

General Dynamics United Kingdom Limited

**Directors' report and financial
statements**

Registered number 1911653

31 December 2006



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Directors' Report for the year ended 31 December 2006

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

Principal Activities

The principal activities of the Company are the design, system integration, manufacture, marketing and support of C4ISTAR (command, control, communications, computing, intelligence, surveillance, target acquisition & reconnaissance), primarily in land and air applications for the Defence Industry. In addition, 2006 saw the emergence of a new business line for GD UK in Ground Systems which is focused on the UK's FRES programme, areas of interest include C4ISTAR but also supply of platforms

Business Review

The year ended 31 December 2006 has been another very successful year. Targets for Order Intake, Profit and Cashflow were all exceeded. Turnover fell by 5.5% between 2005 and 2006 as the single largest contract, Bowman, entered later production stages, but EBIT margin grew to 9.0% (2005 8.8%). Cashflow for the year was £76.8m (2005 £23.6m) being 187% of Profit after tax.

Performance against strategic objectives was also very good. Delivery performance on the Bowman programme was excellent, with a high level of system design maturity achieved and production deliveries up to expectations. Customer feedback on the programme has been positive. Penetration into overseas markets has increased, Turnover outside of the UK was £52.3m (2005 £24.1m) and there is near-term potential for further growth. Business development across other business areas in the UK was also positive, so that the Bowman programme will form a smaller proportion of total Turnover in 2007 than in 2006.

The UK defence market has been difficult throughout the year, with substantial delays to MoD funding of new programmes. Our focus on export, and success in follow-on business due to good performance, has helped to reduce the impact of these delays.

Risks and Opportunities are reviewed thoroughly and regularly by executive management, at both the individual programme and the enterprise levels. Key potential high level business risks have been identified and the key risks include

- denial of access to data or to facilities as a result of an incident
- loss of key staff or failure to recruit adequate engineering resource
- substantial delay to UK MoD funding
- restriction of access to key US technologies

Mitigation activity is in place for each of the risks as follows

- We have major incident plans and disaster recovery planning,
- retention policies are in place and active recruitment is targeted at key skills,
- the customer base is being widened to reduce reliance on UK MoD,
- substantial commercial effort is directed at maintaining free flow of necessary technology from GD sister companies

Directors' Report (continued)

The business is managed using several key performance indicators in addition to the traditional financial measures. These are focused on delivery performance in development and production, staff turnover, the success rate of new business pursuits and measures of cost effectiveness and productivity. Variance analysis is performed monthly. Staff turnover at over 9%, has been a particular concern in the year and management attention is focused on this issue.

Research and development

The Company has a policy of selective investment in the design and development of new technologies and products. Current major areas of interest include base technology and advanced product development of simulation and modelling, data fusion, information management, dynamic fixed and wireless networking, secure processing, graphics and application software. Work is also underway to maximise leverage from complementary technologies available at other General Dynamics Companies.

Results and proposed dividend

Profit after taxation for the year ended 31 December 2006 was £41,017,000 compared to £35,415,000 for the year ended 31 December 2005.

The directors do not recommend the payment of a dividend for the year (2005 Nil).

Directors' and other interests

The directors who held office during the year were as follows:

T J Brammer
D M Spiers
Dr A D Wilson
P K Levene
G J DeMuro

None of the directors who held office at the end of the financial year had any disclosable interest in the shares of group companies.

Corporate Responsibility

During 2006, the Company made good progress and actively ensured delivery of stakeholder commitments.

The Company strives to maintain the highest standards of ethical conduct and corporate responsibility. By operating proactive policies, the Company manages its customer and supplier relationships responsibly.

The single greatest contribution to the communities in which the Company operates is the sustained wealth created by providing hundreds of highly skilled jobs. Charitable donations and community involvement are encouraged across all the UK sites and employees are supported by well-developed policies and practices.

Employees' involvement

Effective training and development of a highly skilled workforce is considered key to future business success. The Company also encourages the employment and retention of disabled persons.

A comprehensive employee communications programme is active which includes bi-annual all-employee briefings in addition to monthly 'flow-down' meetings. Topics covered include market forecasts, product development, facilities and benefit changes and Company financial status.

Directors' Report (continued)

Political and charitable contributions

The company made no political contributions during the year (2005 Nil) Donations to UK charities amounted to £35,100 (2005 £74,143)

Supplier payment policy

The Company's policy is to agree payment terms with suppliers for each contract Trade creditors, at 31 December 2006 were equivalent to 30 days purchases (2005 31) based on the average £1.8m daily amount invoiced by suppliers during the year

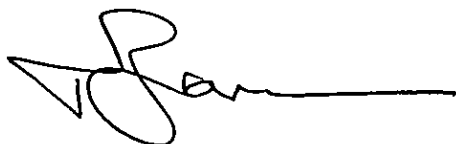
Disclosure of information to auditors

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 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 Auditors are aware of that information

Auditors

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

By Order of the Board



T J Brammer
Director

100 New Bridge Street
London
EC4V 6JA

28 March 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 the directors have elected to prepare the financial statements in accordance with UK Accounting Standards.

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 LLP

1 Forest Gate
Brighton Road
Crawley
RH11 9PT
United Kingdom

Independent auditors' report to the members of General Dynamics UK Limited

We have audited the financial statements of General Dynamics UK 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, the Statement of Shareholders' Funds 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 4.

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.

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

28 March 2007

Profit and loss account
for the year ended 31 December 2006

	<i>Note</i>	2006 £000	2005 £000 (Restated)
Turnover	2	526,136	556,892
Cost of sales		(462,528)	(501,600)
		<hr/>	<hr/>
Gross profit		63,608	55,292
Administrative expenses		(16,006)	(6,617)
		<hr/>	<hr/>
Operating profit		47,602	48,675
Interest receivable	4	7,411	2,796
Interest payable and similar charges	5	(322)	(1,117)
		<hr/>	<hr/>
Profit on ordinary activities before taxation	6	54,691	50,354
Tax on profit on ordinary activities	8	(13,674)	(14,939)
		<hr/>	<hr/>
Retained profit for the financial year		41,017	35,415
		<hr/>	<hr/>

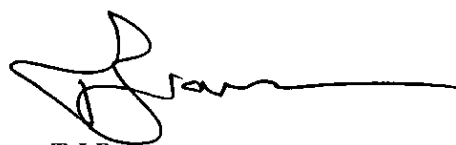
The profit for the year and the preceding year arises entirely from continuing operations

Balance sheet

At 31 December 2006

	Note	2006 £000	2005 £000
Fixed assets			
Tangible assets	9	15,420	16,581
		<u>15,420</u>	<u>16,581</u>
Current assets			
Stocks and work in progress	10	16,744	27,188
Debtors	11	241,071	207,223
Cash at bank		-	41
		<u>257,815</u>	<u>234,452</u>
Creditors amounts falling due within one year	12	(123,557)	(141,757)
Net current assets		<u>134,258</u>	<u>92,695</u>
Total assets less current liabilities		<u>149,678</u>	<u>109,276</u>
Creditors amounts falling due after more than one year	13	(1,833)	(3,192)
Provisions for liabilities and charges	15	(1,313)	(643)
Net assets excluding pension asset/liability		<u>146,532</u>	<u>105,441</u>
Pension asset/(liability)	21	101	(549)
Net assets including pension asset/liability		<u><u>146,633</u></u>	<u><u>104,892</u></u>
Capital and reserves			
Called up share capital	16	9,262	9,262
Capital redemption reserve	17	88	88
Other reserves	17	1	1
Profit and loss account	17	137,282	95,541
Equity Shareholders' funds		<u><u>146,633</u></u>	<u><u>104,892</u></u>

These financial statements were approved by the board of directors on 28 March 2007 and were signed on its behalf by



T J Brammer
Director

Statement of Total Recognised Gains & Losses

	2006 £000	2005 £000
Profit for the financial year (restated – see note 20)	41,017	35,415
Actuarial gain recognised on the pension scheme	246	174
Movement on deferred tax relating to actuarial gains on the pension scheme	(74)	(52)
Total recognised gains and losses for the year	41,189	35,537
Prior year adjustment (FRS20 see note 20)	(1,370)	
Total recognised gains and losses since last annual report	39,819	

Reconciliation of Shareholders Funds

	2006 £000	2005 £000
Profit for the financial year (restated – see note 20)	41,017	35,415
Retained profit for the financial year	41,017	35,415
Other recognised gains relating to pensions	172	122
FRS 20 Share based payment reserves adjustments	552	1,370
Net increase in Shareholder funds	41,741	36,907
Shareholders' funds at beginning of year	104,892	67,985
Shareholders' funds at end of year	146,633	104,892

Notes

(forming part of the financial statements)

1 Accounting policies

The principal accounting policies are summarised below and these have all been applied consistently throughout the year and the preceding year, except for FRS20 (see (e) below)

Basis of Preparation

- a) These financial statements have been prepared in accordance with applicable Accounting Standards and under the historical cost convention
- b) Consolidated financial statements have not been prepared as the Company is a wholly owned subsidiary of another company incorporated in the United Kingdom
- c) Under Financial Reporting Standard 1 the Company is exempt from the requirement to present a cash flow statement on the grounds that its ultimate parent undertaking, General Dynamics Corporation, includes the company in its own published consolidated financial statements (see note 23)
- d) In accordance with Financial Reporting Standard 8, no disclosure has been made in relation to the Company's transactions with other group undertakings, as it is a wholly owned subsidiary of General Dynamics Corporation whose consolidated financial statements are publicly available (see note 23)
- e) FRS20 "Accounting for share-based payments" has been applied for the first time, resulting in a change in accounting for share-based payments as detailed in Note 24

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost, less depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life as follows

Freehold Buildings	50 years
Leasehold Land and Buildings	Life span of lease
Plant and Machinery	4-8 years
Finance Lease Plant and Machinery	3-5 years

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

Stocks and work in progress

Stocks are valued at the lower of cost and net realisable value. For work in progress, cost is taken as production cost, which includes an appropriate proportion of attributable overheads

Notes (continued)

1 Accounting policies (continued)

Long Term Contracts

The amount of profit attributable to the stage of completion of a long term contract is recognised when the outcome of the contract can be foreseen with reasonable certainty. Turnover for such contracts is stated at the cost appropriate to their stage of completion plus attributable profits, less amounts recognised in previous years. Provision is made for any losses as soon as they are foreseen.

Contract work in progress is stated at costs incurred, less that transferred to the profit and loss account, after deducting foreseeable losses and payments on account not matched with turnover.

Amounts recoverable on long term contracts are included in debtors and represent turnover recognised in excess of payments on account.

Short Term Contracts

On short term contracts turnover represents amounts invoiced during the year net of VAT. A short term contract is a contract that is started and completed within the same financial year.

Foreign Currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction or, if hedged forward, at the rate of exchange under the related forward currency contract. Monetary assets and liabilities denominated in foreign currencies are translated using 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.

Warranties

Provision is made for the estimated cost of work to be performed under warranty on products sold before the balance sheet date.

Research and Development

Expenditure on research and development is written off in the year in which it is incurred.

Leases

Assets held under finance leases and other similar contracts which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and depreciated over the shorter of the lease terms and their estimated useful life. The capital element of future lease obligations are recorded as liabilities, while the interest element of the rental obligations is charged to the profit and loss account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding. Rentals paid under operating leases are charged to the profit and loss account on a straight line basis over the term of the lease.

Notes (continued)

1 Accounting policies (continued)

Pensions

The Company operates a hybrid scheme, which includes a defined contribution element and also frozen 'final salary' benefits for pensioners and deferred pensioners. Further details are set out in note 21. The scheme is funded by contributions from both employer and employees. The valuation of the preserved benefits element of the scheme is determined by independent qualified actuaries. Pension contributions are invested separately from the Company's assets.

Any pension scheme surplus (to the extent that it is recoverable) or deficit is recognised in full and shown in the Accounts. The movement in the surplus or deficit is split between operating charges, finance items and, in the statement of total recognised gains and losses, actuarial gains and losses.

Government Grants

Capital based government grants are included within accruals and deferred income in the balance sheet and are credited to operating profit over the estimated useful lives of the assets to which they relate.

Revenue based government grants are credited to the profit and loss account in the period in which they are received.

Employee share schemes

The share option programme allows employees to acquire shares in the 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 a Black - Scholes 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 variations are due only to share prices not achieving the threshold for vesting.

2 Turnover

Turnover has been wholly derived from the operation of design, production and support of avionic, communications and associated electronic equipment, which originates in the United Kingdom. The analysis of turnover by geographical destination is as follows:

	2006 £000	2005 £000
United Kingdom	473,805	532,749
Europe	46,499	20,560
North America	4,632	3,505
Rest of the World	1,200	78
	<u>526,136</u>	<u>556,892</u>

Further analysis of profit before tax and net assets is considered to be seriously prejudicial to the interests of the Company.

Notes (continued)

3 Staff numbers and costs

The average number of persons employed by the company (including directors) during the year, analysed by category, was as follows

	Number of employees	
	2006	2005
Administration	280	294
Production	1,125	985
	<u>1,405</u>	<u>1,279</u>

The aggregate payroll costs of these persons were as follows

	2006 £000	2005 £000
Wages and salaries	55,876	47,407
Social security costs	5,597	4,726
Other pension costs (see note 21)	2,252	2,162
Defined benefit past service costs (see note 21)	50	26
	<u>63,775</u>	<u>54,321</u>

4 Other interest receivable and similar income

	2006 £000	2005 £000
Bank interest	7,373	2,796
Net pension finance income	38	-
	<u>7,411</u>	<u>2,796</u>

5 Interest payable and similar charges

	2006 £000	2005 £000
Interest on finance leases	177	214
On all other loans	145	894
Net pension finance loss	-	9
	<u>322</u>	<u>1,117</u>

Notes (continued)

6 Profit on ordinary activities before taxation

	2006 £000	2005 £000
The profit on ordinary activities before taxation is stated after charging/(crediting)		
Operating leases		
- Land and buildings	850	841
- Motor vehicles	453	265
Research and development	2,155	1,482
Depreciation of owned fixed assets	2,279	2,484
Depreciation of leased assets	3,293	2,162
Government grants	(160)	(2,960)
Exchange loss/(gain)	320	(5,218)
FRS 20 share based payment charges	1,379	1,125
Auditor's Remuneration	2006 £000	2005 £000
Audit of Financial Statements pursuant to legislation	315	308
Other Services pursuant to such legislation	90	85
Other Services relating to Taxation	324	202

7 Directors' remuneration

	2006 £000	2005 £000
Directors' emoluments	736	713
Company contributions to money purchase pension schemes	31	26

Two directors exercised share options of the ultimate parent company in the year (2005 1) The above amounts do not include any gains made on the exercise of share options

Pensions

The number of directors who were members of pension schemes was as follows

	2006 Number	2005 Number
Money purchase scheme	2	2

Highest paid director

The above amounts for remuneration include the following in respect of the highest paid director

	2006 £000	2005 £000
Directors' emoluments	367	349
Company contributions to money purchase pension schemes	19	14

No director had a direct or indirect interest in any transaction, arrangement or agreement, which in the opinion of the other directors requires disclosure under the provisions of the Companies Act 1985

Notes (continued)

8 Taxation

	2006 £000	2005 £000
UK corporation tax	15,879	15,078
Adjustments in respect of prior periods	(1,342)	(5)
Total current tax	14,537	15,073
Foreign tax Payable	21	34
Deferred tax (see note 15)	(810)	(116)
Origination of timing differences excluding pension	(74)	(52)
Tax on profit on ordinary activities	13,674	14,939

Factors affecting the tax charge for the current year

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

	2006 £000	2005 £000
<i>Current tax reconciliation</i>		
Profit on ordinary activities before tax	55,243	51,724
Current tax at 30% (2005 30%)	16,407	15,106
<i>Effects of</i>		
Expenses not deductible for tax purposes	1,096	725
Income not chargeable for tax purposes	(1,679)	(875)
Capital allowances for year less than depreciation	55	122
Adjustments in respect of prior periods	(1,342)	(5)
Total current tax charge (see above)	14,537	15,073

Notes (continued)

9 Tangible fixed assets

	Long leasehold land and buildings £000	Short leasehold land and buildings £000	Plant, machinery and motor vehicles £000	Total £000
Cost				
At 1 January 2006	3,547	6,437	33,368	43,352
Additions	1	11	4,666	4,678
Disposals	-	-	(249)	(249)
Transfers in	22	(22)	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2006	3,570	6,426	37,785	47,781
	<hr/>	<hr/>	<hr/>	<hr/>
Depreciation				
At 1 January 2006	1,478	2,908	22,385	26,771
Charge for year	208	554	4,971	5,733
On disposals	-	-	(143)	(143)
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2006	1,686	3,462	27,213	32,361
	<hr/>	<hr/>	<hr/>	<hr/>
Net book value				
At 31 December 2006	1,884	2,964	10,572	15,420
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2005	2,069	3,529	10,983	16,581
	<hr/>	<hr/>	<hr/>	<hr/>

The net book value of plant and machinery and motor vehicles above includes a net book value of £1,901,000 (2005 £3,540,000) in respect of assets held under finance leases. Depreciation charged in the year on these assets was £2,774,000 (2005 £2,162,000).

Notes (continued)

10 Stocks and work in progress

	2006 £000	2005 £000
Raw materials and consumables	159	74
Work in progress	16,585	27,114
	<u>16,744</u>	<u>27,188</u>

Work in progress includes the following amounts in respect of long-term contracts

Net costs less foreseeable losses	16,585	27,852
Less payments on account received and receivable not matched with turnover	-	(738)
	<u>16,585</u>	<u>27,114</u>

11 Debtors: amounts falling due within one year

	2006 £000	2005 £000
Amounts owed by fellow subsidiary	141,309	65,278
Amounts recoverable on contracts	69,405	62,376
Trade debtors	27,224	76,004
Other debtors	-	24
Prepayments	2,539	3,541
Deferred tax asset (Note 15)	594	-
	<u>241,071</u>	<u>207,223</u>

12 Creditors: amounts falling due within one year

	2006 £000	2005 £000
Bank loans / overdrafts	30	108
Obligations under finance leases (see note 14)	1,197	1,709
Payments on account on long term contracts	45,564	53,744
Trade creditors	39,429	39,505
Amounts owed to parent undertaking	15,126	11,990
Taxation and social security	4,785	15,173
Other loans (see note 13)	231	213
Accruals and deferred income	17,195	19,315
	<u>123,557</u>	<u>141,757</u>

Notes (continued)

13 Creditors: amounts falling due after more than one year

	2006 £000	2005 £000
Obligations under finance leases (see note 14)	703	1,831
Other loans	1,130	1,361
	<u>1,833</u>	<u>3,192</u>
Analysis of other loans		
	2006 £000	2005 £000
Debt can be analysed as falling due		
In one year or less, or on demand	231	213
Between one and two years	250	231
Between two and five years	563	813
In five years or more	317	317
	<u>1,361</u>	<u>1,574</u>

The other loan is from the Welsh Development Agency and is repayable over 10 years and bears interest at 8% p a

14 Obligations under finance leases

The maturity of obligations under finance leases and hire purchase contracts is as follows

	2006 £000	2005 £000
Within one year	1,197	1,709
In the second to fifth years	703	1,831
	<u>1,900</u>	<u>3,540</u>

15 Provisions for liabilities and charges

	Deferred tax £000	Warranty provision £000	Total £000
At 1 January 2006	216	427	643
At 1 January 2006 (restated)	216	427	643
(Utilised)/created during the year	(810)	886	76
At 31 December 2006	<u>(594)</u>	<u>1,313</u>	<u>719</u>
The balance at 31 December 2006 is split as follows			
Debtors (see note 11)			594
Provision for liabilities and charges			(1,313)
			<u>719</u>

Notes (continued)

15 Provisions for liabilities and charges (continued)

The elements of deferred taxation are as follows

	2006 £000	2005 £000
Difference between accumulated depreciation and capital allowances	680	741
Other timing differences	(1,400)	(470)
Timing Difference on pension finance charge	126	(55)
	<hr/>	<hr/>
Deferred tax (asset)/liability	(594)	216
	<hr/>	<hr/>

16 Called up share capital

The share capital of the Company comprises ordinary shares of 50p each

	2006 Number of Shares	£000	2005 Number of Shares	£000
Authorised	100,000,000	50,000	100,000,000	50,000
	<hr/>	<hr/>	<hr/>	<hr/>
Allotted, called-up and fully paid	18,523,150	9,262	18,523,150	9,262
	<hr/>	<hr/>	<hr/>	<hr/>

17 Reserves

	Capital redemption reserve £000	Other reserves £000	Profit and loss account £000	Total £000
At 1 January 2006 (restated)	88	1	95,541	95,630
Retained profit for the year	-	-	41,017	41,017
Net actuarial gain on pension schemes	-	-	172	172
FRS 20 share based payment charges	-	-	552	552
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2006	88	1	137,282	137,371
	<hr/>	<hr/>	<hr/>	<hr/>

Notes (continued)

18 Financial commitments

a) Capital commitments at the end of the financial year, for which no provision has been made, are as follows

	2006 £000	2005 £000
Contracted	307	56
Authorised but not contracted	319	392
	<u> </u>	<u> </u>

(b) Annual commitments under non-cancellable operating leases are as follows

	2006		2005	
	Land and buildings £000	Other £000	Land and buildings £000	Other £000
Operating leases which expire				
Within one year	116	167	116	65
In the second to fifth years inclusive	654	118	596	264
Over five years	152	-	152	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	922	285	864	329
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

19 Contingent liabilities

	2006 £000	2005 £000
Performance guarantees	10,068	16,523
	<u> </u>	<u> </u>

20 Prior Year Adjustments

Due to the first time adoption of FRS20 this year, a prior year adjustment has been recognised resulting in an additional charge to the 2005 profit and loss account of £1,370,000. In accordance with FRS20 this is offset by an equal adjustment to the profit and loss reserves. As such there is no impact on 2005 net assets.

Notes (continued)

21 Pension scheme

The Company sponsors the General Dynamics Retirement and Death Benefit Scheme ('the Scheme'). The Scheme is a hybrid arrangement which includes both a defined contribution section and a defined benefit section comprising of current and deferred pensioners. The defined benefit section of the Scheme was closed from 6 April 1997, at which time members ceased to accrue benefits on a defined benefit basis and were given the option to transfer their benefits to the defined contribution section of the Scheme. The assets of the Scheme are held separately from those of the Company, being invested with an external fund manager. The expenses of the Scheme are borne by the Company.

Defined contribution element

The pension cost for the year was £2,252,000 (2005 £2,162,000). There were no outstanding or prepaid contributions at 31 December 2006 (2005 £nil).

Defined Benefit Section

A full actuarial valuation of this scheme was carried out by a qualified independent actuary as at 6 April 2004. This has been updated on an approximate basis to 31 December 2006. The actuarial valuation resulted in a surplus. This was based on assumptions taking a worst case scenario of all eligible employees retiring early.

The contributions made by the Company totalled £494,000 (2005 £170,100). The pension costs for the year were £nil (2005 £nil) on the basis that the Directors consider it unlikely that all eligible employees will retire early and therefore the scheme is in balance.

The FRS 17 valuations for all the Company's pension schemes were updated to 31 December 2006 by an independent qualified actuary in accordance with FRS 17. As required by FRS 17, the defined benefit liabilities have been measured using the projected unit method.

Assumptions

The assets of the scheme have been taken at market value and the liabilities have been calculated using the following principal actuarial assumptions:

	2006	2005	2004
Revaluation rate for deferred pensioners	3.10%	2.90%	2.90%
Rate of increase in pensions in payment and deferred pensions	3.10%	2.90%	2.90%
Discount rate applied to scheme liabilities	5.20%	4.80%	5.30%
Inflation assumption	3.10%	2.90%	2.90%

The table below sets out the fair value of assets, a breakdown of the assets into the main asset classes, the present value of the FRS 17 liabilities and the deficit of assets below the FRS 17 liabilities (which equals the gross pension liability).

Notes (continued)

21 Pension scheme (continued)

Scheme assets

The fair value of the Scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the Scheme's liabilities, which are derived from cash flow projections over long periods and therefore inherently uncertain, were

	Long term rate of return 2006	Value at 2006 £000	Long term rate of return 2005	Value at 2005 £000	Long term rate of return 2004	Value at 2004 £000
Equities	6.45%	5,221	6.05%	4,666	6.55%	3,726
Bonds	5.20%	2,102	4.80%	1,894	5.30%	1,482
Property	6.20%	193	-	-	-	-
Cash	5.00%	1	4.50%	20	4.75%	4
Total market value of assets		7,517		6,580		5,212
Present value of scheme liabilities		(7,373)		(7,364)		(6,394)
Surplus/(deficit) in the Scheme - Pension (liability)/asset		144		(784)		(1,182)
Related deferred tax		(43)		235		355
Net pension asset/(liability)		101		(549)		(827)

The amount of the net pension asset/(liability) would have a consequential effect on reserves

Movement in the surplus/(deficit) during the year

	2006 £000	2005 £000	2004 £000
Deficit in the Scheme at 1 January	(784)	(1,182)	(1,450)
Past service cost	(50)	(26)	-
Net pension Gain	38	(9)	18
Contribution	494	170	-
Other finance income	200	89	-
Actuarial gain/(loss)	246	174	250
Surplus/(deficit) in the Scheme at 31 December	144	(784)	(1,182)

Notes (continued)

21 Pension scheme (continued)

Analysis of other pension costs charged in arriving at operating profit/loss

	2006 £000	2005 £000
Current service cost	-	-
Past service cost	(50)	(26)
	<u>(50)</u>	<u>(26)</u>

Analysis of amounts included in other finance income

	2006 £000	2005 £000
Expected return on pension scheme assets	386	328
Interest on pension scheme liabilities	(348)	(337)
	<u>38</u>	<u>(9)</u>

Analysis of amount recognised in statement of total recognised gains and losses

	2006 £000	2005 £000
Actual return less expected return on Scheme assets	125	874
Experience gains and losses arising on Scheme liabilities	(134)	11
Changes in assumptions underlying the present value of Scheme liabilities	255	(711)
	<u>246</u>	<u>174</u>

A history of experience gains and losses at 31 December 2006 would have been as follows

	2006 £000	2005 £000	2004 £000
Difference between the expected and actual return on scheme assets			
Amount	125	874	307
Percentage of scheme assets (at end of year)	2%	13%	6%
Experience gains and losses on scheme liabilities			
Amount	(134)	(11)	(4)
Percentage of present value of scheme liabilities (at end of year)	2%	0%	0%
Total amount recognised in statement of total recognised gains and losses:			
Amount	246	174	250
Percentage of present value of scheme liabilities (at end of year)	3%	2%	4%

Notes (continued)

21 Pension scheme (continued)

The expected contribution to be paid to the scheme in the next financial year is £144,000

22 Related party disclosures

The Company is controlled by its immediate parent undertaking General Dynamics Ltd. The ultimate controlling party is General Dynamics Corporation (See note 23)

23 Ultimate parent company

The Company is a 100% owned subsidiary undertaking of General Dynamics Limited, a company incorporated in Great Britain. General Dynamics Corporation is the ultimate parent company incorporated in the USA.

The largest group in which the results of the Company are consolidated is that headed by General Dynamics Corporation, incorporated in the USA. The consolidated accounts of the group are available to the public and may be obtained from 2941 Fairview Park Drive, Suite 100, Falls Church, VA 22042 – 4513, USA.

The smallest group in which the results of the Company are consolidated is that headed by General Dynamics Limited. The consolidated accounts of General Dynamics Limited are available to the public and may be obtained from Companies House, Crown Way, Cardiff, CF14 3UZ.

24 Employee share schemes

Share based payments

General Dynamics operates 3 share schemes. The SAYE scheme is offered to all employees once a year and employees have the option of entering either a 3 year or 5 year scheme. The Restricted Stock scheme is for those employees who have been given a special EC grant by the Managing Director. The T&M options (awarded under the same scheme as EC Options) are granted to employees at their manager's discretion.

The terms and conditions of grants are as follows, whereby all options are settled by physical delivery of shares.

Grant date/ Employees entitled/ nature of scheme	Number of instruments	Vesting conditions	Contractual life of options
2004 Equity-settled award of restricted stock awarded to employees receiving a special EC grant. Awarded by General Dynamics Corporation on 03/03/04	8,982	2 years following award	2 years
2005 Equity-settled award of restricted stock awarded to employees receiving a special EC grant. Awarded by General Dynamics Corporation on 02/03/05	11,542	2 years following award	2 years
2006 Equity-settled award of restricted stock awarded to employees receiving a special EC grant. Awarded by General Dynamics Corporation on 01/03/06	8,960	2 years following award	2 years
2004 Equity-settled award of EC Options awarded to key employees at the Managing Directors discretion. Granted by General Dynamics Corporation on 03/03/04	47,720	50% at end of 1 st year, 50% at end of 2 nd year	5 years
2005 Equity-settled award of EC Options awarded to key employees at the Managing Director's discretion. Granted by General Dynamics	67,060	50% at end of 1 st year, 50% at end of 2 nd year	5 years

Corporation on 02/03/05

Notes (continued)

24 Employee share schemes (continued)

Share based payments (continued)

2006 Equity-settled award of EC Options awarded to key employees at the Managing Directors discretion Granted by General Dynamics Corporation on 01/03/06	63,440	50% at end of 1 st year, 50% at end of 2 nd year	5 years
2003 Equity-settled award of T&M Options awarded to GDUK employees at their managers discretion Granted by General Dynamics Corporation on 05/03/03	46,000	33% at end of 1 st year, 33% at end of 2 nd year, 33% at end of 3 rd year	5 years
2004 Equity-settled award of T&M Options awarded to GDUK employees at their managers discretion Granted by General Dynamics Corporation on 03/03/04	44,200	33% at end of 1 st year, 33% at end of 2 nd year, 33% at end of 3 rd year	5 years
2005 Equity-settled award of T&M Options awarded to GDUK employees at their managers discretion Granted by General Dynamics Corporation on 02/03/05	30,000	33% at end of 1 st year, 33% at end of 2 nd year, 33% at end of 3 rd year	5 years
2006 Equity-settled award of T&M Options awarded to GDUK employees at their managers discretion Granted by General Dynamics Corporation on 01/03/06	31,000	33% at end of 1 st year, 33% at end of 2 nd year, 33% at end of 3 rd year	5 years
2002 Cash-settled 5 year SAYE award to GDUK employees Granted by parent on 27/11/02	17,870	5 years from start of contract	5 years
2003 Cash-settled 3 year SAYE award to GDUK employees Granted by parent on 08/09/03	18,576	3 years from start of contract	3 years
2003 Cash-settled 5 year SAYE award to GDUK employees Granted by parent on 08/09/03	11,236	5 years from start of contract	5 years
2004 Cash-settled 3 year SAYE award to GDUK employees Granted by parent on 10/09/04	25,324	3 years from start of contract	3 years
2004 Cash-settled 5 year SAYE award to GDUK employees Granted by parent on 10/09/04	13,356	5 years from start of contract	5 years
2005 Cash-settled 3 year SAYE award to GDUK employees Granted by parent on 09/09/05	32,924	3 years from start of contract	3 years
2005 Cash-settled 5 year SAYE award to GDUK employees Granted by parent on 09/09/05	11,164	5 years from start of contract	5 years
2006 Cash-settled 3 year SAYE award to GDUK employees Granted by parent on 10/10/06	31,750	3 years from start of contract	3 years
2006 Cash-settled 5 year SAYE award to GDUK employees Granted by parent on 10/10/06	14,832	5 years from start of contract	5 years

Notes (continued)

24 Employee share schemes (continued)

Share based payments (continued)

The number and weighted average exercise prices of share options in are as follows

	2006 Weighted average exercise price £	2006 Number of options	2005 Weighted average exercise price £	2005 Number of options
Outstanding at the beginning of the period	23 72	405,144	19 73	344,976
Granted during the period	35 18	168,013	28 10	139,040
Forfeited during the period	22 44	7,661	20 00	9,824
Exercised during the period	20 70	94,684	18 99	69,048
Lapsed during the period	-	-	-	-
Outstanding at the end of the period	27.65	470,812	23 72	405,144
Exercisable at the end of the period	23 53	121,986	20 54	93,599

The weighted average share price at the date of exercise of share options exercised during the period was £20 70 (2005 £18 99)

The options outstanding at the year end have an exercise price in the range of £18 02 to £35 63 and a weighted average contractual life of 3 5 years

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on a Black Scholes model

Scheme	Fair Value at measurement date (£)	Share price on date of grant (£)	Exercise price (£)	Expected volatility	Option life (months)	Expected dividends	Risk free interest rate
EC Share Options							
March 5, 2003 1 year vest	3 113	17 7125	17 7125	31 9%	27	2 2%	1 73%
March 5, 2003 2 year vest	3 629	17 7125	17 7125	31 9%	39	2 2%	1 73%
March 5, 2003 3 year vest	4 033	17 7125	17 7125	31 9%	51	2 2%	1 73%
March 3, 2004 1 year vest	4 350	25 0384	25 0384	30 7%	27	1 4%	2 27%
March 3, 2004 2 year vest	5 159	25 0384	25 0384	30 7%	39	1 4%	2 27%
March 3, 2004 3 year vest	5 811	25 0384	25 0384	30 7%	51	1 4%	2 27%
March 2, 2005 1 year vest	5 984	27 5654	27 5654	25 9%	45	1 5%	3 62%
March 2, 2005 2 year vest	6 152	27 5654	27 5654	25 8%	48	1 5%	3 61%
March 2, 2005 3 year vest	6 374	27 5654	27 5654	25 9%	51	1 5%	3 65%
March 1, 2006 (all years)	7 056	31 8138	31 8138	23 63%	48	1 5%	4 459%

Notes (continued)

24 Employee share schemes (continued)

Share based payments (continued)

Restricted Stock

March 3, 2004 2 year vest	31 343	25 0384	25 0384	30 7%	39	1 4%	2 27%
March 2, 2005 2 year vest	27 565	27 5654	27 5654	25 8%	48	1 5%	3 61%
March 1, 2006 (all years)	31 814	31 8138	31 8138	23 63%	48	1 5%	4 459%

SAYE

December 1, 2002 3 year	8 491	26 5609	21 7778	32 90%	39	1 4%	2 98%
December 1, 2002 5 year	9 770	26 5609	21 7778	32 90%	63	1 4%	2 98%
November 1, 2003 3 year	7 315	26 4046	22 9689	31 90%	39	1 6%	2 32%
November 1, 2003 5 year	8 488	26 4046	22 9689	31 90%	63	1 6%	2 32%
November 1, 2004 3 year	8 725	28 5127	22 9785	28 30%	39	1 3%	3 01%
November 1, 2004 5 year	9 153	28 5127	22 9785	28 30%	63	1 3%	3 01%
December 1, 2005 3 year	8 612	31 3655	26 6926	25 80%	39	1 5%	3 78%
December 1, 2005 5 year	9 938	31 3655	26 6926	25 20%	63	1 5%	3 81%
November 7, 2006 3 year	7 913	36 5255	32 8724	16 59%	39	1 5%	4 85%
November 7, 2006 5 year	11 117	36 5255	32 8724	24 18%	63	1 5%	4 63%

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information

The total expenses recognised for the period arising from share based payments are as follows

	2006 £000	2005 £000
Equity settled share based payments	991	809
Cash settled share based payments	388	316
	<hr/>	<hr/>
	1,379	1,125
	<hr/>	<hr/>
Total carrying amount of liabilities	<u>1,023</u>	<u>1,067</u>