

**Thales Missile Electronics Limited**

**Annual report and accounts**  
for the year ended 31 December 2012

Registered number **3004769**

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## Directors' Report

The Directors present their annual report and financial statements, together with the auditor's report, for the year ended 31 December 2012

### Principal activities

The Company's principal activities are the development and production of electronics (fuzes, seekers) for missiles

The Company's main customers are European and US missile makers. The Company's research and development programmes are concentrated on the continued evolution of its products, and are typically funded by government agencies.

### Business review

Revenue has reduced from £43,547,000 to £39,925,000, as turnover tends to be cyclical depending on the stage of the contract (ie development/production stages). The business remains profitable throughout the latest financial year.

	2012	2011
		£000
Turnover	39,925	43,547
Operating Profit	6,842	6,947
Profit after tax	4,769	5,192
Net Assets	31,071	26,153
<hr/>		
Number of Employees (No)	192	203

In 2012, the Company continued to invest in Research and Development with spend of £718,000 (2011 - £593,000). The Directors expect the general level of activity to continue. Future prospects are likely in both the domestic and export markets, particularly in the United States.

### Dividends

The Directors do not recommend the payment of a dividend (2011 - £Nil).

### Financial risk management objectives and policies

The Company's principal financial instruments, other than derivatives, comprise cash and short-term deposits. The main purpose of these financial instruments is to raise finance for the Company's operations. The Company has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

The Company also enters into derivative transactions, in the form of forward currency contracts. The purpose is to manage currency risks arising from the Company's operations and its sources of finance.

## Directors' Report (continued)

It is, and has been throughout the year under review, the Company's policy that no trading in financial instruments shall be undertaken

The main risks arising from the Company's financial instruments are foreign currency risk and credit risk. The board reviews and agrees policies for managing each of these risks and they are summarised below. The Company's accounting policies in relation to derivatives are set out in Note 2.

### Foreign currency risk

The Company also has transactional currency exposures. Such exposure arises from sales or purchases by the Company in currencies other than the unit's functional currency. Approximately 30% of the Company's sales are denominated in currencies other than the functional currency of the operating unit making the sale, whilst 1% of costs related to those sales are denominated in the unit's functional currency. The Company uses forward currency contracts to eliminate the currency exposures on any individual transactions in excess of €100,000 for which payment is anticipated more than one month after the Company has entered into a firm commitment for a sale or purchase. The forward currency contracts must be in the same currency as the hedged item. It is the Company's policy not to enter into forward contracts until a firm commitment is in place.

It is the Company's policy to negotiate the terms of the hedge derivatives to match the terms of the hedged item to maximise hedge effectiveness.

At 31 December 2012, the Company had hedged approximately 95% of its foreign currency sales for which firm commitments existed at the date of the statement of financial position, extending to December 2013.

### Credit risk

The Company's principal financial assets are bank balances and cash, trade and other receivables.

The Company trades only with recognised, creditworthy third parties. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. This may also involve the negotiation of third party guarantees of customer creditworthiness. In addition, receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant.

With respect to credit risk arising from the other financial assets of the Company, which comprise cash and cash equivalents, available-for-sale financial assets and certain derivative instruments, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

The Company has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

### Going concern accounting basis

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the business review on page 1. In addition, the notes to the accounts include the Company's objectives, policies and processes for managing its capital and details of its financial instruments and hedging.

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## Directors' Report (continued)

activities. The Company's financial risk management objectives and its exposures to credit and liquidity risk are set out in the preceding paragraphs.

The Company has considerable financial resources together with long-term contracts with a number of customers and suppliers across different geographic areas and industries. As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook.

The Directors have a reasonable expectation that the Company has sufficient resources to continue in operational existence for the foreseeable future and therefore they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

### **Environmental information**

The Thales Group in the UK has implemented an Environmental Policy to conduct our current and future business in a way that protects the environment. This is achieved through development and implementation of Environmental Management Systems against which we report environmental performance regularly to the Thales Holding UK plc board. It is a Thales requirement that operating companies are certified to the International Standard for Environmental Management Systems ISO 14001 to which we have been certified. Current Environmental Programmes include reducing our carbon footprint and implementing a Green Purchasing programme.

## Directors' Report (continued)

### Directors

The Directors who served during the year were as follows

A C K Cresswell

E A McCrone

Alex Cresswell resigned from the board on 1 April 2013 and Marion Broughton was elected in replacement

### Directors' liabilities

The Company has not granted any indemnity against liability to its Directors during the year or at the date of approving the Directors' Report

### Supplier payment policy

It is the Company's normal practice to make payments to suppliers promptly provided that the supplier has performed in accordance with the relevant terms and conditions

Creditors days at 31 December 2012, based on the aggregate of the amounts which were owed to trade payables at that date and the aggregate of the amounts which the Company was invoiced by suppliers during the year, amounted to 53 days (2011 - 34 days)

### Employee matters

People are the Company's greatest assets. With growing competition, attracting and retaining quality workers from the local community is key. Therefore it makes good business sense to incorporate attractive employment policies and principles with the view to creating a skilled, happy, diverse, proud and motivated workforce. This is what the Company tries to achieve.

### Disabled employees

The Company's attitude concerning the employment of disabled persons is the same as that relating to all other staff in matters of recruitment, continuity of employment, training, development and promotion. Nevertheless the Company is very conscious of the difficulties experienced by the disabled and takes account sympathetically of individual circumstances.

### Employee consultation

Employee involvement and commitment is the established responsibility of the Board of Directors and requires their participation. Regular contact and exchanges of information between managers and staff are maintained through departmental managers, the staff council, trade union representatives and social functions. The Company promotes the principle of team briefing on a regular and continuing basis with the aim of ensuring that all employees are personally advised of the financial and commercial progress of the Company.

## Directors' Report (continued)

### Donations

During the period to 31 December 2012 charitable donations of £1,500 (2011 £ 2,400) were made

No political donations were made during the year

### Disclosure of information to the auditors

So far as each person who was a Director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of the auditor, the Director has taken all the steps he is obliged to take as a Director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

### Auditors

In accordance with section 489 of the Companies Act 2006, the Company has not elected to re-appoint its auditors annually and Ernst & Young LLP will therefore continue in office.

2 Dashwood Lang Road  
The Bourne Business Park  
Addlestone, nr Weybridge  
Surrey KT15 2NX

On behalf of the Board



M Broughton

Director

Date 30 September 2013

## Statement of Directors' responsibilities

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 financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted for use in the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they 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 accounting estimates that are reasonable and prudent,
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements,
- provide additional disclosures when compliance with specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance, 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 adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

## Independent auditor's report to the shareholders of Thales Missile Electronics Limited

We have audited the financial statements of Thales Missile Electronics Limited for the year ended 31 December 2012 which comprise the Statement of Financial Position, the Statement of Comprehensive Income, the Statement of Changes in Equity, the Statement of Cash Flow and the related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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

As explained more fully in the Directors' Responsibilities Statement set out on page 6, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements.

In addition, we read the financial and non-financial information in the Directors' report and accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements we consider the implications of our report.

### Opinion on the financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent auditor's report to the shareholders of Thales Missile Electronics Limited  
(continued)

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

*Ernst & Young LLP*

J I Gordon (Senior Statutory Auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
London

Date 30 September 2013

Statement of comprehensive income  
for the year ended 31 December 2012

	Note	2012 £000	2011 £000
<b>Continuing operations</b>			
Revenue	4	39,925	43,547
Cost of sales		<u>(26,890)</u>	<u>(31,149)</u>
<b>Gross profit</b>		13,035	12,398
Administrative expenses		(6,193)	(5,451)
<b>Operating profit</b>		<u>6,842</u>	<u>6,947</u>
Finance income	6	215	166
Finance expenses	7	(448)	(190)
Other Operating expenses	7	<u>(634)</u>	<u>-</u>
<b>Profit before tax</b>		5,975	6,923
Income tax expense	9	<u>(1,206)</u>	<u>(1,731)</u>
<b>Profit for the year</b>		<u>4,769</u>	<u>5,192</u>
<b>Other comprehensive income for the year, net of tax</b>			
Net movement on cash flow hedges		<u>147</u>	<u>(118)</u>
<b>Total comprehensive income for the year</b>		<u>4,918</u>	<u>5,074</u>

The accompanying notes are an integral part of this statement of comprehensive income

Statement of financial position  
for the year ended 31 December 2012

Company Registered Number 3004769

	Note	2012 £000	2011 £000
<b>ASSETS</b>			
<b>Non-current assets</b>			
Other Intangible assets	10	-	-
Other non-current financial assets	19	-	1,128
Property, plant & equipment	11	1,195	1,181
Deferred tax asset	20	1,243	1,072
		<u>2,438</u>	<u>3,381</u>
<b>Current assets</b>			
Inventories	12	2,732	2,182
Trade and other receivables	13	7,201	10,219
Cash and cash equivalents	15	43,146	37,765
Derivative financial instruments	18	235	186
		<u>53,314</u>	<u>50,352</u>
<b>Total assets</b>		<u>55,752</u>	<u>53,733</u>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade and other payables	16	(21,499)	(22,201)
Current tax liabilities		(2,000)	(1,783)
Provisions	17	(1,120)	(3,371)
Derivative financial instruments	18	(62)	(225)
		<u>(24,681)</u>	<u>(27,580)</u>
<b>Net current assets</b>		<u>28,633</u>	<u>22,772</u>
<b>Total liabilities</b>		<u>(24,681)</u>	<u>(27,580)</u>
<b>Net assets</b>		<u>31,071</u>	<u>26,153</u>

Statement of financial position (continued)  
for the year ended 31 December 2012

Company Registered Number: 3004769

**EQUITY**

Share capital	21	-	-
Capital reserves		1,747	1,747
Other reserves		154	152
Hedging reserves		119	(28)
Retained earnings		29,051	24,282
<b>Total equity</b>		<u>31,071</u>	<u>26,153</u>
<b>Total equity and liabilities</b>		<u>55,752</u>	<u>53,733</u>

The accounts on pages 9 to 51 were approved by the board of directors and authorised for issue on 30 September 2013. They were signed on its behalf by



M Broughton

Director

The accompanying notes are an integral part of this statement of financial position

Statement of changes in equity  
for the year ended 31 December 2012

Attributable to equity holders of the Company

	Share capital £000 (Note 21)	Other reserves £000	Hedging reserves £000	Retained Earnings £000	Total equity £000
<b>At 1 January 2011</b>	-	1,894	90	19,090	21,074
Profit for the year	-	-	-	5,192	5,192
Net movement on cash flow hedges	-	-	(118)	-	(118)
Total comprehensive income	-	-	(118)	5,192	5,074
Share options granted in the year	-	5	-	-	5
<b>At 31 December 2011</b>	-	1,899	(28)	24,282	26,153
Profit for the year	-	-	-	4,769	4,769
Net movement on cash flow hedges	-	-	147	-	147
Total comprehensive income	-	-	147	4,769	4,916
Share options granted in the year	-	2	-	-	2
<b>At 31 December 2012</b>	-	1,901	119	29,051	31,071

A capital reserve of £1,747,000 was granted in 1996 by the Company's immediate parent company. It is to be held by the Company as a contribution to its permanent capital as a non-distributable reserve. This has now been included in the "other" reserve.

Other reserves are in respect of share-based payments plus the former capital reserve.

Hedging reserves represent the cash flow hedge in equity in accordance with IAS 39.

**Statement of cash flows**  
for the year ended 31 December 2012

	Notes	2012 £000	2011 £000
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>			
Profit before tax from continuing operations		5,975	6,923
Non-cash adjustments to reconcile profit before tax to net cash flows,			
Depreciation of property, plant & equipment	5,11	181	153
Investment income	6	(215)	(166)
Finance costs	7	448	190
Amortisation & impairment of intangible assets	5,10	-	447
Cash flow hedges		(20)	-
Decrease in retirement benefit obligations	19	680	(35)
Decrease in provisions	17	(2,251)	1,647
Share-based payments	23	2	5
Working capital adjustments			
Decrease/(increase) in inventories	12	(550)	(818)
(Increase)/decrease in construction contracts work-in-progress	14	(590)	(272)
(Increase)/decrease in receivables		3,369	(3,973)
Increase/(decrease) in payables		(463)	4,404
		6,566	8,505
Income taxes paid	9	(1,205)	(620)
<b>Net cash from operating activities</b>		<b>5,361</b>	<b>7,885</b>
<b>INVESTING ACTIVITIES</b>			
Interest received	6	215	166
Proceeds on disposal of property, plant and equipment		-	-
Purchases of property, plant and equipment	11	(195)	(348)
<b>Net cash used in investing activities</b>		<b>20</b>	<b>(182)</b>
<b>Net increase in cash &amp; cash equivalents</b>		<b>5,381</b>	<b>7,703</b>
<b>Cash &amp; cash equivalents at beginning of year</b>	15	<b>37,765</b>	<b>30,062</b>
<b>Cash &amp; cash equivalents at end of year</b>	15	<b>43,146</b>	<b>37,765</b>

## Notes to accounts for the year ended 31 December 2012

### 1. Corporate Information

The financial statements for the year ended 31 December 2012 were authorised for issue in accordance with a resolution of the directors on 30 September 2013. The Company is a limited Company incorporated and domiciled in England & Wales. The address of the registered office is given on page 5. The nature of the Company's operations and principal activities are set out in the Directors' report. Information on its ultimate parent is presented in note 25.

### 2. Accounting Policies

#### Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS's) adopted for use in the European Union and therefore comply with Article 4 of the EU IAS regulations. The financial statements have been prepared on a historical cost basis (except for investment properties, land and buildings, derivative financial instruments and available for sale financial assets that have been measured at fair value). The carrying values of recognised assets and liabilities that are designated as hedged items in fair value hedges that would otherwise be carried at amortised cost are adjusted to record changes in the fair values attributable to the risks that are being hedged in effective hedge relationships. The financial statements are presented in pounds sterling, the currency in which the majority of the Company's transactions are denominated, and all values are rounded to the nearest thousand, (£000), except when otherwise indicated.

The principal accounting policies adopted are set out below.

#### Going concern basis

After making enquiries on 30 September 2013, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Notes to accounts (continued)  
for the year ended 31 December 2012

**Intangible fixed assets**

*Research and development*

Research expenditure is written off as incurred. Development expenditure is also written off, except where the Directors are satisfied that all the following conditions are met:

- an asset is created that can be identified,
- it is probable that the asset created will generate future economic benefits, and
- the development cost of the asset can be measured reliably

In such cases, an internally generated intangible asset is recognised and amortised on a straight-line basis over its useful life.

*Patents and trademarks*

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

**Property, plant and equipment**

Properties in the course of construction for production, rental or administrative purposes, or for purposes not yet determined, are carried at cost, less any recognised impairment loss. Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with Thales Group's accounting policy. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Land, buildings, fixtures and equipment are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets, other than investment properties and freehold land, at rates calculated to write off the cost or valuation, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

Leasehold land and buildings	10 years/ 10% per annum/term of lease
Plant and machinery	5 years/ 20% per annum
Fixtures & fittings	5 years/ 20% per annum
Computers	3 years/ 33% per annum

Residual value is calculated on prices prevailing at the date of acquisition or revaluation and is revised annually.

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of comprehensive income when the asset is derecognised.

Notes to accounts (continued)  
for the year ended 31 December 2012

Interest costs incurred in bringing assets to a state where they are ready to be used are capitalised as part of the costs of the asset

**Impairment of property, plant and equipment and intangible assets**

At each reporting date the Company reviews the carrying amounts of its property, plant and equipment 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 the impairment loss, (if any)

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.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, 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 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 in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, 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.

**Financial instruments**

Financial assets and financial liabilities are recognised on the Company's statement of financial position when the Company becomes a party to the contractual provisions of the instrument.

**Trade receivables**

Trade receivables are carried at fair value (in the majority of cases this will equate to original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts at the year-end). Bad debts are written off when identified. Long term receivables are discounted where necessary.

**Cash and cash equivalents**

Cash and cash equivalents comprise cash on hand and demand deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

**Financial liabilities and equity**

Financial liabilities and equity instruments issued by the Company are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities. The accounting policies adopted for specific financial liabilities and equity instruments are set out below.

Notes to accounts (continued)  
for the year ended 31 December 2012

**Bank borrowings**

Interest-bearing bank loans and overdrafts are initially recorded at the proceeds received, net of direct issue costs, and are subsequently measured at amortised cost, using the effective interest rate method. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised over the term of the borrowings in accordance with the Company's accounting policy for borrowing costs.

**Trade payables**

Trade payables are initially measured at fair value and are subsequently measured at amortised cost using the effective interest rate method.

**Derivative financial instruments and hedge accounting**

The Company's activities expose it primarily to the financial risks of changes in foreign exchange rates. The Company uses derivative financial instruments (primarily foreign currency forward contracts) to hedge its risks associated with foreign currency fluctuations relating to certain firm commitments and forecasted transactions.

The use of financial derivatives is governed by the Company's policies approved by the board of Directors, which provide written principles on the use of financial derivatives consistent with the Company's risk management strategy.

The Company does not use derivative financial instruments for speculative purposes.

Derivative financial instruments are initially measured at fair value on the contract date, and are remeasured to fair value at subsequent reporting dates. Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in profit or loss. The Company's policy with respect to hedging the foreign currency risk of a firm commitment is to designate it as a cash flow hedge. If the cash flow hedge of a firm commitment or forecasted transaction results in the recognition of an asset or a liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in profit or loss in the same period in which the hedged item affects profit or loss.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in profit or loss as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, for forecast transactions, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to profit or loss for the period.

Derivatives embedded in other financial instruments or other non-financial host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value with unrealised gains or losses reported in profit or loss.

**Notes to accounts (continued)**  
for the year ended 31 December 2012

**Government grants**

Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with

Government grants relating to property, plant and equipment are included in non-current liabilities as deferred income and credited to the statement of comprehensive income on a straight line basis over the expected useful lives of the assets concerned

Other grants are credited to the statement of comprehensive income as the related expenditure is incurred

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost includes materials, direct labour and an attributable proportion of manufacturing overheads based on normal levels of activity. Cost is calculated using the first-in-first-out method. Net realisable value is based on estimated selling price, less further costs expected to be incurred to completion and disposal. Provision is made for obsolete, slow-moving or defective items where appropriate. Un-invoiced research and development fully funded by customers is carried forward as work in progress

**Construction contracts**

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable, and contract costs are recognised when incurred

When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs are recognised over the period of the contract, respectively, as revenue and expenses. The Company uses the percentage of completion/technical milestone method to determine the appropriate amount of revenue and costs to recognise in a given period. This is normally measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately

In determining costs incurred up to the year end, any costs relating to future activity on a contract are excluded and are shown as contract work in progress. The aggregate of the cost incurred and the profit/loss recognised on each contract is compared against the progress billings up to the year end

Where costs incurred and recognised profits (less recognised losses) exceed progress billings, the balance is shown as due from the customers on construction contracts, under receivables and prepayments. Where the progress billings exceed costs incurred plus recognised profits (less recognised losses), the balance is shown as due to customers on construction contracts, under trade and other payables

Notes to accounts (continued)  
for the year ended 31 December 2012

**Taxation**

The tax charge comprises current and deferred tax. Income tax expense is recognised in the income statement except to the extent that it relates to items recognised directly in equity in which case it is recognised in equity. Current tax is the expected tax payable on the profit for the year and any adjustments in respect of previous years using tax rates enacted or substantively enacted at the reporting date.

Deferred tax is recognised using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes, and the amounts used for taxation purposes. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax is provided using rates of tax that have been enacted or substantively enacted at the balance sheet date or the date that the temporary differences are expected to reverse. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

**Leases**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

*Lessee activities*

Assets held under finance leases are recognised as assets at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets in which case they are capitalised in accordance with the Company's policy on borrowing costs.

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

**Notes to accounts (continued)**  
for the year ended 31 December 2012

**Revenue recognition**

Revenue represents the fair value of consideration received or receivable for goods and services provided in the normal course of business, net of trade discounts, VAT and other sales related taxes

Sales of goods are recognised when goods are delivered and title has passed

Operating revenue from services provided are recognised insofar as the transaction has been completed on the reporting date

Revenue from construction contracts is recognised in accordance with the Company's accounting policy on construction contracts as previously detailed in this note

Interest income is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable

**Retirement benefit costs**

Payments to defined contribution retirement benefit plans 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 plans where the Company's obligations under the plans are equivalent to those arising in a defined contribution retirement benefit plan

For defined benefit retirement benefit plans, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being updated to each reporting date. Actuarial gains and losses that exceed 10 per cent of the greater of the present value of the Company's defined benefit obligation and the fair value of plan assets are amortised over the expected average remaining working lives of the participating employees

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

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

The expected return on plan assets and the interest cost on scheme liabilities are included within financial income and expense in the statement of comprehensive income

Notes to accounts (continued)  
for the year ended 31 December 2012

**Foreign currencies**

Transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing on the dates of the transactions. At each reporting date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the reporting date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the period except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are recognised directly in equity.

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

**Provisions**

Provisions are recognised when the Company has a present obligation as a result of a past event, and it is probable that the Company will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the reporting date, and are discounted to present value where the effect is material.

**Share-based payments**

Share options granted by the Company's parent to its employees are accounted for in accordance with the requirements of IFRS 2.

The Company issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. Thales Group uses a binomial model to measure the amount of the benefit to employees receiving the options granted. The fair value of such options is determined at the date of grant. The amounts thus obtained are taken to statement of comprehensive income over the vesting period of the rights. Recognition in the statement of comprehensive income is linear over the vesting period of each scheme. No expense is recognised for options that do not ultimately vest, with the exception of options where vesting is conditional upon a market condition.

This expense is included in income from operations and a corresponding credit is recognised increasing retained earnings. It thus has no effect on the overall amount of shareholders' funds.

**Free Shares**

During the period ended 31 December 2012, the company has recorded an expense of £25,862 relating to the free shares. The assumptions used in the valuation of the free shares have been included in the share options disclosures on Page 49.

**Significant accounting judgements, estimates and assumptions**

The preparation of financial statements requires the Company to make estimates and assumptions that affect the application of policies and reported amounts. Estimates and judgements are continually evaluated and are based on

Notes to accounts (continued)  
for the year ended 31 December 2012

historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The estimates and assumptions which have a significant risk of causing a material adjustment to the carrying amount of assets recognised in the financial statements are listed below.

*Deferred Tax Recognition*

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits. Further details on deferred tax asset recognition are disclosed in Note 20.

*Post-retirement benefits*

The determination of the pension cost and retirement benefit obligation of the Company's share of the Thales UK group's defined benefit pension schemes is dependent upon the selection of certain assumptions which include the discount rate, inflation rate, salary growth, mortality and expected return on scheme assets. Differences arising from actual experiences will be reflected in future years.

*Long-term contracts*

Long-term contract arrangements are accounted for in accordance with IAS 11. This requires judgements to estimate future expected costs to be incurred.

Notes to accounts (continued)  
for the year ended 31 December 2012

### 3 Application of new and revised International Financial Reporting Standards (IFRSs)

#### New and amended standards and interpretations

The accounting policies adopted are consistent with those of the previous financial year except for the following new and amended International Financial Reporting Standards (IFRS's) and International Financial Reporting Interpretations Committee (IFRIC) interpretations effective as of 1 January 2012,

**Amendments to IFRS 7 Disclosures – transfers of financial assets in the current year.** The amendments enhance existing disclosure requirements for transferred financial assets that are not derecognised and require additional disclosure on an entity's continuing involvement in derecognised assets. This had no material impact on the financial position or performance of the Company in the current or prior year, as the Company use the cost model rather than the fair value model

**Income Tax (IAS 12 - Amended)** The amendment states that the measurement of associated deferred tax arising on investment properties that are measured using the fair value model under IAS 40 "investment properties" should reflect the presumption that the carrying amount of the underlying asset will, normally, be recovered through sale rather than use. This had no material impact on the financial position or performance of the Company in the current or prior year

#### New standards issued but not yet effective

Standards issued but not yet effective up to the date of issuance of the Company's financial statements are listed below. The listing is of standards and interpretations issued, which the Company reasonably expects to be applicable at a future date. The Company does not intend to adopt those standards until they become effective.

The new standards are

**Presentation of Financial Statements (IAS 1):** The amendment is to the presentation of other comprehensive income (OCI), those items of OCI that could be reclassified to profit or loss at a future date will be presented separately from those items that will never be reclassified to profit or loss. The amendment to IAS 1 is effective for annual periods beginning on or after 1 July 2012 and the adoption of the amendment is not expected to have a material impact on the results of the Company.

**Employee Benefits (IAS 19 - Amended):** The amendment provides three key changes to the requirements for post-employment benefits: firstly, the elimination of the option to defer the recognition of actuarial gains and losses, known as the 'corridor approach', secondly improving the presentational requirements for movements in defined benefit plan assets and liabilities, and thirdly, enhancing the disclosure requirements to provide better information about the characteristics and risks of defined benefit plans. The presentational requirements will result in the service cost and net interest cost being presented within profit or loss, and all re-measurement changes to be presented with other comprehensive income. The amendment has also changed the definition of a curtailment and requires all past service costs to be recognised immediately in profit or loss.

IAS 19 is effective for annual periods beginning on or after 1 January 2013 and the company intends to adopt this new standard with effect from that date. The evaluation of the effect of adoption of IAS 19 has not yet been completed.

## Notes to accounts (continued)

for the year ended 31 December 2012

**Financial Instruments (IFRS 9)** This standard is the first step in the process to replace IAS 39 "Financial Instruments recognition and measurement". It introduces new requirements for the classification and measurement of financial assets with all recognised financial assets that are within the scope of IAS 39 to be subsequently measured at amortised cost or fair value. In addition, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment in other comprehensive income with only dividend income generally recognised in profit or loss.

With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in fair value attributable to changes in credit risk is presented in other comprehensive income unless recognition would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to credit risk are not subsequently reclassified to profit or loss.

This is effective for annual periods beginning on or after 1 January 2015. The effect of adoption of IFRS 9 has not yet been evaluated.

**Consolidation, joint arrangements, associates and disclosures (IFRSs 10, 11 & 12, IAS 27 & 28):** In May 2011 a package of five standards on consolidation, joint arrangements, associates and disclosures was issued.

Under IFRS 10 there is only one basis for consolidation and that is control. Control has a new definition under IFRS 10 that contains three elements, power over an investee, exposure or rights to variable returns from its involvement with the investee and the ability to use its power over the investee to affect returns.

IFRS 11 classifies joint arrangements as either joint operations or joint ventures with joint ventures required to be accounted for using the equity method of accounting.

IFRS 12 introduces more extensive disclosure requirements than under existing standards.

These new standards are effective for annual periods beginning on or after 1 January 2013 and the company intends to adopt them from this date. Adoption of these standards is not expected to have a significant impact on the Company.

**Fair Value Measurement (IFRS 13):** This new standard sets out a comprehensive framework for defining and measuring fair value and also includes additional disclosure requirements about fair value measurements. The standard does not extend the use of fair value accounting, but brings together all the requirements for how to measure and disclose information about fair value under all circumstances into this one standard. IFRS 13 is effective for annual periods beginning on or after 1 January 2013 and the company intends to adopt it from this date. The adoption of IFRS 13 is not expected to have a significant impact on the business.

**Financial Instruments, presentation (IAS 32 - Amended) & disclosure (IFRS 7 - Amended)** These amendments introduce new disclosure requirements regarding the effect of offsetting financial assets and financial liabilities on the balance sheet. The amendments to IFRS 7 are effective for annual periods beginning on or after 1 January 2013 and the amendments to IAS 32 effective for annual periods beginning on or after 1 January 2014. Thales intends to adopt these amendments with effect from 1 January 2013 and 1 January 2014 respectively. The evaluation of the effect of the adoption of these standards has not yet been completed.

Notes to accounts (continued)  
for the year ended 31 December 2012

**Improvements to IFRSs (Issued in May 2012)**

The IASB issued improvements to IFRSs, an omnibus of amendments to its IFRS standards. The amendments are effective for annual periods beginning on or after 1 January 2013 and include

- Amendments to IAS 16 Property, Plant and Equipment
- Amendments to IAS 32 Financial Instruments Presentation

**Amendments to IAS 16.** The amendments clarify that spare parts, stand-by equipment and servicing equipment should be classified as property, plant and equipment when they meet the definition of property, plant and equipment in IAS 16 and as inventory otherwise. The Directors do not anticipate that the amendments to IAS 16 will have a significant impact on the Company's financial statements.

**Amendments to IAS 32.** The amendments clarify that income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction should be accounted for in accordance with IAS 12 "Income Taxes". The Directors do not anticipate that the amendments to IAS 32 will have any impact on the Company's financial statements.

Notes to accounts (continued)  
for the year ended 31 December 2012

**4 Revenue**

An analysis of the Company's revenue is as follows

	2012 £000	2011 £000
<b>Sale of goods</b>	<b>7,917</b>	<b>23,416</b>
Revenue from construction contracts	10,208	3,736
Rendering of services	21,800	16,395
Revenue per statement of comprehensive income	39,925	43,547
Finance income	215	166
Revenue as defined in IAS18	40,140	43,713

**5. Operating profit**

Operating profit is stated after charging/(crediting)

	2012 £000	2011 £000
Net foreign exchange (gains)/ losses	(6)	9
Research and development costs	718	593
Depreciation of property, plant and equipment	181	153
Operating lease expenses (note 24)	123	206
Amortisation of intangible assets included in other operating expenses	-	447
Cost of inventories recognised as an expense	26,890	31,149
Staff costs (note 8)	9,453	10,229
Warranty provisions	(131)	-
Auditors' remuneration - for audit services	40	39
- non-audit services	-	3

Notes to accounts (continued)  
for the year ended 31 December 2012

**6 Finance Income**

	2012 £000	2011 £000
Interest on bank deposits	215	166
	<u>215</u>	<u>166</u>

**7. Finance costs**

	2012 £000	2011 £000
Interest on pension fund liabilities (net) (note 19)	(448)	(190)
Total finance costs	<u>(448)</u>	<u>(190)</u>

**8. Staff costs**

The average monthly number of employees (including executive Directors) was

	2012 Number	2011 Number
Programmes	19	20
Technical	14	13
Production and Materials	124	130
Sales, Commercial and Marketing	12	14
Management/Administration	23	26
	<u>192</u>	<u>203</u>

	2012 £000	2011 £000
Their aggregate remuneration comprised		-
Wages and salaries	7,889	8,574
Social security costs	861	938
Post employment benefits costs (see note 19)	701	712
Share-based payment expense (see note 23)	2	5
	<u>9,453</u>	<u>10,229</u>

Notes to accounts (continued)  
for the year ended 31 December 2012

**8 Staff costs (continued)**

**Directors' Remuneration**

Remuneration	2012 £000	2011 £000
Remuneration of directors	113	194
Gains made on the exercise of share options	—	—
Pension scheme contributions	24	40
	Number	Number
During the period the following number of Directors		
Accrued benefits under defined benefit pension schemes	2	3
Exercised share options	-	1
Received entitlement to shares under long term incentive schemes	1	3

**9. Income tax expense**

	2012 £000	2011 £000
<b>Current tax:</b>		
Current income tax expense	1,591	1,783
Adjustments in respect of current income tax of previous year	(168)	(49)
<b>Total current tax</b>	<u>1,423</u>	<u>1,734</u>
<b>Deferred tax</b>		
Origination and reversal of timing differences	(217)	(3)
<b>Total deferred tax</b>	<u>(217)</u>	<u>(3)</u>
<b>Total tax charge for the year</b>	<u>1,206</u>	<u>1,731</u>

Notes to accounts (continued)  
for the year ended 31 December 2012

**9 Income tax expense (continued)**

The tax charge for the year can be reconciled to the statement of comprehensive income as follows

	2012 £000	2011 £000
<b>Profit on ordinary activities before tax</b>	<b>5,975</b>	<b>6,923</b>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 24.5% (2011: 26.5%)	1,464	1,834
Tax effect of		
Expenses not deductible for tax purposes	7	15
Enhanced research & development tax reduction	(202)	(152)
Deferred tax rate change impact movement	105	83
Adjustments to prior year (current tax)	(168)	(49)
<b>Total tax charge for the year</b>	<b>1,206</b>	<b>1,731</b>

In addition to the amount charged to the statement of comprehensive income deferred tax has been charged directly to equity as detailed below

	2012 £000	2011 £000
Net loss on revaluation of cash flow hedges	45	(51)
<b>Deferred tax expense reported in other comprehensive income</b>	<b>45</b>	<b>(51)</b>

Finance Act 2012 reduced the main rate of UK corporation tax to 23% with effect from 1 April 2013. As this rate has been substantively enacted at the balance sheet date, the deferred tax figures within these accounts have been calculated at this rate.

The Chancellor announced in the Budget on 20 March 2013 that the full rate of UK corporation tax would reduce by a further two percent to 21% from 1 April 2014, followed by a further one percent to 20% from 1 April 2015. The effect of this subsequent rate reduction on deferred tax balances has not been reflected in these accounts due to the relevant legislation not having been substantively enacted at the balance sheet date.

A reduction to 20% would reduce the company's deferred tax asset by approximately £162,000.

Notes to accounts (continued)  
for the year ended 31 December 2012

**10. Intangible assets**

	Patents & trademarks £000
<b>Cost</b>	
<b>At 1 January 2011</b>	<b>1,165</b>
Additions	-
At 31 December 2011	1,165
Additions	-
At 31 December 2012	1,165
<b>Amortisation and Impairment</b>	
At 1 January 2011	718
Charge for the year	447
At 31 December 2011	1,165
Charge for the year	-
At 31 December 2012	1,165
<b>Carrying amount</b>	
At 31 December 2012	-
At 31 December 2011	-
At 1 January 2011	447

During 2011 the carrying value of the Company's intangible assets were fully impaired based on the Directors assessment of their future recoverable value. Previously, patents and trademarks were amortised over their estimated useful lives, which was an average of 5 years.

Notes to accounts (continued)  
for the year ended 31 December 2012

**11. Property, plant and equipment**

	Leasehold improvements £000	Plant and machinery £000	Fixtures & Fittings £000	Total £000
<b>Cost or valuation</b>				
At 1 January 2011	4,732	2,129	1,480	8,341
Additions	-	343	5	348
Disposals	-	-	-	-
At 31 December 2011	4,732	2,472	1,485	8,689
Additions	-	195	-	195
Disposals	-	-	-	-
At 31 December 2012	4,732	2,667	1,485	8,884
<b>Accumulated depreciation and impairment</b>				
At 1 January 2011	4,367	1,552	1,436	7,355
Charge for the year	70	75	8	153
Disposals	-	-	-	-
At 31 December 2011	4,437	1,627	1,444	7,508
Charge for the year	70	103	8	181
Disposals	-	-	-	-
At 31 December 2012	4,507	1,730	1,452	7,689
<b>Carrying amount</b>				
At 31 December 2012	225	937	33	1,195
At 31 December 2011	295	845	41	1,181
At 1 January 2011	365	577	44	986

Notes to accounts (continued)  
for the year ended 31 December 2012

**12. Inventories**

	2012 £000	2011 £000
Work-in-progress	2,732	2,182
	<u>2,732</u>	<u>2,182</u>

**13. Trade and other receivables**

	2012 £000	2011 £000
Amounts receivable from the sale of goods	5,799	9,168
Amounts receivable from construction contract customers (note 14)	1,402	1,051
	<u>7,201</u>	<u>10,219</u>

At 31 December the aged trade receivables analysis is as follows

	Total £000	Neither past due nor impaired £000	Overdue less than 3 months £000	Overdue 3 to 6 months £000	Overdue more than 6 months £000
<b>2012</b>					
Amounts receivable from the sale of goods	<u>5,799</u>	<u>5,491</u>	<u>308</u>	<u>-</u>	<u>-</u>
<b>2011</b>					
Amounts receivable from the sale of goods	<u>9,168</u>	<u>8,857</u>	<u>295</u>	<u>16</u>	<u>-</u>

Notes to accounts (continued)  
for the year ended 31 December 2012

**14 Construction contracts**

	2012 £000	2011 £000
Contracts in progress at date of statement of financial position		
Amounts due from contract customers included in trade and other receivables	1,402	1,051
Amounts due to contract customers included in trade and other payables	(240)	(479)
	<u>1,162</u>	<u>572</u>
Contract costs incurred plus recognised profits less recognised losses to date	145,496	136,007
Less progress billings	(144,334)	(135,435)
	<u>1,162</u>	<u>572</u>

At 31 December 2012, retentions held by customers for contract work amounted to nil (2011 £Nil) Advances received from customers for contract work amounted to £3,014,000 (2011 £3,640,000)

At 31 December 2012, amounts of nil (2011 £Nil) included in trade and other receivables and arising from construction contracts are due for settlement after more than 12 months

**15. Cash and cash equivalents**

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

**16. Trade and other payables**

	2012 £000	2011 £000
Trade payables and accruals	21,259	21,722
Amounts due to construction contract customers (note 14)	240	479
	<u>21,499</u>	<u>22,201</u>

The Directors consider that the carrying amount of trade payables approximates their fair value.

The average credit period taken for trade purchases is 53 days (2011 34 days)

Notes to accounts (continued)  
for the year ended 31 December 2012

**17. Provisions**

	Warranty Provisions £000	Future Cost Provisions £000	Other Provisions £000	Total £000
<b>At 1 January 2012</b>	524	2,803	44	3,371
Additional provision/(release) in the year	(131)	538	(44)	363
<b>Utilisation of provision</b>	-	<b>(2,614)</b>	-	<b>(2,614)</b>
<b>At 31 December 2012</b>	<b>393</b>	<b>727</b>	-	<b>1,120</b>
			2012 £000	2011 £000
Included in current liabilities			1,120	3,371
			<b>1,120</b>	<b>3,371</b>

The provision for post-sale rectification and support costs relates to anticipated costs to be borne by the Company in respect of rectification and support of products already delivered to customers and will be utilised over 3 years. The balance of the provision represents future cost provision for existing contracts.

**18. Financial instruments**

**Fair value**

Set out below is a comparison of the carrying amounts and fair value of all of the Company's financial instruments, including those classified under discontinued operations that are carried in the financial statements.

As at 31 December 2012 the Company held the following financial instruments measured at fair value:

	2012		2011	
	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000
<b>Financial assets</b>				
Cash	43,146	43,146	37,765	37,765
Trade and other receivables	7,201	7,201	10,219	10,219
Derivative financial instruments	235	235	186	186
<b>Financial liabilities</b>				
Trade and other payables	21,499	21,499	22,201	22,201
Derivative financial instruments	62	62	225	225

The carrying amount of the assets above represents the Company's maximum exposure to credit risk.

All trade payables will be paid within the next 3 months.

**Notes to accounts (continued)**  
for the year ended 31 December 2012

**Fair value hierarchy**

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique

Level 1 quoted (unadjusted) prices in active markets for identical assets or liabilities

Level 2 other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly

Level 3 techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

**Currency derivatives**

The Company utilises currency derivatives to hedge significant future transactions and cash flows. The Company is party to a number of foreign currency forward contracts and options in the management of its exchange rate exposures. The instruments are purchased internally from the Group treasury department in Paris and are primarily denominated in the currencies of the Company's principal markets. At the date of the statement of financial position, the total notional amount of outstanding forward foreign exchange contracts to which the Company is committed are as follows

	2012 £000	2011 £000
Forward foreign exchange contracts	<u>14,437</u>	<u>11,736</u>

The Company had no options to sell currency as a hedge against exchange losses on future sale of goods and no options to purchase currency as a hedge against exchange losses on future purchases of goods. These arrangements are made with Thales treasury to cover the period between tender date and contract award.

At 31 December 2012, the fair value of the Company's currency derivatives is estimated to be approximately £173,000 (2011: £39,000). These amounts are based on quoted market prices for equivalent instruments at the date of the statement of financial position, comprising £235,000 assets (2011: £186,000) and £62,000 liabilities (2011: £225,000). The fair value of currency derivatives that are designated and effective as cash flow hedges amounting to £155,000 (2011: £38,000) has been deferred in equity.

Notes to accounts (continued)  
for the year ended 31 December 2012

The following table details the Company's liquidity analysis for its derivative financial instruments. The table has been drawn up based on the undiscounted net cash inflows and outflows on derivative instruments that settle on a net basis and the undiscounted gross inflows and outflows on those derivatives that require gross settlement.

	Timing of cash flows					Net carrying amount in statement of financial position
	Within one year £000	Between one and two years £000	Between two and five years £000	More than five years £000	Total £000	£000
<b>At 31 December 2012</b>						
Derivative assets -						
Gross cash inflows	12,452	-	-	-	12,452	
Gross cash outflows	(12,452)	-	-	-	(12,452)	
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>235</u>
Derivative liabilities -						
Gross cash inflows	1,985	-	-	-	1,985	
Gross cash outflows	(1,985)	-	-	-	(1,985)	
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>62</u>
<b>At 31 December 2011</b>						
Derivative assets -						
Gross cash inflows	8,252	-	-	-	8,252	
Gross cash outflows	(8,252)	-	-	-	(8,252)	
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>186</u>
Derivative liabilities -						
Gross cash inflows	3,484	-	-	-	3,484	
Gross cash outflows	(3,484)	-	-	-	(3,484)	
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>225</u>

Notes to accounts (continued)  
for the year ended 31 December 2012

**Maturity of financial liabilities**

The contractual maturity of the Company's non-derivative financial liabilities is as follows

	Timing of cash flows				Total £000
	Within one year £000	Between one and two years £000	Between two and five years £000	More than five years £000	
<b>At 31 December 2012</b>					
Trade payables	3,093	-	-	-	3,093
Other payables	18,406	-	-	-	18,406
	<u>21,499</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>21,499</u>
<b>At 31 December 2011</b>					
Trade payables	3,490	-	-	-	3,490
Other payables	18,711	-	-	-	18,711
	<u>22,201</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>22,201</u>

**Maturity of financial assets**

The contractual maturity of the Company's non-derivative financial assets is as follows

	Timing of cash flows				Total £000
	Within one year £000	Between one and two years £000	Between two and five years £000	More than five years £000	
<b>At 31 December 2012</b>					
Cash	43,146	-	-	-	43,146
Trade receivables	3,971	-	-	-	3,971
Other receivables	3,367	-	-	-	3,367
	<u>50,484</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>50,484</u>
<b>At 31 December 2011</b>					
Cash	37,765	-	-	-	37,765
Trade receivables	8,438	-	-	-	8,438
Other receivables	1,781	-	-	-	1,781
	<u>47,984</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>47,984</u>

The Company's funding strategy is to ensure a mix of funding sources offering flexibility and cost effectiveness to match its requirements

Notes to accounts (continued)  
for the year ended 31 December 2012

**Sensitivity analysis – Foreign Currency**

The Company is mainly exposed to the US Dollar

The table below illustrates the estimated impact on the profit before tax and equity as a result of market movements in foreign exchange of 10% in relation to the Company's financial instruments. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates.

The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Group where the denomination of the loan is in a currency other than the functional currency of the lender or the borrower. A positive number below indicates an increase in profit or equity where the CU strengthens 10% against the relevant currency. For a 10% weakening of the CU against the relevant currency, there would be a comparable impact on the profit or equity, and the balances below would be negative.

	2012 £000	2011 £000
Impact on profit before tax gain/(loss)	-	-
Impact on equity increase/(decrease) +10%	453	252
Impact on equity increase/(decrease) -10%	(498)	(278)

**Sensitivity analysis – Interest Rates**

The sensitivity analyses below have been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the end of the reporting period. For floating rate liabilities, the analysis is prepared assuming the amount of the liability outstanding at the end of the reporting period was outstanding for the whole year. A 1% increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

If interest rates had been 1% higher/lower and all other variables were held constant, the Company's

- 1 Profit for the year ended 31 December 2012 would increase/decrease by £430,000 (2011: £332,000). This is mainly attributable to interest received on cash balances.
- 2 Other comprehensive income for the year would decrease/increase by £430,000 (2011: £332,000), mainly as a result of interest received on cash balances.

Notes to accounts (continued)  
for the year ended 31 December 2012

**19. Retirement benefit schemes**

The Thales Group operates a number of schemes within the UK for the benefit of employees. The schemes include both defined benefit schemes and defined contribution schemes. During 2007 and 2008, the Group undertook a pension project which merged 8 defined benefit schemes into a single scheme with 2 sections.

**Defined contribution schemes**

The total cost charge to income in relation to defined contribution schemes amounted to £185,000 for 2012 (2011 £221,000) representing contributions payable to the schemes by the Company at rates specified in the rules of the plan.

**Defined benefit schemes**

The Thales Group in the UK, operates two defined benefit schemes, sponsored by Thales UK Ltd, namely the Thales UK Pension Scheme (TUPS) and the Avimo Pension Scheme. The third scheme, the Thales Shared Cost Section of the Railways Pension scheme is sponsored by Thales Transport and Security Ltd.

In previous years, we applied an estimated methodology which enabled a 'split' of the Company's share of assets and liabilities in the scheme, derived on a proportional basis related to the cash contributions made. Due to recent Group reorganisations, and consequent mobility and movement of staff between the UK companies, management is now of the view this previously used methodology no longer provides meaningful information.

At the end of 2012 we have changed the way we account for the pension scheme in the statutory accounts by allocating the defined benefit cost in totality to the sponsoring company on the basis that we consider we are unable to apply an appropriate allocation across all the statutory financial statements. To this end we have now moved the pension asset from all individual Thales participating employer entities to the sponsoring employer, Thales UK Ltd for the TUPS and Avimo schemes and Thales Transport and Security for the Railways scheme. The impact of this adjustment is an expense of £634,000 in Thales Missile Electronics Ltd.

Notes to accounts (continued)  
for the year ended 31 December 2012

The following tables summarise the components of net benefit expense recognised in the Statement of comprehensive income and the funded status and amounts recognised in the statement of financial position for the plan

	2012 £000	2011 £000
<b>Net benefit expense</b>		
Current service cost	(516)	(491)
Total service charge	(516)	(491)
Interest cost	(722)	(2,752)
Expected return on plan assets	556	2,604
Effect of asset limit	-	293
Amortisation of unrecognised gains & losses	(282)	(335)
Total before pension adjustment	(964)	(681)
Transfer of asset to Thales UK Ltd	(634)	-
Total Income Statement credit (Charge)	(1,598)	(681)
Return on plan assets	1,326	2,349

Notes to accounts (continued)  
for the year ended 31 December 2012

	2012 £000	2011 £000
Benefit asset		
Present value of wholly or partly funded obligations	(30,041)	(28,315)
Fair value of plan assets	18,245	16,938
Funded status	(11,796)	(11,377)
Present value of wholly unfunded obligations	-	(91)
Unrecognised actuarial losses	12,430	12,596
Transfer of assets to Thales UK Ltd	(634)	-
Net amount recognised	-	1,128

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

Opening present value of obligations	(28,406)	(18,942)
Current service cost	(516)	(491)
Interest cost	(722)	(2,752)
Plan participants' contributions	(56)	(227)
Actuarial (losses) on obligation	(887)	(7,909)
Benefits paid	546	1,915
Present value of obligations before adjustments	(30,041)	(28,406)

Changes in the fair value of Plan Assets are as follows

Opening fair value of plan assets	16,938	15,752
Expected return on plan assets	556	2,603
Employers' contributions	471	525
Plan participants' contributions	56	227
Benefits paid	(546)	(1,915)
Actuarial gains on plan assets	770	(254)
Fair value of plan assets before adjustment	18,245	16,938

Actual return on plan assets in 2012 was £1,326,000

Thales Missile Electronics Ltd expects to contribute £570,000 to its defined benefit pension plans in 2013

Notes to accounts (continued)  
for the year ended 31 December 2012

Amounts for the current and previous four periods are as follows

	2008 £000	2009 £000	2010 £000	2011 £000	2012 £000
Defined benefit obligation	(14,470)	(17,568)	(18,942)	(28,406)	(30,041)
<b>Plan assets</b>	<b>11,833</b>	<b>14,249</b>	<b>15,752</b>	<b>16,938</b>	<b>18,245</b>
(Deficit)/surplus	(2,637)	(3,319)	(3,126)	(11,377)	(11,796)
Experience adjustments on plan assets	(5,301)	1,246	691	(254)	770
Experience adjustments on plan liabilities	(567)	845	41	(7,909)	(887)

The following relates to the total Thales UK disclosure for all schemes

	2012 £000	2011 £000
Net benefit expense		
Current Service Cost	(18,400)	(16,700)
Amortisation of scheme amendments	-	-
Total service charge	(18,400)	(16,700)
Interest cost	(113,500)	(111,500)
Expected return on plan assets	89,100	107,500
Effect of Asset Limit	-	11,100
Amortisation of unrecognised gains & losses	(45,300)	(14,600)
Curtailment	800	-
Total Income Statement (charge)	(87,300)	(24,200)
Return on plan assets	168,700	73,300

Notes to accounts (continued)  
for the year ended 31 December 2012

	2012 £000	2011 £000
Benefit asset / (liability)		
Present value of wholly or partly funded obligations	(2,617,600)	(2,426,700)
Fair value of plan assets	2,000,700	1,839,400
Funded status	(616,900)	(587,300)
Effect of asset limit	-	-
Unrecognised actuarial losses	682,700	669,300
Transfer of asset to Thales UK Ltd	-	-
Net amount recognised	65,800	89,300

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

Opening present value of obligations	(2,426,700)	(2,056,400)
Current service cost	(18,400)	(16,700)
Interest cost	(113,500)	(111,500)
Plan participants' contributions	(8,200)	(8,600)
Scheme amendments	-	-
Actuarial losses on obligation	(138,500)	(311,900)
Benefits paid	86,700	78,400
Plan curtailments	1,000	-
Present value of obligations before adjustments	(2,617,600)	(2,426,700)

	2012 £000	2011 £000
Changes in the fair value of Plan Assets are as follows		

Opening fair value of plan assets	1,839,400	1,763,000
Expected return on plan assets	89,100	107,500
Employers' contributions	71,100	72,900
Plan participants' contributions	8,200	8,600
Benefits paid	(86,700)	(78,400)
Actuarial gains on plan assets	79,600	(34,200)
Fair value of plan assets before adjustment	2,000,700	1,839,400

Actual return on plan assets in 2012 was £168 7m

The Thales Group expects to contribute £89 2m to its defined benefit pension plans in 2013 (2012 £79 3m)

Notes to accounts (continued)  
for the year ended 31 December 2012

	Year ended 31 December 2012	Year ended 31 December 2011
The major categories of plan assets as a percentage of the fair value of total plan assets are as follows		
<b>Equities</b>	<b>44%</b>	<b>49%</b>
Gilts and corporate bonds	51%	50%
Property	3%	0%
Cash/Other	2%	1%
The expected rates of return on each category of plan assets are as follows		
Equities	6.2%	6.3%
Gilts and corporate bonds	4.5%	4.2%
Property	4.7%	4.8%
Cash/Other	0.5%	0.7%

The overall expected rate of return on assets is determined based on market prices prevailing at that date, applicable to the period over which the obligation is to be settled

The principal assumptions used in determining pension obligations for the Group's plans are shown below

Discount rate	4.48%	4.76%
Expected rate of return on assets	4.61%	4.84%
Future salary increases	3.73%	3.79%
Future retail price inflation	2.73%	2.79%
Future 5% LPI pension increases	2.60%	2.60%
Future 2.5% LPI pension increases	2.10%	2.10%

In determining the pension liabilities the Thales Group uses mortality assumptions, which are based on published mortality tables. The actuarial table used for former members of the Racal Group Executive or Senior Managers Pension Schemes (Male and Female) is SAPS light year of birth tables, and medium cohort future projections with a 0.75% p.a. minimum improvement starting in 2003. The actuarial tables for all other members are, SAPS normal year of birth tables projections also with a 0.75% p.a. minimum improvement starting in 2003.

The measurement bases required by IAS19 are likely to give rise to significant fluctuations in the reported amounts of the defined benefit pension schemes assets and liabilities from year to year, and do not necessarily give rise to a change in the contributions payable into the schemes, which are recommended by the independent actuaries based on the expected long term rate of return on the schemes assets.

Notes to accounts (continued)  
for the year ended 31 December 2012

**20. Deferred tax**

The following are the major deferred tax assets and liabilities recognised by the Company and movements thereon during the current and prior reporting period

<b>Deferred tax asset</b>	Capital allowances £'000	Cash flow hedges £'000	Tax losses £'000	Total £'000
As at 1 January 2011	1,405	-	-	1,405
Charged to Statement of comprehensive income	(61)	-	-	(61)
Charged to equity	-	10	-	10
As at 31 December 2011	1,344	10	-	1,354
Charged to Statement of comprehensive income	(65)	-	-	(65)
Charged to equity	-	(10)	-	(10)
As at 31 December 2012	1,279	-	-	1,279

<b>Deferred tax liability</b>	Retirement benefit obligations £'000	Cash flow hedges £'000	Total £'000
As at 1 January 2011	(347)	(41)	(388)
Charged to Statement of comprehensive income	65	-	65
Charged to equity	-	41	41
As at 31 December 2011	(282)	-	(282)
Charged to Statement of comprehensive income	282	-	282
Charged to equity	-	(36)	(36)
As at 31 December 2012	-	(36)	(36)

**Net deferred tax position**

	2012 £000	2011 £000
Deferred Tax Asset	1,279	1,354
Deferred Tax (Liability)	(36)	(282)
Net Deferred Tax Asset	1,243	1,072

Notes to accounts (continued)  
for the year ended 31 December 2012

**21. Share capital**

	2012 £000	2011 £000
<i>Authorised</i>		
100 ordinary shares of £1 each	<u>100</u>	<u>100</u>
<i>Allotted, called-up and fully-paid</i>		
100 ordinary shares of £1 each	<u>100</u>	<u>100</u>

**Capital management**

The primary objective of the Company's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value. The Company manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years end 31 December 2012 and 31 December 2011.

Notes to accounts (continued)  
for the year ended 31 December 2012

## 22 Share based payments

### Share Options

The Group grants options in the shares of Thales SA to employees as part of an employee incentive program. All options granted under this program are equity-settled. Historically, these have been issued annually.

Type of arrangement	General employee share option plan							
Date of grant	1 July 2004	30 June 2005	9 November 2006	4 July 2007	1 July 2008	25 June 2009	23 September 2010	15 September 2011
Number granted	4,900	2,200	4,150	350	3,970	2,820	-	-
Contractual life	All options are granted for a 10 year period							
Vesting conditions	Fully vested after 4 years							

The estimated fair value of each share option granted in the general employee share option plan in 2012 was nil (2011 £4.93). There were no Share Options granted in 2012.

This estimated fair value was calculated by applying a binomial option pricing model.

At 31 December 2012, the following options were outstanding:

	2012		2011	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at start of year	28,324	£30.96	41,939	£31.64
Granted	0	-	-	£22.96
Exercised	0	£20.87	(200)	£22.41
Cancelled	0	£33.26	(13,415)	£36.79
Outstanding at end of year	28,324	£27.89	28,324	£30.96
Exercisable at end of year	27,972	£28.25	27,019	£31.45

In accordance with IFRS 2, the Group values the costs represented by options attributed to employees. The fair value of these options is determined at their respective attribution date. This amount is taken to profit and loss, spreading over the period of acquisition of benefits.

The expense arising from share and share option plans was £1,586 (2011 £5,013).

Notes to accounts (continued)  
for the year ended 31 December 2012

Type of arrangement	General employee share option plan							
Date of grant	1 July 2004	30 June 2005	9 November 2006	4 July 2007	1 July 2008	25 June 2009	23 September 2010	15 September 2011
Share price at grant date	€ 29.50	€ 33.59	€ 37.32	€ 45.13	€ 35.72	€ 31.93	€ 26.40	€ 25.20
Exercise price	€ 29.50	€ 34.01	€ 36.47	€ 44.77	€ 38.50	€ 32.88	€ 26.34	€ 26.34
Expected volatility*	32%	30%	30%	20%	20%	25%	25%	25%
Dividend rate	3.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Risk-free interest rate	4.4%	2.75%	3.75%	4.5%	4.5%	3.9%	3.09%	3.51%
Expected rate of cancellation pre-vesting	2%	2%	2%	2%	2%	2%	2%	2%
Expected rate of departure post-vesting	3%	3%	3%	3%	3%	3%	3%	3%
Early exercise multiple	1.5	1.5	1.5	1.3	1.3	1.3	1.3	1.3

\*Measured on the basis of a mix between historical and implicit volatility

To allow for the effects of early exercise, it was assumed that the employees would exercise the options after vesting date when the share price was 1.3 times the exercise price

The weighted average share price at the date of exercise for share options exercised during the period was €25.70 (2011: €28.23). The options outstanding at 31 December 2012 had exercise prices in the range €26.34 to €44.77, and the weighted average remaining contractual life of 6.3 years (2011: 7.3 years).

Notes to accounts (continued)  
for the year ended 31 December 2012

**Free Shares**

Beneficiaries of this programme will receive vested shares over a four-year period, provided that the conditions of presence have been met as stipulated in the programme terms and conditions. Performance-based allocation of shares

- The allotment of shares under this programme is contingent upon the achievement of internal performance targets over the three following financial years. The performance criteria are EBIT, operating cash flow and order intake, with a weighting of 60%, 25% and 15% respectively. Shares may be vested in three equal blocks, once the Board of Directors has approved the Group consolidated accounts of the related periods.
- The number of shares vested will not exceed the number of shares initially allotted.
- Beneficiaries of this programme will receive vested shares over a four-year period, provided that the conditions of presence have been met as stipulated in the programme terms and conditions.
- Beneficiaries who are French tax residents or covered by the French social security system may not sell the shares for a period of two years. This condition does not apply to beneficiaries who are not French tax residents.

Type of arrangement	Free Shares						
Date of grant	June 2009	Sept 2010	Sept 2010*	Sept 2011	Sept 2011*	Dec 2012	Dec 2012*
Number granted	860	1,120	550	1,050	-	1,730	-
The model inputs were							
Share price at grant date	€ 31.93	€ 26.40	€ 26.40	€ 25.20	€ 25.20	€ 27.47	€ 27.47
Risk-free rate	3.9%	3.09%	-	3.51%	-	-	-
Vesting Conditions	Fully vested after 4 years						
*Free shares with Performance Conditions							

The estimated fair value of free shares issued in 2012 was €24.86 (2011: €22.80)

This estimated fair value was calculated by applying a binomial option pricing model.

The number of free shares outstanding at 31 December 2012 were 5,310 (2011: 5,335)

Notes to accounts (continued)  
for the year ended 31 December 2012

**23. Operating lease arrangements**

**The Company as lessee**

	2012 £000	2011 £000
Minimum lease payments under operating leases charged to expense for the year	<u>123</u>	<u>206</u>

At the date of the statement of financial position the Company has outstanding commitments under non-cancellable operating leases, which fall due as follows

	2012 £000	2011 £000
- Within one year	18	39
- In the second to fifth years inclusive	<u>18</u>	<u>25</u>
	<u>36</u>	<u>64</u>

Operating lease payments represent rentals payable by the Company for certain of its office properties and cars. Leases are negotiated for an average term of 4 years and rentals are fixed for an average of 4 years.

**24. Related party transactions**

The immediate parent Company is Thales UK Limited, a Company incorporated in the UK. The ultimate parent Company is Thales SA a Company incorporated in France. This is also both the largest and smallest group which includes the Company and for which consolidated financial statements are prepared. Copies of the group financial statements of Thales SA are available from 45 rue de Villiers, 92526 Neuilly sur Seine Cedex, France.

**Trading transactions**

During the year, the Company entered into the following trading transactions with related parties

	Sales of goods		Purchases of goods		Amounts owed by related parties		Amounts owed to related parties	
	2012 £'000	2011 £'000	2012 £'000	2011 £'000	2012 £'000	2011 £'000	2012 £'000	2011 £'000
Parent Company	-	-	4,482	3,568	-	8	76	1,184
Fellow subsidiaries	3,067	6,998	6,216	4,323	401	806	491	216

Sales of goods to related parties were made at the Company's usual list prices. Purchases were made at market price discounted to reflect the quantity of goods purchased and the relationships between the parties.

Notes to accounts (continued)  
for the year ended 31 December 2012

**25 Related party transactions (continued)**

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No expense has been recognised in the period for bad or doubtful debts in respect of the amounts owed by related parties.