133
Social security costs	**264,186**	332,418
Share based payments (See note 20)	**154,644**	77,222
Other pension costs	**140,517**	142,284
	2,547,899	2,437,057

6 Interest receivable

	2006 £	2005 £
Interest receivable from group companies	**39,728**	15,143
Other	**371,595**	344,364
	411,323	359,507

Notes *(continued)*

7 Taxation

Analysis of charge in period

	2006 £	2005 £
UK corporation tax		
Current tax on income for the period	**1,121,649**	652,299
Adjustments in respect of prior periods	**39,794**	46,104
Total current tax	**1,161,443**	698,403
Deferred tax (see note 11)	**50,248**	(11,793)
Tax on profit on ordinary activities	**1,211,691**	686,610

Factors affecting the tax charge for the current period

The current tax charge for the period is higher *(2005 lower)* than the standard rate of corporation tax in the UK (30%, *2005 30%*) The differences are explained below

	2006 £	Restated 2005 £
Current tax reconciliation		
Profit on ordinary activities before tax	**3,567,238**	2,688,183
Current tax at 30% *(2005 30%)*	**1,070,171**	783,288
Effects of		
Expenses not deductible for tax purposes	**75,171**	57,290
Depreciation for period in excess of capital allowances	**5,255**	11,793
Corporation tax relief for employee share acquisition	**(28,948)**	(200,072)
Adjustments to tax charge in respect of previous periods	**39,794**	46,104
Total current tax charge (see above)	**1,161,443**	698,403

Deferred tax asset

A deferred tax asset of £79,941 (*2005 £130,189*) has been recognised (See note 11) due to differences between accumulated depreciation and capital allowances

Notes *(continued)*

8 Dividends

The aggregate amount of dividends comprises

	2006	2005
	£	£
Interim dividends paid in respect of the current year	**1,600,000**	-

9 Tangible fixed assets

	Short leasehold land and buildings	**Fixtures, fittings, tools and equipment**	**Computer hardware/ software**	**Total**
	£	**£**	**£**	**£**
Cost				
At 1 January 2005	501,596	1,114,836	166,119	1,782,551
Additions	160,886	501,583	24,058	686,527
Disposals	-	(80,876)	-	(80,876)
At 31 December 2006	662,482	1,535,543	190,177	2,388,202
Depreciation				
At 1 January 2005	455,561	575,185	119,412	1,150,158
Charged in year	52,225	371,627	30,163	454,015
On disposals	-	(53,919)	-	(53,919)
At 31 December 2006	507,786	892,893	149,575	1,550,254
Net book value				
At 31 December 2006	**154,696**	**642,650**	**40,602**	**837,948**
At 31 December 2005	46,035	539,651	46,707	632,393

10 Stocks

	2006	2005
	£	£
Finished goods and goods for resale	**1,666,920**	1,626,173

Notes *(continued)*

11 Debtors

	2006 £	2005 £
Trade debtors	**8,088,852**	8,704,227
Amounts owed by group undertakings	**395,335**	1,441,994
Other debtors	**-**	1,818
Deferred tax asset	**79,941**	130,189
Prepayments and accrued income	**631,508**	407,275
	9,195,636	10,685,503

12 Creditors: amounts falling due within one year

	2006 £	2005 £
Payments received on account	**1,333,322**	159,169
Trade creditors	**836,681**	1,539,766
Amounts owed to group undertakings	**5,671,312**	6,903,781
Corporation tax	**187,438**	112,885
Other taxation and social security costs	**184,287**	281,696
Other creditors	**575,506**	724,968
Accruals	**1,547,309**	1,633,914
Deferred income	**1,204,191**	1,191,773
	11,540,046	12,547,952

13 Creditors: amounts falling due after more than one year

	2006 £	2005 £
Other creditors	**114,567**	-
	114,567	-

14 Called up share capital

	2006 £	2005 £
Authorised		
465,000 ordinary shares of £1 each	**465,000**	465,000
Allotted, called up and fully paid		
465,000 ordinary shares of £1 each	**465,000**	465,000

Notes *(continued)*

15 Reserves

	Capital contributions £	Restated Profit and loss account £
At 1 January 2006	250,000	8,527,197
Profit for the year	-	2,355,547
Capital contribution relating to share based payments	-	154,645
Dividend paid in the year	-	(1,600,000)
At 31 December 2006	**250,000**	**9,437,389**

16 Reconciliation of movement in shareholders' funds

	2006 £	Restated 2005 £
Opening shareholders' funds	**9,242,197**	7,240,624
Profit for the year	**2,355,547**	1,924,351
Credit in relation to share based payments	**154,645**	77,222
Dividend paid in the year	**(1,600,000)**	-
Closing shareholders' funds	**10,152,389**	9,242,197

17 Contingent liabilities

The company has a contingent liability regarding tender and performance guarantees and duty deferment at 31 December 2006 to the extent of £250,000 *(2005 £257,177)*

18 Commitments under operating leases

Annual commitments under non-cancellable operating leases are as follows

	2006		2005	
	Land and buildings £	**Other £**	Land and buildings £	Other £
Operating leases which expire				
- within one year	-	**25,872**	112,750	27,526
- within two to five years	-	**139,986**	-	278,222
- greater than five years	**253,750**	-	-	-
	253,750	**165,858**	112,750	305,748

Notes *(continued)*

19 Pension obligations

In June 2000, the company established a new defined contribution pension scheme for its employees The assets of the scheme are held in a separate trustee administered fund The company contributes 4% of pensionable pay to the scheme and matches employee contributions up to a further 4% These contributions are charged to the profit and loss account as incurred The company contributed £140,517 (*2005 £142,284*) to the scheme during the year of which £16,529 (*2005 £15,222*) was accrued but not yet paid at year end

20 Employee share schemes

The Company has a stock-based compensation program that provides equity based incentives for employees in its ultimate parents stock This program includes incentive and non-statutory stock options and non-vested stock awards (referred to as restricted stock awards) granted under two plans, the FLIR Systems, Inc 1992 Stock Incentive Plan (the "1992 Plan") and the FLIR Systems, Inc 2002 Stock Incentive Plan (the "2002 Plan") Prior to 1st January 2006, all stock options were time-based with vesting schedules ranging from immediate vesting to vesting over three years and generally expire ten years from the grant date The Company has discontinued issuing option awards out of the 1992 Plan, but previously granted options under those plans remain outstanding until their expiration

During 2006, the Company also began granting performance-based options and restricted stock awards The vesting of performance-based options is contingent upon meeting certain diluted earnings per share growth targets in three independent tranches over a three year period and the options expire ten years from the grant date The vesting of each tranche is not dependent on the other tranches Restricted stock awards are time-based and generally vest over a three year period

Additionally, the Company has an Employee Stock Purchase Plan (the "ESPP") which allows employees to purchase shares of the Company's ultimate parents common stock at 85% of the fair market value at the lower of either the date of enrolment or the purchase date

The number and weighted average exercise price of the share options activity in the year are as follows

	Weighted average exercise price	**Number of options**
	£	**£**
Outstanding at the beginning of the period	12 18	73,600
Granted during the period	12 80	20,600
Forfeited during the period	-	-
Exercised during the period	5 13	7,200
Lapsed during the period	-	-
Outstanding at the end of the period	12 91	87,000
Exercisable at the end of the period	10 47	36,667

The weighted average share price of the share options exercised during the period was £15 86 The options outstanding at the year end have an exercise price in the range of £0 78 to £15 98 and a weighted average contractual life of 8 4 years

Notes *(continued)*

20 Employee share schemes (continued)

The amount recognised as an expense in relation to each of the above incentive plans is shown below

	2006	2005
	£	£
Time-based stock options	84,240	77,222
Performance-based stock options	20,595	-
Restricted stock awards	36,574	-
Employee stock purchase plan	13,236	-
	154,645	77,222

The fair value of the stock-based awards expensed in the years ended 31st December 2005 and 2006 reported above was estimated using the Black-Scholes model with the following weighted-average assumptions

	2006	2005
Stock Option Awards		
Risk-free interest rate	4 7%	3 5%
Expected dividend yield	0 0%	0 0%
Expected term	2 6 years	3 0 years
Expected volatility	39 9%	43 5%
Employee Stock Purchase Plan		
Risk-free interest rate	5 0%	3 8%
Expected dividend yield	0 0%	0 0%
Expected term	6 months	6 months
Expected volatility	40 1%	40 4%

21 Ultimate parent undertaking and parent undertaking of larger group of which the company is a member

The company is a subsidiary undertaking of FLIR Systems Inc , a company incorporated in the United States of America

The largest group in which the results of the company are consolidated is that headed by FLIR Systems Inc , incorporated in the United States of America The consolidated accounts of this company are available to the public and may be obtained from FLIR Systems Inc , 27700A SW Parkway Avenue, Wilsonville, OR97070, United States of America No other group accounts include the results of the company