

Thales UK Limited

Annual report and accounts
for the year ended 31 December 2005

Registered number: 868273



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Directors' report

The directors present their annual report and financial statements, together with the auditors' report, for the year ended 31 December 2005. The Company has adopted International Financial Reporting Standards (IFRS) for the first time, as detailed in note 1.

Principal activities

The principal activities of the company comprise the design, manufacture and sale of defence electronics products, encompassing electronic warfare, radar, displays, defence radio and command information systems.

The subsidiary undertakings held by the Company are listed in note 10 to the accounts. Consolidated accounts are not presented as the Company takes advantage of the exemption afforded by Section 228 of the Companies Act 1985 and IAS27.

Business review

Revenue for the period was £249.2 million (year ended 31 December 2004 - £207.8 million) of which £74.3 million (year ended 31 December 2004 - £77.6 million) related to exports.

The Company continues to invest in research and development. The directors regard investment in this area as a prerequisite for success in the medium to long-term future.

Details of significant events since the balance sheet date are contained in note 26 to the accounts.

Dividends

The directors do not recommend the payment of a dividend (2004 – nil).

Financial risk management objectives and policies

The Company's principal financial instruments, other than derivatives, comprise bank overdrafts, 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.

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 1.

Directors' report (continued)

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 7% of the Company's sales are denominated in currencies other than the functional currency of the operating unit making the sale, whilst almost all of the Company's costs 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 2005, the Company had hedged 11% of its foreign currency sales for which firm commitments existed at the balance sheet date, extending to August 2012.

Credit risk

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

Commodity price risk

The Company's exposure to price risk is minimal.

Cash flow interest rate risk

The Company's exposure to the risk for changes in market interest rates is minimal.

Liquidity risk

The Company's exposure to liquidity risk is minimal.

Directors' report (continued)

Directors

The directors who served during the year were as follows:

Name	Date of appointment	Date of resignation
A. Dorrian		
Lord Freeman	1 st July 2005	
S.C. Grant	1 st July 2005	
D.R.G. Horne		
K.H. Jenkins		
J.P. Perrier	1 st July 2005	
W.P. Moffatt		
E.A.N. Lowe		
J.F. Howe		
D.H. Barnes		1 st July 2005
T.M. Robinson	1 st July 2005	
A.C. Cameron		1 st July 2005
W.M. Crawford		1 st July 2005
R.S. Deakin		1 st July 2005
C.N. Gane		1 st July 2005
K. Oddey		1 st July 2005

On 1st February 2006 T.M. Robinson resigned as a director of the Company. On 24th July 2006 V M Chavez was appointed as a director of the Company and E A N Lowe resigned as a director of the Company. On 31st January 2007 S.C. Grant resigned as a director of the Company. On 1st February 2007 M Barclay was appointed as a director of the Company.

Directors' interests

According to the register of directors' interests, no director had any beneficial interests in the shares of the Company or held the right to subscribe for shares during the year. The directors did hold shares in the French parent company Thales SA as at 31 December 2005, but have taken advantage of SI 1985/802 not to disclose details in these financial statements.

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.

Directors' report (continued)

Creditors days at 31 December 2005, based on the aggregate of the amounts which were owed to trade creditors at that date and the aggregate of the amounts which the Company was invoiced by suppliers during the year, amounted to 24 days (2004 – 29 days).

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.

Donations

During the period to 31 December 2005 charitable donations of £15,000 (2004: £8,000) were made.

No political donations were made during the year.

Auditors

Both Ernst & Young LLP and Mazars LLP have indicated their willingness to continue in office as joint independent auditors of the Company and a resolution proposing their reappointments will be submitted at the Annual General Meeting.

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

By order of the Board



W.P. Moffatt

Secretary

26 March 2007

Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which 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 those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;
- 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 which 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 1985. 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 auditors' report to the shareholders of Thales UK Limited

We have audited the financial statements of Thales UK Limited for the year ended 31 December 2005 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement and the related Notes numbered 1 to 28. 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 auditors' 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 discussed in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards as adopted for use in the European Union.

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 if, in our opinion, the Directors' Report is not consistent with the financial statements, if 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 transactions with the company 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 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 shareholders of Thales UK Limited (continued)

Opinion

In our opinion the financial statements give a true and fair view, in accordance with International Financial Reporting Standards as adopted for use in the European Union, of the state of affairs of the company as at 31 December 2005 and of the company's loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Mazars LLP

Mazars LLP
Chartered Accountants
and Registered Auditors
24, Bevis Marks
London EC3A 7NR

Ernst & Young LLP

Ernst & Young LLP
Registered Auditors
1 More London Place
London
SE1 2AF

27 March 2007

Income statement

for the year ended 31 December 2005

	Note	2005 £000	2004 £000
Continuing operations			
Revenue	2	249,222	207,763
Cost of sales		(213,736)	(169,286)
Gross profit		35,486	38,477
Distribution costs		(23,786)	(19,786)
Administrative expenses		(17,099)	(16,741)
Amounts written off investments		(81,060)	-
(Loss)/profit from operations	3	(86,459)	1,950
Investment income	4	21,109	17,000
Finance costs	5	(7,186)	(6,254)
(Loss)/Profit before taxation		(72,536)	12,696
Tax credit	7	10,972	4,024
(Loss)/Profit for the period from continuing operations		(61,564)	16,720
Profit for the period from discontinued operations		-	8,033
(Loss)/Profit for the period attributable to the equity holders of the parent		(61,564)	24,753

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

There were no recognised gains or losses in either period other than the (loss)/profit for each period.

Balance sheet
at 31 December 2005

	Note	2005 £000	2004 £000
ASSETS			
Non-current assets			
Goodwill	8	652	652
Other intangible assets	9	4,221	3,701
Investment in subsidiaries	10	563,339	281,116
Property, plant & equipment	11	20,055	15,221
Deferred tax asset	21	21,623	20,748
Trade and other receivables	13	-	15,723
		<u>609,890</u>	<u>337,161</u>
Current assets			
Inventories	12	22,988	31,292
Trade and other receivables	13	123,703	125,248
Corporation tax recoverable		7,536	7,163
Cash and cash equivalents	15	62,903	746
Derivative financial instruments	19	1,287	-
		<u>218,417</u>	<u>164,449</u>
Total assets		<u>828,307</u>	<u>501,610</u>
LIABILITIES			
Current liabilities			
Trade and other payables	16	117,868	109,831
Provisions	18	6,528	-
Bank overdrafts & loans	17	7,386	54,016
Derivative financial instruments	19	85	-
		<u>131,867</u>	<u>163,847</u>
Net current assets		<u>86,171</u>	<u>602</u>

Balance sheet (continued)

at 31 December 2005

	Note	2005 £000	2004 £000
Non-current liabilities			
Retirement benefit obligation	20	109,207	117,291
Trade and other payables	16	313,634	182,173
Provisions	18	14,053	18,331
		<u>436,894</u>	<u>317,795</u>
Total liabilities		<u>568,761</u>	<u>481,642</u>
Net assets		<u>259,546</u>	<u>19,968</u>
Equity			
Share capital	22	481,938	181,938
Share premium account	23	92,906	92,906
Hedging and translation reserves	23	852	-
Retained earnings	23	(316,150)	(254,876)
Total equity		<u>259,546</u>	<u>19,968</u>

The accounts on pages 8 to 46 were approved by the board of directors and authorised for issue on 26 March 2007.
They were signed on its behalf by:


D R G Home

Director

The accompanying notes are an integral part of this balance sheet

Cash flow statement

for the year ended 31 December 2005

	Notes	2005 £000	2004 £000
Cash flows from operating activities			
(Loss)/profit from operations		(86,459)	1,950
Adjustments for;			
Depreciation of property, plant & equipment		6,240	5,458
Impairment charge		81,060	-
Amortisation of intangible assets		623	141
Loss on discontinued operations		-	8,033
IFRS2 charge		178	112
Increase in provisions		2,250	2,547
Operating cash flows before movement in working capital		3,892	18,241
Decrease in inventories		8,304	15,856
Decrease in receivables		17,377	3,850
Increase/(decrease) in payables		127,580	(73,840)
Cash generated from operations		157,153	(35,893)
Income taxes received		9,357	3,835
Interest paid		(3,332)	(3,545)
Net cash from operating activities		163,178	(35,603)
INVESTING ACTIVITIES			
Interest received		109	-
Dividends received		23,000	17,000
Purchases of investments		(322,283)	-
Recapitalisations of subsidiaries		(43,000)	-
Proceeds on disposal of property, plant and equipment		574	2,140
Purchases of property, plant and equipment		(12,791)	(5,524)
Net cash used in investing activities		(354,391)	13,616
FINANCING ACTIVITIES			
Proceeds on issue of new share capital		300,000	30,000
Decrease in bank overdrafts		(46,630)	(7,455)
Net cash from investing activities		253,370	22,545
Net increase/(decrease) in cash & cash equivalents		62,157	558
Cash & cash equivalents at beginning of year	15	746	188
Cash & cash equivalents at end of year	15	62,903	746

Notes to accounts

General Information

The Company is incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page 4. The nature of the Company's operations and principal activities are set out in the directors' report.

The financial statements are presented in pounds sterling, the currency in which the majority of the Company's transactions are denominated.

1. Accounting Policies

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards, (IFRSs), for the first time. The disclosures required by IFRS1 concerning the transition from UK GAAP to IFRSs are given in note 28. The financial statements have also been prepared in accordance with IFRS's adopted for use in the European Union. The company has elected to make use of exemptions available in IFRS 1 as follows:

- On first adoption the company has elected to recognise all actuarial gains and losses in full at the date of transition to IFRS being 1 January 2004.
- IFRS 3 'Business combinations' is not being applied retrospectively to business combinations that occurred before 1 January 2004. Accumulated amortisation on goodwill arising before 1 January 2004 has not therefore been reversed
- IAS 32 'Financial instruments: Presentation and Disclosure' and IAS 39 "Financial instruments: Recognition and measurement" prospectively only and not to restate prior period comparatives on first-time adoption
- IFRS 2 'Share-based payment' has only been applied to share options granted after 7 November 2002 and which have not vested by 1 January 2005

The financial statements have been prepared on the historical cost basis; except for the revaluation of certain properties and financial instruments. The principal accounting policies adopted are set out below:

These financial statements contain information about Thales UK Limited as an individual company and do not contain consolidated financial information as the parent of a group. The Company has taken advantage of the exemption from preparing consolidated accounts afforded by Section 228 of the Companies Act 1985 because it is a wholly owned subsidiary of Thales SA which prepares consolidated accounts which are publicly available.

Notes to accounts (continued)

Intangible fixed assets

Goodwill

Goodwill arising on the acquisition of unincorporated businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 31 December 1997 has not been reinstated in the balance sheet.

On disposal of a previously acquired business, the attributable amount of goodwill is included in determining the profit or loss on disposal.

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

Fixtures and equipment are stated at cost or valuation, 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 / reducing balance basis over its expected useful life, as follows:

Long-term leasehold land and buildings	50 years
Short-term leasehold land and buildings	term of lease - which ranges from 2 to 3 years
Plant and machinery	4-10 years

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

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.

Notes to accounts (continued)

Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of 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 balance sheet when the Company becomes a party to the contractual provisions of the instrument.

Trade receivables

Trade receivables are carried at 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.

Investments

Fixed asset investments, being investments in wholly owned subsidiary companies, are shown at cost less provision for impairment. These investments are outside the scope of IAS 32.

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)

Bank borrowings

Interest-bearing bank loans and overdrafts are initially measured at fair value, 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 (see below).

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)

Government grants

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

Other grants are credited to the income statement 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. Uninvoiced 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 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)

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

- Deferred income tax is provided in full, using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The principal temporary differences arise from depreciation on property, plant and equipment, revaluations of certain non-current assets and derivative contracts, provisions for pensions and other post retirement benefits and tax losses carried forward; and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base.
- Tax rates enacted or substantively enacted by the balance sheet date are used to determine deferred income tax.
- Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.
- Deferred income tax is provided on temporary difference arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

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.

Lessor activities

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Company's net investment outstanding in respect of the leases.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

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 balance sheet as a finance lease obligation. Lease payments are apportioned between finance

Notes to accounts (continued)

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.

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.

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.

Dividend income from investments is recognised when the shareholders' rights to receive payments have been established.

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 carried out at each balance sheet 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 balance sheet 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.

Notes to accounts (continued)

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 balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet 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 below for details of the Company's accounting policies in respect of such derivative financial instruments).

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

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 balance sheet date, and are discounted to present value where the effect is material.

Notes to accounts (continued)

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. The 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 income statement over the vesting period of the rights. Recognition in the income statement is linear over the vesting period of each scheme.

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.

Critical accounting judgements and key sources of estimation uncertainty

Critical judgements in applying the Company's accounting policies

In the process of applying the Company's accounting policies management considers that it has not made any judgements that will have a significant effect on the amounts recognised on the financial statements apart from those involving estimations.

Key sources of estimation uncertainty

The Company has determined that the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, would not have a significant risk of causing a material adjustment of the carrying amounts of assets and liabilities within the next financial year.

Notes to accounts (continued)

2 Revenue

An analysis of the Group's revenue is as follows:

	2005 £000	2004 £000
Sale of goods	135,452	125,461
Revenue from construction contracts	92,490	67,508
Rendering of services	21,280	14,794
Revenue per income statement	249,222	207,763
Investment income	21,109	17,000
Total revenue	270,331	224,763

3 Profit from operations

Profit from operations is stated after charging/(crediting):

	2005 £000	2004 £000
Net foreign exchange (gains)/losses	(95)	73
Research and development costs	5,018	4,177
Depreciation of property, plant and equipment	6,240	5,458
Amortisation of internally generated intangible assets included in other operating expenses	623	141
Cost of inventories recognised as an expense	1,025	756
Staff costs (note 6)	84,013	89,069
Auditors' remuneration for audit services		
- Mazars LLP	61	53
- Ernst & Young LLP	204	82
Impairment losses	81,060	-

Amounts payable to Ernst & Young LLP and their associates by the Company in respect of non-audit services were £7,000 (2004 - £nil). No amounts were payable to Mazars LLP and their associates by the Company in respect of non-audit services in either year.

Notes to accounts (continued)

4 Investment Income

	2005 £000	2004 £000
Interest on bank deposits	109	-
Dividends from equity investments	21,000	17,000
	<u>21,109</u>	<u>17,000</u>

5 Finance costs

	2005 £000	2004 £000
Interest paid to group companies	3,332	3,545
Financing component of pensions	3,854	2,709
	<u>7,186</u>	<u>6,254</u>

6 Staff costs

The average monthly number of employees (including executive directors) was:

	2005 Number	2004 Number
Production	1,572	1,522
Distribution	82	137
Sales	63	105
Administration	237	397
	<u>1,954</u>	<u>2,161</u>

	2005 £000	2004 £000
Their aggregate remuneration comprised:		
Wages and salaries	70,815	74,050
Social security costs	6,721	6,651
Other pension costs (see note 20)	6,477	8,368
	<u>84,013</u>	<u>89,069</u>

Notes to accounts (continued)

6 Staff Costs (continued)

Directors' Emoluments

Remuneration	2005 £000	2004 £000
Emoluments	<u>1,306</u>	<u>458</u>

The emoluments of directors disclosed above include the following amounts paid to the highest paid director:

Emoluments	<u>503</u>	<u>184</u>
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During the period the following number of directors:

Accrued benefits under defined benefit pension schemes	<u>4</u>	<u>2</u>
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Notes to accounts (continued)

7 Income tax expense

	2005 £000	2004 £000
Current tax:		
UK Corporation tax	(12,218)	(5,994)
Adjustments in respect of prior years	2,488	748
Total current tax	<u>(9,730)</u>	<u>(5,246)</u>
Deferred tax		
Origination and reversal of timing differences charge	(1,242)	1,222
Total tax (credit) on profit on ordinary activities	<u>(10,972)</u>	<u>(4,024)</u>

Corporation tax is calculated at 30% (2004 - 30%) of the estimated assessable profit for the year.

The tax charge/(credit) for the year can be reconciled to the income statement as follows:

	2005 £000	2004 £000
(Loss)/profit on ordinary activities before tax	<u>(72,536)</u>	<u>12,696</u>
(Loss)/profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30%	(21,761)	3,809
Tax effect of:		
Expenses not deductible for tax purposes	14,406	(4,675)
Timing differences not recognised (current year)	(6,105)	(3,906)
Tax underprovided in previous years (current tax)	2,488	748
Total tax charge	<u>(10,972)</u>	<u>(4,024)</u>

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

	2005 £000	2004 £000
Net loss on revaluation of cash flow hedges	<u>367</u>	<u>-</u>

Notes to accounts (continued)

8 Goodwill

	Total £000
At 31 December 2004 and 2005	<u>652</u>

9 Other intangible assets

	Development costs £000	Computer software £000	Total £000
Cost			
At 1 January 2005	3,503	1,660	5,163
Additions	<u>904</u>	<u>239</u>	<u>1,143</u>
At 31 December 2005	<u>4,407</u>	<u>1,899</u>	<u>6,306</u>
Amortisation			
At 1 January 2005	142	1,320	1,462
Charge for the year	<u>394</u>	<u>229</u>	<u>623</u>
At 31 December 2005	<u>536</u>	<u>1,549</u>	<u>2,085</u>
Carrying amount			
At 31 December 2005	<u>3,871</u>	<u>350</u>	<u>4,221</u>
At 31 December 2004	<u>3,361</u>	<u>340</u>	<u>3,701</u>

The amortisation period for development costs incurred on the Company's High Frequency Software Defined Radio development is 5 years.

Notes to accounts (continued)

10 Investment in subsidiaries

The company has investments in ordinary shares of the following subsidiary undertakings, all of which are incorporated in England & Wales and are 100% owned. To avoid a statement of excessive length, details of investments which are not significant have been omitted.

	Principal activity	
Thales Air Defence Limited	Defence equipment	
Thales Communications Holdings Limited	Holding company	
Thales Missile Electronics Limited	Defence equipment	
Thales Optronics Holdings Limited	Holding company	
Thales Underwater Systems Limited	Defence equipment	
Thales Naval Limited	Defence equipment	
Quintec Associates Limited	Defence equipment	
Thales Universite Limited	Training and education	
Thales Insurance & Risk Management (UK) Limited	Insurance services	
Thales Corporate Services Limited	Central services	
Thales Research & Technology (UK) Limited	Research & Development	
Thales Properties Limited	Property management	
Thales Telematics plc	Vehicle telematic products and services	
Thales e-Security Limited	Secure payment systems	
Thales e-Transactions Limited	Electronic terminals	
Thales Telecommunication Services Limited	Transportation services	
Thales ATM Limited	Air traffic management	
Thales Training & Simulation Limited	Simulation equipment	
Thales Avionics Limited	Navigation and satellite communication equipment	
		Total £000
Cost		
At 1 January 2005		309,892
Additions		365,283
Dividend received from pre-acquisition profits		(2,000)
At 31 December 2005		<u>673,175</u>
Amounts written off		
At 1 January 2005		28,776
Charged during the year		81,060
At 31 December 2005		<u>109,836</u>
Net book value at 31 December 2005		<u>563,339</u>
Net book value at 1 January 2005		<u>281,116</u>

Notes to accounts (continued)

11 Property, plant and equipment

	Long-term Leasehold premises £000	Short-term Leasehold premises £000	Plant, machinery, furniture and vehicles £000	Total £000
Cost				
At 1 January 2005	126	28	60,638	60,792
Additions	-	-	11,648	11,648
Disposals	-	(28)	(1,426)	(1,454)
At 31 December 2005	<u>126</u>	<u>-</u>	<u>70,860</u>	<u>70,986</u>
Accumulated depreciation and impairment				
At 1 January 2005	73	16	45,482	45,571
Charge for the year	10	-	6,230	6,240
Disposals	-	(16)	(864)	(880)
At 31 December 2005	<u>83</u>	<u>-</u>	<u>50,848</u>	<u>50,931</u>
Carrying amount				
At 31 December 2005	<u>43</u>	<u>-</u>	<u>20,012</u>	<u>20,055</u>
At 31 December 2004	<u>53</u>	<u>12</u>	<u>15,156</u>	<u>15,221</u>

12 Inventories

	2005 £000	2004 £000
Raw materials and consumables	11,316	10,912
Work-in-progress	10,179	19,069
Finished goods and goods for resale	<u>1,493</u>	<u>1,311</u>
	<u>22,988</u>	<u>31,292</u>

The amount of write down of inventories recognised as an expense is £1,025,000 (2004: £756,000). This is included in the cost of sales line item as a cost of inventories recognised as an expense. (See note 3.)

Notes to accounts (continued)

13 Trade and other receivables

	2005 £000	2004 £000
Trade and other receivables:		
Amounts receivable from the sale of goods	25,217	18,128
Amounts receivable from construction contract customers (note 14)	44,372	64,798
Non-trading balance with fellow subsidiaries	51,670	56,298
Other receivables and prepayments	2,444	1,747
	<u>123,703</u>	<u>140,971</u>

An allowance has been made for estimated irrecoverable amounts from the sale of goods of £337,000 (2004: £169,000). This allowance has been determined by reference to past default experience.

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

14 Construction Contracts

	2005 £000	2004 £000
Contracts in progress at balance sheet date:		
Amounts due from contract customers included in trade and other receivables	44,372	64,798
Amounts due to contract customers included in trade and other payables	(1,323)	(720)
	<u>43,049</u>	<u>64,078</u>
Contract costs incurred plus recognised profits less recognised losses to date	499,876	514,892
Less: progress billings	(456,827)	(450,814)
	<u>43,049</u>	<u>64,078</u>

At 31 December 2005, retentions held by customers for contract work amounted to £415,000 (2004: £2,013,000). Advances received from customers for contract work amounted to £29,810,000 (2004: £5,223,000).

At 31 December 2005, amounts of £nil (2005: £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.

Notes to accounts (continued)

16 Trade and other payables

	2005 £000	2004 £000
Trade payables and accruals	62,644	47,562
Advances from customers	23,816	18,578
Amounts due to construction contract customers (note 14)	1,323	720
Loan from fellow group company	316,561	207,356
Other payables & accruals	27,158	17,788
	<u>431,502</u>	<u>292,004</u>

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

17 Bank overdrafts and loans

	2005 £000	2004 £000
Bank overdrafts	<u>7,386</u>	<u>54,016</u>

The overdrafts are all denominated in sterling and are repayable on demand.

The weighted average interest rates paid were as follows:

	2005 %	2004 %
Bank overdrafts	6.3	6.1

The directors estimate the fair value of the Company's overdrafts, to be equal to their book value.

The average effective interest rate on bank overdrafts approximated 4.65 per cent (2004: 4.38 per cent) in the year and is determined based on 0.25 per cent plus base rate.

Notes to accounts (continued)

18 Provisions

	Accrued contract costs £000	Restructuring £000	Post-sale rectification and support costs £000	Other £000	Total £000
At 1 January 2005	445	2,216	11,342	4,328	18,331
Additional provision in the year	2,224	2,921	3,282	2,550	10,977
Utilisation of provision	(284)	(4,690)	(1,596)	(2,157)	(8,727)
At 31 December 2005	<u>2,385</u>	<u>447</u>	<u>13,028</u>	<u>4,721</u>	<u>20,581</u>
Included in current liabilities					6,528
Included in non-current liabilities					14,053
					<u>20,581</u>

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.

Other provisions represent reserves for penalties and price reductions.

19 Derivative financial instruments

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 balance sheet date, the total notional amount of outstanding forward foreign exchange contracts to which the Company is committed are as follows:

	2005 Assets £000	Liabilities £000	2004 Assets £000	2004 £000
Forward foreign exchange contracts	<u>1,287</u>	<u>85</u>	<u>-</u>	<u>-</u>
Analysed as:				
Current	1,287	85	-	-
Non-current	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>1,287</u>	<u>85</u>	<u>-</u>	<u>-</u>

At 31 December 2005, the fair value of the Company's currency derivatives is estimated to be approximately £1,202,000 (2004: £ nil). These amounts are based on quoted market prices for equivalent instruments at the balance sheet date, comprising £1,287,000 assets (2004: £ nil) and £85,000 liabilities (2004: £ nil). The fair value of currency derivatives that are designated and effective as cash flow hedges amounting to £1,202,000 (2004: £ nil) has been deferred in equity.

Notes to accounts (continued)

20 Retirement benefit schemes

The Group operates a number of schemes within the UK for the benefit of employees. The schemes are both defined benefit schemes and defined contribution schemes that are operated by the former Racal and former Thomson-CSF companies.

Defined contribution schemes

The total cost charge to income in relation to defined contribution schemes amounted to £529,000 (2004:£338,000) representing contributions payable to the schemes by the Company at rates specified in the rules of the plan.

Defined benefit schemes

The Group operates 10 defined benefit schemes that provide benefits to the majority of its UK employees. The Company participates in a number of funded group defined benefit schemes. The Company's share of assets and liabilities in the schemes are derived on a proportionate basis related to the cash contributions made. The management consider this the most appropriate basis of allocation.

The following tables summarise the components of net benefit expense recognised in the consolidated income statement and the funded status and amounts recognised in the consolidated balance sheet for the plan.

	2005 £000	2004 £000
Net benefit expense:		
Current service cost	(5,948)	(5,526)
Amortisation of scheme amendments	-	-
Total service charge	(5,948)	(5,526)
Interest cost	(38,895)	(51,384)
Expected return on plan assets	35,041	48,918
Amortisation of unrecognised gains & losses	-	-
Curtailment charge	-	(100)
Total charge	(9,802)	(8,092)
Actual return on plan assets	84,002	62,541

Notes to accounts (continued)

20 Retirement benefit schemes (continued)

	2005 £000	2004 £000
Benefit asset / (liability):		
Present value of defined obligations	(715,775)	(581,835)
Fair value of plan assets	523,165	436,005
Funded status	(192,610)	(145,830)
Unrecognised actuarial losses	84,242	30,550
Unrecognised scheme amendments	(839)	(2,011)
Net amount recognised	<u>(109,207)</u>	<u>(117,291)</u>
Changes in the present value of the defined benefit obligation are as follows:		
Opening present value of obligations	(581,835)	(495,940)
Current service cost	(5,948)	(5,526)
Interest cost	(38,895)	(51,384)
Plan participants' contributions	(3,880)	(3,213)
Scheme amendments	(1,677)	2,011
Curtailments / Settlements	-	(100)
Actuarial losses on obligation	(102,202)	(41,203)
Benefits paid	18,662	13,520
Closing present value of obligations	<u>(715,775)</u>	<u>(581,835)</u>
Changes in the fair value of Plan Assets are as follows:		
Opening fair value of plan assets	436,005	373,365
Expected return on plan assets	35,041	48,918
Employers' contributions	17,940	10,406
Plan participants' contributions	3,880	3,213
Benefits paid	(18,662)	(13,520)
Actuarial gains on plan assets	48,961	13,623
Closing fair value of plan assets	<u>523,165</u>	<u>436,005</u>

The Group expects to contribute £54m to its defined benefit pension plans in 2006.

Notes to accounts (continued)

20 Retirement benefit schemes (continued)

	Year ended 31 December 2005	Year ended 31 December 2004
The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:		
Equities	60%	58%
Bonds	38%	38%
Property	1%	1%
Cash	1%	3%

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

Discount rate	5.1%	5.5%
Expected rate of return on assets	6.2%	6.6%
Future salary increases	3.8%	3.8%
Future price inflation	2.8%	2.8%
Future pension increases	2.6%	2.6%

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)

21 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.

Deferred Tax Asset	Capital allowances £'000	Retirement benefit obligations £'000	Cash flow hedges £'000	Tax losses £'000	Other £'000	Total £'000
As at 31 December 2004	10,229	10,519	-	-	-	20,748
Charged to profit and loss account	(1,962)	3,125	-	-	79	1,242
As at 31 December 2005	8,267	13,644	-	-	79	21,990

Deferred Tax Liability	Accelerated tax depreciation £'000	Retirement benefit obligations £'000	Cash flow hedges £'000	Deferred development costs £'000	Other £'000	Total £'000
As at 31 December 2004	-	-	-	-	-	-
IAS39 restated	-	-	(105)	-	-	(105)
Deferred Tax Liability as at 1 January 2005	-	-	(105)	-	-	(105)
Charged to equity	-	-	(262)	-	-	(262)
As at 31 December 2005	-	-	(367)	-	-	(367)

Unrecognised deferred tax asset

	2005 £'000	2004 £'000
Pension	19,106	24,632
Tax losses	18,242	18,254
	37,348	42,886

Notes to accounts (continued)

22 Share capital

	2005 £000	2004 £000
<i>Authorised</i>		
490,000,000 (2004: 190,000,000) ordinary shares of £1 each	<u>490,000</u>	<u>190,000</u>
<i>Allotted, called-up and fully-paid</i>		
481,937,600 (2004: 181,937,600) ordinary shares of £1 each	<u>481,938</u>	<u>181,938</u>

During the year the Company allotted 300,000,000 ordinary shares with a nominal value of £300,000,000 for cash consideration of £300,000,000.

23 Statement of changes in equity

	Share capital account £000	Share premium account £000	Hedging and translation reserves £000	Retained earnings £000	Total £000
At 31 December 2004 as previously stated	181,938	92,906	-	(182,608)	92,236
Effect of IFRS	-	-	-	(72,268)	(72,268)
At 31 December 2004 as restated	<u>181,938</u>	<u>92,906</u>	<u>-</u>	<u>(254,876)</u>	<u>19,968</u>
Implementation of IAS39	-	-	350	-	350
At 1 January 2005 as restated	<u>181,938</u>	<u>92,906</u>	<u>350</u>	<u>(254,876)</u>	<u>20,318</u>
Issue of shares	300,000				300,000
Share option costs	-	-	-	290	290
Increase in fair value of hedging derivatives	-	-	502	-	502
Retained loss for the year	-	-	-	(61,564)	(61,564)
At 31 December 2005	<u>481,938</u>	<u>92,906</u>	<u>852</u>	<u>(316,150)</u>	<u>259,546</u>

The hedging and translation reserves is shown net of associated deferred tax.

Notes to accounts (continued)

24 Share based payments

The Group grants options in the shares of Thales SA to employees as part of an employee incentive program. Historically, these have been issued annually. At 31 December 2005, the following options were outstanding:

Type of arrangement	General employee share option plan	General employee share option plan	General employee share option plan
Date of grant	1 July 2003	1 July 2004	30 June 2005
Number granted	63,600	39,000	53,950
Contractual life	10 years	10 years	10 years
Vesting conditions	Fully vested after 4 years	Fully vested after 4 years	Fully vested after 4 years

The estimated fair value of each share option granted in the general employee share option plan is £6.06 (2004 - £6.01).

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

The model inputs were:

Share price at grant date	€ 25.70	€ 29.50	€ 34.01
Exercise price	€ 25.70	€ 29.50	€ 34.01
Expected volatility	34%	32%	30%
Dividend rate	3.5%	3.5%	2.5%
Risk-free interest rate	3.8%	4.4%	3.0%

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 1.5 times the exercise price.

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.

Changes in fair value of share option issued after 7 November 2002 (date of first application of the standard) are presented below:

Notes to accounts (continued)

24 Share based payments (continued)

	2005	2005	2004	2004
	Number of	Weighted	Number of	Weighted
	options	average	options	average
		exercise price		exercise price
Outstanding at start of year	102,600	£19.14	63,600	£18.11
Granted	53,950	£23.31	39,000	£20.80
Exercised	-	-	-	-
Outstanding at end of year	156,550	£20.22	102,600	£19.14
Exercisable at end of year	61,119	£18.86	28,725	£18.57

The options outstanding at 31 December 2005 had exercise prices in the range €25.70 to €34.01, and the weighted average remaining contractual life of 8.4 years.

The expense arising from share and share option plans was £290,087 (2004 £111,904).

25 Operating lease arrangements

The Company as lessee

	2005	2004
	£000	£000
Minimum lease payments under operating leases recognised in income for the year	652	905

At the balance sheet date, the Company has outstanding commitments under non-cancellable operating leases, which fall due as follows:

	2005	2004
	£000	£000
- Within one year	396	491
- In the second to fifth years inclusive	1,520	2,322
- After five years	15,073	15,536
	16,989	18,349

Operating lease payments represent rentals payable by the Company for certain of its office properties, cars and office equipment.

Notes to accounts (continued)

26 Events after the balance sheet date

On 15th February 2007, the Company sold the entire issued share capital of Thales Telematics plc for £1,000,000.

27 Related party transactions

The immediate parent company is Thales Holdings UK plc, 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	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Parent company	-	-	-	-	51,670	17,224	-	-
Fellow subsidiaries	8,010	6,526	17,978	10,441	4,457	2,812	375,223	182,026
Other Thales group companies	4,860	3,562	-	-	1,810	825	-	-

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.

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.

Compensation of key management personnel

The remuneration of directors and other members of key management during the year was as follows:

	2005 £000	2004 £000
Short-term employee benefits	<u>1,455</u>	<u>458</u>

Other related party transactions

In addition to the above, Thales Corporate Services Limited performed certain administrative services for the Company, for which a management fee of £3,337,000 (2004: £2,964,000) was charged and paid, being an appropriate allocation of costs incurred by relevant administrative departments.

Notes to accounts (continued)

28 Explanation of transition to IFRSs

This is the first year that the Company has presented its financial statements under IFRS. The following disclosures are required in the year of transition. The last financial statements under UK GAAP were for the year ended 31 December 2004 and the date of transition to IFRSs was therefore 1 January 2004.

Notes to accounts (continued)

Reconciliation of equity at 1 January 2004 (date of transition to IFRSs)

	Note	UK GAAP £000	Effect of transition to IFRSs £000	IFRSs £000
Goodwill		652	-	652
Other intangible assets	(a)	-	1,714	1,714
Investment in subsidiaries		281,116	-	281,116
Property, plant & equipment		19,423	-	19,423
Deferred tax asset	(h)	-	22,083	22,083
Trade and other receivables		3,045	-	3,045
Total non-current assets		304,236	23,797	328,033
Inventories	(b)	52,035	(4,887)	47,148
Trade and other receivables	(c)	143,877	(2,101)	141,776
Corporation tax recoverable		5,752	-	5,752
Cash and cash equivalents		188	-	188
Total current assets		201,852	(6,988)	194,864
Total assets		506,088	16,809	522,897
Trade and other payables	(d)	151,781	(15,109)	136,672
Bank overdrafts & loans		61,471	-	61,471
Provisions	(f)	8,050	7,734	15,784
Total current liabilities		221,302	(7,375)	213,927
Retirement benefit obligations	(g)	11,169	111,433	122,602
Trade and other payables		221,153	-	221,153
Total non-current liabilities		232,322	111,433	343,755
Total liabilities		453,624	104,058	557,682
Total assets less total liabilities		52,464	(87,249)	(34,785)
Issued capital		151,938	-	151,938
Share premium		92,906	-	92,906
Retained earnings	(i)	(192,380)	(87,249)	(279,629)
Total equity		52,464	(87,249)	(34,785)

Notes to accounts (continued)

Notes to the reconciliation of equity at 1 January 2004

- (a) Under International Accounting Standard 38, development expenditure of £1,714,000 that had previously been expensed through the profit and loss account under UK GAAP has been capitalised and shown on the balance sheet.
- (b) Under International Accounting Standards £4,887,000 of Inventories has been reclassified into Trade and Other Payables, mainly as advances from customers.
- (c) Under International Accounting Standards £2,101,000 of Trade and Other Receivables has been reclassified into Trade and Other Payables, mainly as advances from customers.
- (d) Under International Accounting Standards Trade and Other Payables have decreased by £15,109,000. Of this amount £8,121,000 has been reclassified as Provisions whilst £4,887,000 represents corresponding reductions in Inventories and £2,101,000 represents corresponding reductions in Trade and Other Receivables.
- (e) Under International Accounting Standard 12, deferred taxation of £35,477,000 that had previously not been recognised under UK GAAP has been shown on the balance sheet.
- (f) Under IFRS provisions have increased by £7,734,000. Of this amount £387,000 has been adjusted through the income statement and after an associated reduction in the deferred tax asset of £116,000 retained earnings have increased by £271,000. The balance of £8,121,000 represents a reclassification of items previously included in Trade and Other Payables under UK GAAP.
- (g) Under International Accounting Standard 19, pension assets and liabilities of the defined benefit schemes have been recognised in full at 1 January 2004. This has increased the retirement benefit obligations liability by £111,433,000 and increased the deferred tax asset by £33,430,000 giving a net decrease in retained earnings of £78,002,000.
- (h) Further to the adjustments in (e),(f) and (g), the total deferred tax asset has then been restricted by £46,708,000 to £22,083,000 as it is considered that there will not be sufficient future profit to fully utilise this asset.
- (i) the adjustment to retained earnings reflects the net impact of adjustments (a) to (h)

Notes to accounts (continued)

Reconciliation of equity at 31 December 2004 (date of last UK GAAP financial statements)

	Note	UK GAAP £000	Effect of transition to IFRSs £000	IFRSs £000
Goodwill	(a)	568	84	652
Other intangible assets	(b),(c)	-	3,701	3,701
Investment in subsidiaries		281,116	-	281,116
Property, plant & equipment	(b)	15,560	(339)	15,221
Deferred tax asset	(j)	-	20,748	20,748
Trade and other receivables		15,723	-	15,723
Total non-current assets		312,967	24,194	337,161
Inventories	(e)	34,680	(3,388)	31,292
Trade and other receivables	(f)	118,282	6,966	125,248
Corporation tax recoverable		7,163	-	7,163
Cash and cash equivalents		746	-	746
Total current assets		160,871	3,578	164,449
Total assets		473,838	27,772	501,610
Current liabilities				
Trade and other payables	(g)	114,697	(4,866)	109,831
Bank overdrafts & loans		54,016	-	54,016
Total current liabilities		168,713	(4,866)	163,847
Retirement benefit obligations	(i)	20,591	96,700	117,291
Provisions	(h)	10,125	8,206	18,331
Trade and other payables		182,173	-	182,173
Total non-current liabilities		212,889	104,906	317,795
Total liabilities		381,602	100,040	481,642
Total assets less total liabilities		92,236	(72,268)	19,968
Issued capital		181,938	-	181,938
Share premium		92,906	-	92,906
Retained earnings	(k)	(182,608)	(72,268)	(254,876)
Total equity		92,236	(72,268)	19,968

Notes to accounts (continued)

Notes to the reconciliation of equity at 31 December 2004

- (a) Under International Accounting Standard 38, goodwill is no longer subject to amortisation but is reviewed on an annual basis for impairment. In the opinion of the directors, the goodwill had not suffered any impairment at 31 December 2004 and the amortisation of £84,000 charged under UK GAAP has been written back.
- (b) In accordance with International Accounting Standard 38 £339,000 of computer software included within fixed assets under UK GAAP has been classified as an intangible asset.
- (c) Under International Accounting Standard 38, development expenditure of £3,362,000 that had previously been expensed through the profit and loss account under UK GAAP has been capitalised and shown on the balance sheet.
- (d) Under International Accounting Standard 12, deferred taxation of £34,660,000 that had previously not been recognised under UK GAAP has been shown on the balance sheet. The total deferred tax asset has then been restricted to £20,748,000 as it is considered that there will not be sufficient future profit to fully utilise this asset.
- (e) Under International Accounting Standards Inventories have reduced by £3,388,000 through reclassifications into other balance sheet categories.
- (f) Under International Accounting Standards Trade & Other Receivables have increased by £6,966,000 through reclassifications with other balance sheet categories.
- (g) Under International Accounting Standards Trade & Other Payables of £4,866,000 have been reclassified as Provisions.
- (h) Under IFRS provisions have increased by £8,206,000. Of this amount £8,444,000 has come from reclassification of items previously included in other balance sheet categories under UK GAAP. Whilst £238,000 has been charged to the income statement which, after an associated reduction in the deferred tax asset of £71,000 means retained earnings have increased by £167,000.
- (i) Under International Accounting Standard 19, pension assets and liabilities of the defined benefit schemes have been recognised in full at 1 January 2004. This has increased the retirement benefit obligations liability by £96,700,000 and increased the deferred tax asset by £29,010,000 giving a net decrease in retained earnings of £67,690,000.
- (j) Following the adjustments in (d),(h) and (i), the total deferred tax asset has then been restricted by £40,242,000 to £20,748,000 as it is considered that there will not be sufficient future profit to fully utilise this asset.
- (k) the adjustment to retained earnings reflects the net impact of adjustments (a) to (j)

Notes to accounts (continued)

Effect of first-time application of financial instruments standards on 1 January 2005

The Company took the option of only applying International Accounting Standards 32 and 39 from 1 January 2005. The effect of first-time application of these standards on shareholders' equity at that date is detailed below.

	£000
Trade and other receivables	(2)
Fair value of derivative exchange instruments - assets	633
Total current assets	631
Trade and other payables	130
Fair value of derivative exchange instruments - liabilities	151
Total current liabilities	281
Total assets less total liabilities	350
Currency hedge reserve	350

Notes to accounts (continued)

Reconciliation of profit or loss for 2004

	UK GAAP £000	Discontinued operations £000	Effect of transition to IFRSs £000	IFRSs £000
Revenue	211,239	(3,476)	-	207,763
Cost of sales	(187,371)	2,241	15,844	(169,286)
Gross profit	23,868	(1,235)	15,844	38,477
Distribution costs	(21,668)	233	1,649	(19,786)
Administrative expenses	(18,644)	484	1,419	(16,741)
Finance income	17,000	-	-	17,000
Finance costs	(3,665)	120	(2,709)	(6,254)
Profit on disposal of discontinued operation	7,635	(7,635)	-	-
Profit before taxation	4,526	(8,033)	16,203	12,696
Tax credit	5,246	-	(1,222)	4,024
Profit for the period from continuing operations	9,772	(8,033)	14,981	16,720
Profit for the period from discontinued operations	-	8,033	-	8,033
Profit for the period	9,772	-	14,981	24,753

Notes to the reconciliation of profit or loss for 2004

- a) Following the full recognition of the assets and liabilities of the pension schemes in the balance sheet pension costs under IFRS are £14,732,000 lower than under UK GAAP, (£10,312,000 lower net of tax). Of this amount £15,993,000 has been credited to cost of sales, £1,448,000 to administrative expenses and £2,709,000 charged to finance costs.
- b) In accordance with International Accounting Standard 38, goodwill amortisation of £84,000 charged under UK GAAP has been reversed through administrative expenses.
- c) In accordance with International Accounting Standard 38, development expenditure of £1,648,000 expensed under UK GAAP has been reversed through distribution costs and capitalised on the balance sheet.
- d) Under International Financial Reporting Standard 2, there is an expense of £112,000 in administrative expenses in respect of share options that was not previously charged under UK GAAP.

Notes to accounts (continued)

- e) Under International Financial Reporting Standards there is a charge of £149,000 to cost of sales (£104,000 net of tax) that did not arise under UK GAAP.
- f) In accordance with International Accounting Standard 12, there is a deferred tax credit of £1,222,000 to the income statement in 2004 that did not arise under UK GAAP.