

Aspire Defence Finance plc

Directors' report and financial statements

**Registered number 5700404
31 December 2006**



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Directors' report

The Directors present their annual report and the audited financial statements for the 11 month period from the date of incorporation to 31 December 2006

Principal activities

The Company's principal activity is that of a finance company, acting as a special purpose vehicle to raise the debt finance associated with the Allenby/Connaught Private Finance Initiative Project ("the Project") from the capital markets, and on-lend it to Aspire Defence Limited a fellow subsidiary of Aspire Defence Holdings Limited

The Project involves the design and build of new living accommodation, other similar structures, supporting infrastructure and amenities at sites on Salisbury Plain and in Aldershot, the demolition and refurbishment of various assets in those areas, and the provision of certain hard and soft facilities maintenance services to those assets and to other existing assets at the sites and associated locations. The Project Agreement was signed on 6 April 2006. It has a thirty five year duration, with the construction activities planned to be substantially complete by 2014.

Review of the period

On 7 February 2006 the Company was incorporated as a public limited company, and on 15 February 2006 the Company's certificate to commence business and borrow was issued under Section 117 of the Companies Act 1985.

On 6 April 2006, the Company issued £884m 4.674% Series A Fixed Rate Guaranteed Secured Bonds due 2040 (including up to £152.5m Series A Variation Bonds), and £884m 4.674% Series B Fixed Rate Guaranteed Secured Bonds due 2040 (including up to £152.5m Series B Variation Bonds), and entered into various other agreements to give effect to the financing of the Project. The Variation Bonds, which total £305m, are being held by Citibank N.A. on behalf of the Company until such time as any additional finance is required. The Series A Bonds and Series B Bonds are unconditionally and irrevocably guaranteed as to scheduled payments of principal and interest pursuant to financial guarantees issued by Ambac Assurance UK Limited and MBIA UK Insurance Limited respectively. All the financing raised during the period is for the purpose of funding the Project.

During 2006, the Company entered into loan stock subscription arrangements pursuant to which Carillion Private Finance (Defence) Limited, Kellogg Brown & Root Limited, and HSBC Infrastructure Fund Management Limited agreed to subscribe for £120m 12% Loan Stock in twenty equal quarterly instalments from April 2008 to January 2013. This funding commitment is secured by Letters of Credit issued by HSBC Bank plc and Citibank International plc.

Key Risks and Uncertainties

Aspire Defence Finance plc is a special purpose vehicle formed to finance the performance of the Project. The Company is dependent on an income stream from one borrower, Aspire Defence Limited, to meet its commitments as they fall due. Aspire Defence Limited, with its single customer, is allocated numerous responsibilities under the Project Agreement. However, the contractual arrangements for the Project are structured so as to minimise risks inherent to the Project which are retained by Aspire Defence Limited. Risks assumed by Aspire Defence Limited are largely passed on to insurers or sub-contractors, subject to agreed limits of liability. Only to the extent that any subcontractor, or if applicable its guarantor, or insurer, fails to meet their obligations or claims by Aspire Defence Limited exceed their limits of liability, is Aspire Defence Limited at risk.

The principal risks retained directly by Aspire Defence Limited relate to lifecycle works to the estate, insurance premia and overhead cost overruns, indexation and interest risk, and termination.

Directors' report (*continued*)

Key Performance Indicators

Receipt of interest

The Company monitors the performance and ability of the Project Company, Aspire Defence Limited, to meet its on-loan debt service obligations. The Company records whether interest payments due from Aspire Defence Limited are received in full and in strict compliance with the timings laid out in the relevant financing documents. During the period ended 31 December 2006, the Company recorded that all requirements were met satisfactorily.

Debt service

The Company also measures compliance with its own debt service obligations. Any scheduled payments of interest, principal or fees due to Bondholders, Loan Note Holders, or the financial guarantors must be made in full and in strict compliance with the timings laid out in the relevant financing documents. During the period ended 31 December 2006, the Company recorded that all measures in this respect had been successfully achieved.

Financial Performance

The Company has modelled the anticipated financial outcome of the Project across its full term. The Company monitors actual financial performance against anticipated performance. As at 31 December 2006, the Company's performance against this measure was satisfactory.

Safety Performance

The Company is committed to providing a safe environment for its employees and those impacted by its activities. The Company monitors actual performance against anticipated performance. In respect of the period ended 31 December 2006, the Company's performance against this measure was satisfactory.

Results and dividend

The results for the period are set out in the profit and loss account on page 9.

The Directors do not recommend payment of a dividend.

Financial Instruments

The Company's funding has been arranged using the principles of project finance with the terms of the financial instruments, and the resulting profile of the debt service costs, tailored to match the expected revenues arising from the Project Agreement.

Other disclosures in respect of financial instruments are given in Notes 11 and 14 to the financial statements.

Directors' report (*continued*)

Directors and Directors' interests

The Directors who held office during the period were as follows

Director	Appointed	Resigned	Position
G Bryden	28 November 2006		Non Executive Director
D E Dickson	8 February 2006	31 May 2006	Non Executive Director
L J Henry	8 February 2006		Non Executive Director
F R. Herzberg	31 May 2006		Non Executive Director
Dr Se Ming Hung	8 February 2006	11 September 2006	Non Executive Director
T D Kenny	30 April 2006		Non Executive Director
K A Koye	28 November 2006		Non Executive Director
A R. McColl	7 February 2006		Finance Director
A H Moore	8 February 2006		Chairman
S Nadesan	8 February 2006	28 November 2007	Non Executive Director
P Smart	7 February 2006		Chief Executive
M R. Woodhams	6 April 2006		Non Executive Director
K Woodward	8 February 2006	30 April 2006	Non Executive Director

Also, Mowlem Secretariat Limited, represented by Ms Hillary Ellson, resigned as Company Secretary with effect from the 1 June 2006 to be replaced by Mr A. R. McColl

None of the Directors who held office at the end of the financial year had any disclosable interest in the shares of the Company

According to the Register of Directors' Interests, no rights to subscribe for shares in or debentures of the Company were granted to any of the Directors or their immediate families, or exercised by them, during the period ended 31 December 2006

Employees

There were no direct employees of the Company during the period ended 31 December 2006

Political and charitable contributions

The Company made no political contributions or charitable donations during the period ended 31 December 2006

Supplier payment policy

The Company's policy is to settle the terms of payment with suppliers when agreeing the terms of each transaction or series of transactions, and to abide by these terms of payment where it is satisfied the supplier has provided the goods or services in accordance with the agreed terms

The average time taken to pay suppliers at the period end was 0 days

Directors' report (*continued*)

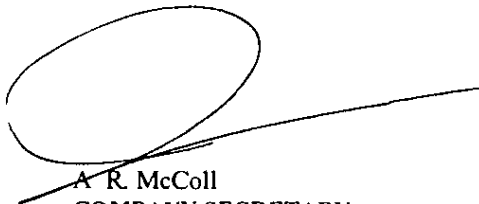
Disclosure of information to auditors

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

Auditors

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

By order of the board



A. R. McColl
COMPANY SECRETARY

24 Birch Street
Wolverhampton
West Midlands
WV1 4HY
26 Aug 2007

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 they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice)

The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss 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 accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements,
- 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 a 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

KPMG Audit Plc

8 Salisbury Square
London
E4Y 8BB
United Kingdom

Independent auditors' report to the members of Aspire Defence Finance plc

We have audited the financial statements of Aspire Defence Finance plc for the period ended 31 December 2006 which comprise the Profit and Loss Account, the Balance Sheet, the Reconciliation of Movements in 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 6.

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

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

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

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

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Independent auditors' report to the members of Aspire Defence Finance plc
(continued)

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2006 and of its profit for the period 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 Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor

26/4/ 2007

Profit and loss account
for the period ended 31 December 2006

	<i>Note</i>	2006
		£'000
Administrative expenses	2	(6)
Interest receivable and similar income	5	53,095
Interest payable and similar charges	6	(52,952)
Profit on ordinary activities before taxation	2	137
Tax on profit on ordinary activities	7	(41)
Profit on ordinary activities after taxation		96
Retained profit for the period		96

All activities are continuing

There are no recognised gains or losses other than the profit or loss for the current period

The notes on pages 12 to 17 form part of these accounts

Balance sheet
at 31 December 2006

	<i>Note</i>	2006	
		£'000	£'000
Current assets			
Debtors amounts falling due within one year	8	18,023	
Debtors amounts falling due after more than one year	9	1,463,200	
Cash at bank and in hand		99	
Creditors amounts falling due within one year	10		1,481,322 (18,549)
Net current assets			1,462,773
Total assets less current liabilities			1,462,773
Creditors , amounts falling due after more than one year	11		(1,462,627)
Net assets			146
Capital and reserves			
Called up share capital	12		50
Profit and loss account	13		96
Equity shareholders' funds			146

The notes on pages 12 to 17 form part of these accounts

These financial statements were approved by the Board of Directors on 26 April 2007 and were signed on its behalf by



A R McColl
Director

Reconciliation of movements in equity shareholders' funds
for the period ended 31 December 2006

	2006 £'000
Profit for the financial period	96
Issue of shares	50
	<hr/>
Net addition to equity shareholders' funds	146
Opening equity shareholders' funds	-
	<hr/>
Closing equity shareholders' funds	146
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Notes to the accounts *(forming part of the financial statements)*

1 Accounting policies

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

(a) Basis of preparation

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

(b) Cash flow statement

A cash flow statement is not included with these financial statements as a consolidated cash flow statement, produced under FRS 1, is included in the financial statements of Aspire Defence Holdings Limited, the Company's immediate parent

(c) Debt issue costs

Costs arising in connection with the arrangement of loan finance are offset against the carrying value of the loan and are amortised through the profit and loss account over the period of the loan on the effective interest rate method. The costs are fully recovered from Aspire Defence Limited so an equal and opposite receivable and interest income is shown in the balance sheet and profit and loss respectively

(d) Taxation

The charge for taxation is based on the result for the period 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

(e) Related party transactions

The Company has taken advantage of the exemption in FRS 8 'Related Party Disclosures' to dispense with the requirement to disclose transactions with group companies

(f) Classification of financial instruments issued by the Company

Following the adoption of FRS 25, financial instruments issued by the Company are treated as equity (i.e. forming part of shareholders' funds) only to the extent that they meet the following two conditions

a) they include no contractual obligations upon the Company to deliver cash or other financial assets or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Company, and

b) where the instrument will or may be settled in the Company's own equity instruments, it is either a non-derivative that includes no obligation to deliver a variable number of the Company's own equity instruments or is a derivative that will be settled by the Company exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments

To the extent that this definition is not met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in these financial statements for called up share capital and share premium account exclude amounts in relation to those shares

Finance payments associated with financial liabilities are dealt with as part of interest payable and similar charges. Finance payments associated with financial instruments that are classified as part of shareholder's funds, are dealt with as appropriations in the reconciliation of movements in shareholders' funds

Notes (continued)
(forming part of the financial statements)

2 Profit on ordinary activities before taxation

2006
£'000

Profit on ordinary activities before taxation is stated after charging

Auditors' remuneration – audit of these financial statements
Listing fees

15
6

One consolidated audit fee is paid by a fellow subsidiary company in respect of the audit of the group. The above amount represents the Directors' best estimate of the audit fee attributable to the Company.

3 Remuneration of Directors

The Chief Executive is employed by Aspire Defence Limited and is remunerated by that company for his services to the Aspire Defence Holdings group as a whole.

The other Directors of the Company are employed by either Carillion plc or KBR Inc or HSBC Bank plc or a subsidiary thereof and are remunerated by subsidiary companies of the respective groups for their services to each group as a whole. They receive no emoluments in respect of services provided to the Company.

4 Employees

The Company has no employees.

5 Other interest receivable and similar income

2006
£'000

Interest on cash deposits
Interest on amounts owing from Aspire Defence Limited
Recovery of initial debt issue costs from Aspire Defence Limited

33
52,662
400

53,095

6 Interest payable and similar charges

2006
£'000

Interest payable on Guaranteed Secured Bonds
Monoline credit enhancement fees
Commitment fees
Amortisation of debt issue costs

50,310
2,029
213
400

52,952

Notes (continued)
(forming part of the financial statements)

7 Tax on profit on ordinary activities

	2006 £'000
Analysis of charge in period -	
<i>UK corporation tax</i>	
Current tax on income for the period	41
	<hr/>
Tax on profit on ordinary activities	41
	<hr/>

There is no unprovided deferred tax,

Factors affecting the tax charge for the current period

The tax charge for the current period is profit on ordinary activities multiplied by the standard rate of corporation tax in the UK (30%) There are no other factors affecting the tax charge for the current period

8 Debtors: amounts falling due within one year

	2006 £'000
Prepayments and accrued income	18,023
	<hr/>

9 Debtors: amounts falling due after more than one year

	2006 £'000
Amounts due from fellow subsidiary undertakings	1,463,200
	<hr/>

10 Creditors: amounts falling due within one year

	2006 £'000
Corporation tax	41
Accruals and deferred income	18,508
	<hr/>
	18,549
	<hr/>

Notes (continued)
(forming part of the financial statements)

11 Creditors amounts falling due after more than one year

	2006 £'000
Guaranteed Secured Bonds	
At the beginning of the period	-
Bonds issued during the period	1,768,150
Variation bonds retained during the period	(305,000)
	<hr/>
At the end of the period	1,463,150
Finance costs capitalised	
Debt issue costs	(13,287)
Less amortisation of net finance costs capitalised	400
	<hr/>
	1,450,263
Accruals and deferred income	12,364
	<hr/>
	1,462,627
	<hr/>

Analysis of debt

	2006 £'000
Amounts payable within one year	-
Amounts payable in the second to fifth years	-
Amounts payable after five years	1,463,150
	<hr/>
	1,463,150
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The Bonds are secured by first priority charges over the whole of the Company's undertaking, property and assets, and those of its parent, Aspire Defence Holdings Limited, and its fellow subsidiary, Aspire Defence Limited. The bonds were issued on 6 April 2006 and are repayable on a scheduled basis from 2015 to 2040. Interest is payable half yearly in March and September. The Company retained £230m Authority Variation Bonds and £75m Rescue Variation Bonds which it may later sell, subject to certain restrictions in the Collateral Deed, to finance change and certain contingencies.

12 Called up share capital

	2006 £'000
<i>Authorised</i>	
50,000 Ordinary shares of £1 each	50
	<hr/>
<i>Allotted, called up and fully paid</i>	
50,000 Ordinary shares of £1 each	50
	<hr/>

Notes (continued)
(forming part of the financial statements)

13 Profit and loss account

	2006 £'000
At beginning of period	-
Retained profit for the period	96
	<hr/>
At end of period	96
	<hr/>

14 Financial instruments

Financial risk management policies and objectives

The Company's financial instruments comprise of short term bank deposits, guaranteed secured bonds, and the on-loan of the bond proceeds, junior debt and equity to the project company, Aspire Defence Limited. The objective of the Company's financial instruments is to provide sufficient financial resources to fund the operating requirements of the project company, Aspire Defence Limited, whilst ensuring that the Company's own cash flows are efficiently tailored to meet its debt service obligations.

The Company does not undertake financial instrument transactions which are speculative or unrelated to the Company's trading activities. Board approval is required for the use of any new financial instrument, and the Company's ability so to do is restricted by covenants in its existing funding agreements.

Exposure to liquidity, credit and interest rate risks arise in the normal course of the Company's business.

Price risk

Price risk, which is principally borne by the Ministry of Defence ("MoD"), is limited to the market value of the variation bonds not yet sold into the secondary market.

Credit and Liquidity risk

The Directors are satisfied that the Secretary of State for Defence on behalf of the Crown will be able to fulfil its obligations under the PFI contract to the project company, Aspire Defence Limited. They are therefore also content that Aspire Defence Limited will make the scheduled payments required under the senior and junior on-loan agreements so that the Company can meet its own debt service obligations.

Interest rate risk

The following table provides the effective interest rate and re-pricing analysis in respect of income earning financial assets and interest bearing financial liabilities. The analysis indicates the effective interest rates at the balance sheet date and the periods in which the assets and liabilities mature.

	Effective Interest Rate	Total £'000	1 year or less £'000	1 to 2 years £'000	2 to 5 years £'000	> 5 years £'000
Bank balances	4.36%	99	99	-	-	-
Senior on-loan*	4.68%	1,463,150	-	-	-	1,463,150
Junior on-loan	6.43%	50	-	-	-	50
Series A bond*	4.67%	(731,575)	-	-	-	(731,575)
Series B bond*	4.67%	(731,575)	-	-	-	(731,575)
		<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total		149	99	-	-	50
* Fixed rates		<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

Notes (continued)
(forming part of the financial statements)

The fair values together with the carrying amounts show in the balance sheet of all financial assets and liabilities are as follows

	Carrying Value £'000	Fair Value £000
Bank balances	99	99
Senior on-loan	1,463,150	1,463,150
Junior on-loan	50	50
Series A bonds	(731,575)	(709,759)
Series B bonds	(731,575)	(706,840)
	<hr/> 149	<hr/> 46,700
	<hr/>	<hr/>

Fair values

The Series A and Series B fair values were measured at 31 December 2006 using the market prices quoted by HSBC, the bond lead arranger. The fair value of the other assets and liabilities is deemed to be equal to the carrying value.

15 Related party disclosures

The Company entered into the following material transaction with related parties

On 6 April 2006 the Company entered into a Loan Stock Subscription Agreement pursuant to which (as amended by subsequent Deeds of Accession and Adherence) Carillion Private Finance (Defence) Limited, Kellogg Brown & Root Limited, and HSBC Infrastructure Fund Management Limited, all of which are the shareholders of the Company's parent, agreed to subscribe for £120m 12% Loan Stock in twenty equal quarterly instalments from April 2008 to January 2013.

16 Immediate parent undertaking

The Company's immediate parent undertaking is Aspire Defence Holdings Limited, which is registered in England and Wales.

The smallest group in which the financial statements of the Company are consolidated is that headed by Aspire Defence Holdings Limited. The consolidated financial statements of that group may be obtained from The Registrar of Companies, Companies House, Crown Way, Maindy, Cardiff.