

Group Activities

Senior is a global engineering group, with operations in 11 countries, principally serving the aerospace and automotive markets. The aerospace business is relatively evenly spread across the large commercial, military and regional jet marketplaces supplying both airframe, engine and aerospace component manufacturers. The Automotive Division principally produces products using the Group's flexible thin-walled metal "Flexonics" technology supplying exhaust, fuel, turbocharger, engine emission and cooling parts to both the car assemblers themselves and also their Tier 1 suppliers. The Group also supplies a variety of industrial markets including the oil and gas, chemical and HVAC industries.

Acquisition

Subsequent to the year-end, the Group completed the acquisition of Sterling Machine Co., Inc., a US manufacturer of precision machined parts for the aerospace industry. Sterling Machine is a pre-eminent manufacturer of transmission and rotor-head helicopter components for military platforms, principally to Sikorsky Aircraft Corporation. The business operates from a freehold site in Connecticut, USA. In 2005, Sterling Machine reported sales of US\$18.8m and profit before interest and tax of US\$4.2m. The cash consideration, including assumed net debt, was US\$37.6m which was funded through a combination of a placing of 15 million new Senior plc shares at 60p each and utilisation of the Group's existing borrowing facilities.

Future Structure of the Group

Starting with the 2006 interim results, the plan is to present the Group as having two divisions. The Senior Aerospace Division will have 11 subsidiaries, including the newly acquired Sterling Machine, while a newly named Senior Flexonics Division will include both the existing eight automotive operations and the three industrial operations. The reason for this move is threefold: the Group's dependence upon traditional automotive components is diminishing with the increase in heavy duty diesel applications; the Group already has an industry recognised common brand in "Flexonics" and much common technology across the automotive and industrial market sectors; and the move to only two divisions signifies the end of a period of rationalisation of the Group and marks the beginning of a sustained period of growth for Senior both as a result of new products and expanding markets.

Changes in Accounting Policy

Companies listed on security exchanges within the European Union were required to adopt International Financial Reporting Standards (IFRS) for accounting periods beginning on or after 31 December 2004. Accordingly, the Group's 2005 Financial Statements represent the first time the Group has reported under IFRS. The Company, Senior plc, is also reporting under IFRS for the first time. All comparative figures for 2004 have been restated with Note 39 to the financial statements explaining the effect of the transition to IFRS on the balance sheets at the start and end of 2004 and the income statement for 2004. The most significant effects relate to the non-amortisation of goodwill, the non-accrual for period end dividends and a change in the treatment of previously written-off goodwill upon the disposal of operations. The reconciliation at Note 39 shows that other effects were minor with the Group trading profit on continuing operations for 2004 being £0.3m lower under IFRS than previously reported under UK GAAP.

Financial Performance of the Group

Sales

Total sales from continuing operations were £338.6m compared to £306.8m in 2004, an increase of £31.8m or 10.4%. Exchange rate movements had little year-on-year impact accounting for only £3.4m of the improvement. The underlying improvement was widely spread with each of the three divisions reporting improved turnover levels.

Operating Profit

The Group's operating profit on continuing operations was £19.6m, an 18.1% increase on the £16.6m reported for 2004. This result includes a loss on sale of fixed assets of £0.2m (2004 – £0.5m profit) which, when added back, results in a Group trading profit from continuing operations of £19.8m. This is £3.7m or 23.0% ahead of 2004's £16.1m with only £0.3m of the increase due to exchange rate movements. All three divisions reported improved profitability.

Investment Income and Finance Costs

Investment income fell to £1.3m from £2.1m in 2004 due to a one-off benefit in 2004 when £0.8m of interest relating to a US tax refund was received.

Finance costs remained relatively stable at £6.3m (2004 – £6.2m) despite the slightly higher levels

of net debt in the year. Finance costs include £1.1m (2004 – £1.2m) of net finance costs in respect of retirement benefit obligations.

Profit before Tax

Adjusted profit before tax (that arising from continuing and discontinued businesses before a £0.2m loss on disposal of fixed assets (2004 – £0.5m gain), £2.0m exchange gain on long-term intercompany loans (2004 – £nil) and a loss on disposal of discontinued businesses of £nil (2004 – £4.8m)) increased by 18.4% to £14.8m (2004 – £12.5m). Profit before tax on continuing operations was £16.6m (2004 – £12.5m). This includes the £2.0m gain (2004 – £nil) from foreign exchange movements on long-term intercompany loans as required by IAS 21 ("The Effects of Changes in Foreign Exchange Rates"), as currently endorsed by the European Union. It should be noted that an amendment to IAS 21 was issued in December 2005 which, when endorsed by the European Union, will require such foreign exchange differences to be taken to reserves rather than the income statement.

Taxation

The total tax charge on continuing operations increased to £2.5m (2004 – £1.6m). The effective tax rate, expressed as a percentage of profit before tax on continuing operations (excluding the foreign exchange gain on intercompany loans) was 17.1% (2004 – 12.8%). The low effective tax rate for 2004 benefited from £0.9m of adjustments in respect of prior periods whereas 2005 benefited by only £0.5m.

Disposals

There were no disposals in the year. In 2004 a loss of £4.4m was recognised in respect of discontinued operations being a profit before tax of £0.5m less tax of £0.1m and less the loss on disposal of £4.8m.

Earnings

Basic earnings per share from continuing operations was 4.59p an increase of 28.9% over 2004 (3.56p), reflecting both the underlying trading improvement and the £2.0m foreign exchange gain on intercompany loans discussed above. Adjusted earnings per share, the measure which the Board believes best reflects the true underlying performance of the business and whose derivation is set out at Note 12 to the financial statements, increased by 11.7% to 4.01p (2004 – 3.59p). Adjusted earnings per share exclude the effect of the disposal of businesses

and fixed assets and also foreign exchange gains or losses on long-term intercompany loans.

Dividend

As noted in the Chairman's Statement, an unchanged final dividend of 1.35p per share is proposed. Together with the unchanged interim dividend of 0.65p, the total dividend for 2005 will be 2.00p (2004 – 2.00p) assuming the final dividend is approved. The total dividend is covered 2.0x (2004 – 1.8x) by adjusted earnings per share.

Cash Flow

	2005	2004
	£m	£m
Net cash from operating activities	16.5	17.7
Interest received	1.4	2.5
Capital expenditure	(16.6)	(10.4)
Proceeds from sale of fixed assets	0.9	0.7
Free cash flow	2.2	10.5
Dividends paid	(6.1)	(6.1)
Acquisitions/disposals	(0.1)	4.5
Share issues	0.5	–
Effect of exchange rates	(7.8)	4.7
Change in net borrowings	(11.3)	13.6
New borrowings under IFRS	(0.5)	–
Opening net borrowings	(50.6)	(64.2)
Closing net borrowings	(62.4)	(50.6)

Free cash flow, as set out above and in Note 34(b) to the financial statements, decreased from £10.5m to £2.2m. This was largely due to an increase of £6.2m in capital expenditure to £16.6m (2004 – £10.4m) with the increase arising in the Automotive Division where capital expenditure rose to £13.2m (2004 – £4.4m) as plant and machinery began to be installed ready for the manufacture of the new heavy duty diesel engine products for North America which are scheduled to go into production towards the end of 2006.

Net Borrowings

At the end of 2005, the Group had net borrowings of £62.4m, an increase of £11.8m in the year (31 December 2004 – £50.6m). The increase was due in part to exchange movements as well as increased capital expenditure. The Group primarily finances its borrowings through the US private placement market in US dollars and through two revolving credit facilities (one US dollar; one multi-currency). The US dollar strengthened from \$1.92:£1 at the start of the year to \$1.72:£1 at the end and this, together with other currency movements, caused £7.8m of the increase in net borrowings.

At the end of 2005 the Group had total borrowing facilities of £138.3m, of which £119.2m were committed facilities. £53.3m (2004 – £59.0m) of the committed facilities remained undrawn at the end of the year. Gearing at the year-end was 68% (2004 – 61%) measured on total net assets of £92.3m (2004 – £83.7m).

Shareholders' Equity

The increase in total shareholders' equity of £8.6m in the year; to £92.3m, largely arose from the £14.1m profit for the period less the £6.1m of dividends paid. Also of note was a £0.2m increase in share capital and a £0.3m increase in the share premium account following the exercise of options over 1.8 million shares under employee share save schemes.

Divisional Review

Aerospace Division

£m	2005	2004	Change
Sales [®]	156.2	140.3	+11.3%
Trading profit [®]	13.0	11.2	+16.1%
Margin [®]	8.3%	8.0%	–

[®]2004 results translated at 2005 exchange rates

In the Aerospace Division (ten operations in 2005), sales grew by 11.3% to £156.2m (2004 – £140.3m at constant currency). Recovery in build rates within the industry helped this growth along with new programmes coming on stream. Trading profit increased by 16.1% to £13.0m (2004 – £11.2m at constant currency) as a result of the growth in revenue, maintained control of spending and a continued focus on process improvement and efficiency. The improved operating margin of 8.3% (2004 – 8.0%) arose as a result of better throughput in the factories partially offset by the steady rise in raw material prices. Whilst the large civil aircraft builders finished 2005 with record order-books, the smaller regional jet builders recorded poor bookings in the year. Business jet and defence and military demand remained at a good level and a number of sectors, military helicopters for instance, move into 2006 with growing order books.

Another important consequence of the ongoing industry growth is the increasing opportunity for the Division to take on work being outsourced by the aircraft and engine assemblers as they seek to free up manufacturing space at their own factories. Bird Bellows benefited, during 2005, from Airbus outsourcing some ducting parts, whilst Ketema won outsourced engine parts from

Rolls-Royce which will add to sales from 2006 onwards. On the other hand, the decline in the regional jet market impacted Ketema particularly hard during 2005 and there is little sign of recovery in this market. As well as benefiting generally from the increase in aircraft build-rates, the Division also saw improved performances as a result of the business and factory rationalisations carried out at Stainless Steel Products, in the USA, and Bosman, in Holland, during the prior year.

Overall, the recent addition of Sterling Machine and the generally healthy marketplace mean prospects for the Aerospace Division should remain positive for the foreseeable future.

Automotive Division

£m	2005	2004	Change
Sales [®]	135.9	125.1	+8.6%
Trading profit [®]	8.9	8.1	+9.9%
Margin [®]	6.5%	6.5%	–

[®]2004 results translated at 2005 exchange rates

Despite the flat markets, sales in the Automotive Division (eight operations) grew by 8.6% to £135.9m (2004 – £125.1m at constant currency) and trading profits by 9.9% to £8.9m (2004 – £8.1m at constant currency) as new programmes came on stream at a number of locations. The operating margin remained unchanged at 6.5% with the gearing benefit of the increase in sales offset by the additional engineering resource and start-up costs associated with bringing the new heavy duty diesel engine parts into production at Bartlett, in the USA.

The lower cost operations in Brazil, India and South Africa continued to perform well, with new automotive programmes starting up in all three locations. Sales in the Crumlin factory in Wales, however, fell as MG Rover went into bankruptcy and replacement exhaust programmes started up in South Africa rather than Crumlin. More positively, Crumlin's newly developed EGR Cooler for diesel engine passenger vehicles continues to attract interest from a number of vehicle manufacturers which may lead to orders being placed in the coming months. As anticipated, the French operation, having resolved its material supply problems, made a profit in the second half of the year after a difficult 2004 and its prospects remain encouraging for 2006.

As mentioned previously in the Chief Executive's Statement, the introduction of the heavy duty

diesel engine products in the USA remains firmly on track with production scheduled to start in late 2006. To put these new products into production requires substantial capital investment in new capacity to be able to produce the necessary volumes. Capital expenditure, at £13.2m for the Division, was over double depreciation for the year, and is expected to be at least this level in 2006. The sales are scheduled to come through in 2007.

With such a large number of new products being introduced and the associated plant and equipment being installed, 2006 is likely to bring a number of challenges. 2007 is anticipated to be the first year to benefit from the additional volumes. Significant enquiries continue to be received for opportunities beyond those already booked which, together with growing volumes at a number of other locations, leave the Division well placed for growth from 2007 onwards.

Industrial Division

£m	2005	2004	Change
Sales ^o	47.8	45.4	+5.3%
Trading profit ^o	2.2	0.9	+144%
Margin ^o	4.6%	2.0%	–

^o2004 results translated at 2005 exchange rates

Sales in the Industrial Division (three operations) increased by 5.3% to £47.8m (2004 – £45.4m at constant currency) with trading profits improving to around two and a half times 2004 levels (2005 – £2.2m; 2004 – £0.9m at constant currency). This significant improvement was achieved despite Senior Hargreaves being adversely impacted by the losses incurred on its Wembley Stadium ducting contract as previously described. Whilst the Canadian operation once again improved its performance, the main driver for the Divisional improvement was the larger Pathway operation, in the USA, where improved markets, such as oil and gas, and the site consolidation and operational improvement actions undertaken during 2004, drove its performance well ahead of the break-even position reported in 2004. Its markets remain strong and, with the completion of Wembley Stadium in the first half of 2006, the Division can anticipate improved prospects for 2006.

Other Financial Matters

Financial Risk Management

The main financial risks faced by the Group continue to be movements in interest rates and foreign currency exchange rates as well as funding

and liquidity risks. All such risks are managed by a centralised treasury department which reports to the Group Finance Director. It operates under the guidance of the Treasury Committee, which meets quarterly and acts according to the laid-down objectives, policies and authority levels approved by the Board. The Group's external auditors normally attend the Treasury Committee once a year. All activities are focused on the management and hedging of risk and it is Group policy not to engage in speculative financial transactions.

The Group is exposed to movements in exchange rates for both foreign currency transactions and the translation of net assets and income statements of overseas operations. The Group has a policy of hedging its net investment in overseas operations through currency denominated loans and forward contracts but it does not hedge the effects of currency movements on the translation of its overseas earnings into sterling. Transaction exposures are, however, normally hedged through forward exchange contracts on a rolling 12 month basis. Changes in the fair value of derivative financial instruments that are designated and are effective as a cash flow hedge are recognised through reserves with any ineffective portion recognised in the income statement.

It is Group policy to have the majority of its gross borrowings subject to fixed rates of interest. This is achieved through having a mixture of fixed and variable rate borrowings and by entering into interest rate swaps.

Pensions

The Group operates a number of defined benefit pension plans, with the largest being the UK scheme, as well as a number of geographically based defined contribution and government sponsored arrangements.

At the end of 2005, total IAS 19 pension and post-retirement net liabilities were £39.9m (2004 – £41.4m), a reduction of £1.5m (2004 – £2.8m) in the year. Whilst equity returns were very strong, with the Group's pension fund assets increasing by £11.0m more than anticipated in the year, interest rates on long-term index-linked government bonds fell such that the liabilities of the Group's pension schemes, as calculated at the year-end, rose by £10.8m more than anticipated, effectively cancelling out the increase in asset valuations.

The UK defined benefit scheme with around 5,200 members, 460 of which are active members, accounted for the vast majority, £31.3m (2004 – £33.7m), of the Group's total net pension liabilities. The latest actuarial valuation of the UK scheme was carried out during 2004 with the past service deficit calculated at that time as £18.5m. From 2006 onwards this is being funded by additional company contributions of £3.0m per annum (2005 – £2.6m). The actuarial deficit for the UK scheme is lower than the IAS 19 deficit primarily due to the different discount rates used to value the liabilities.

In total, £1.8m (2004 – £2.0m) was charged to the profit and loss account in the year in respect of defined benefit schemes, in addition to the £1.1m (2004 – £1.2m) of net finance costs discussed earlier. The total charge for the Group's defined contribution schemes was £2.2m (2004 – £2.2m). Note 37 to the financial statements provides comprehensive details of the Group's pension plans.

Non-statutory Information

In the commentary to the year's results reference is made to non-statutory financial information. Such information includes:

- Trading profit – this is used to illustrate the underlying trading performance of the Group and excludes any profit or loss on the sale of fixed assets. The Consolidated Income Statement provides the information to reconcile this to operating profit.
- Adjusted earnings per share – this indicates the overall performance of the Group before the effect of the disposal of businesses and fixed assets and foreign exchange gains or losses on long-term intercompany loans. Note 12 to the financial statements reconciles this to reported results.
- Free cash flow – this highlights the total net cash generated by the Group prior to corporate activity such as acquisitions, disposals and dividend payments. Note 34(b) to the financial statements reconciles this to the reported results.

Going Concern

Having assessed the future funding of the Group, the Directors are of the opinion that it is appropriate for the financial statements to be prepared on a going concern basis.