



Graham Menzies, Group Chief Executive

“ AMT and Sterling Machine, the two aerospace businesses that joined the Group in 2006, have proved to be excellent acquisitions. ”

To the members of Senior plc

This Operating and Financial Review (“OFR”) has been prepared solely to provide additional information to enable shareholders to assess the Company’s strategies and the potential for those strategies to be fulfilled. The OFR should not be relied upon by any other party for any other purpose.

The OFR contains certain forward looking statements. Such statements are made by the Directors in good faith based on the information available to them at the time of their approval of this report and they should be treated with caution due to the inherent uncertainties underlying any such forward-looking information.

In preparing this OFR, the Directors have sought to comply with the guidance set out in the Accounting Standards Board’s Reporting Statement: “Operating and Financial Review”.

This OFR has been prepared for the Group as a whole and therefore gives greatest emphasis to those matters that are significant to Senior plc and its subsidiary undertakings when viewed as a whole. The OFR is organised under the following headings:

- Operations
- Long-term Strategy and Business Objectives
- Key Performance Indicators
- Acquisitions
- Financial Review
- Divisional Review
- Outlook
- Risks and Uncertainties
- Resources
- Corporate Responsibility

Operations

Senior is an international manufacturing group with operations in 11 countries. Senior designs, manufactures and markets high technology components and systems for the principal original equipment producers in the worldwide aerospace, defence, diesel engine, exhaust system and energy markets. The Group is split into two Divisions, Aerospace and Flexonics.

Aerospace

Following the recent acquisition of two aerospace businesses, Absolute Manufacturing, Inc. (“Absolute”) in December 2007 and Capo Industries, Inc. (“Capo”) at the end of January 2008, the Aerospace Division now consists of 14 operating companies, nine of which are located in the USA, two in the United Kingdom and three in continental Europe. In 2007, the Division’s main products were engine structures and mounting systems (27% of divisional sales), metallic ducting systems (19%), airframe and other structural parts (16%), composite ducting systems (12%), helicopter machined parts (7%) and fluid control systems (5%). 14% of divisional sales were to non-aerospace, but related technology, markets. Sales of airframe and other structural parts increased significantly during 2007 (3% of divisional sales in 2006) as AMT had only been owned by Senior for the final two months of 2006. The Division’s largest customers include Boeing, representing 12% of 2007 divisional sales, United Technologies, GE, Airbus, Rolls-Royce, Goodrich and Bombardier.

Flexonics

The Flexonics Division has 11 operations. These are located in North America (three), the United Kingdom (two), continental Europe (three), South Africa, India and Brazil. In 2007, the Division’s sales comprised of flexible mechanisms for vehicle exhaust systems (29% of divisional sales), cooling and emission control components (15%), diesel fuel distribution pipework (14%) and expansion joints and ducting for the heating and ventilation market (11%). Expansion joints, control bellows and hoses for the power and boiler market accounted for 12% of divisional sales, for the oil and gas and chemical processing industries (5%) and for other industrial markets (14%). In 2007, an increased percentage of sales came from diesel fuel distribution pipework and cooling and emission control component sectors as production of the Group’s new heavy duty diesel products ramped up. Whilst the Division’s three largest end users remain automotive customers (General Motors, PSA and Ford), the percentage of divisional sales coming from the automotive market fell to 47% (2006 – 55%) with sales to the heavy duty diesel engine market (e.g. Cummins, Caterpillar, and Siemens) growing to 11% of divisional sales (2006 – 2%).

Key Performance Indicator

Organic revenue

+18%

Key Performance Indicator

Adjusted earnings per share

+66%

Long-term Strategy and Business Objectives

Senior is a manufacturer of products used principally in the aerospace, diesel engine, exhaust system and energy markets.

There are four key elements to Senior's strategy for accelerating growth and creating real shareholder value. These remain unchanged from those reported last year:

- targeted investment in new product development for markets having higher than average growth potential;
- exceeding customer expectation through advanced process engineering and excellent factory execution;
- focused acquisitions which meet strict financial and commercial criteria; and
- creating an entrepreneurial culture, with strong controls, amongst its operating businesses.

The Group implements and monitors its performance against the strategy by having the following financial objectives:

- to have organic annual sales growth in excess of the rate of inflation;
- to increase adjusted earnings per share on an annual basis by more than the rate of inflation;
- to increase the Group's return on revenue margin each year;
- to generate sufficient cash to enable the Group to follow a progressive dividend policy; and
- to maintain an overall return on capital employed in excess of the Group's cost of capital and to target a return in excess of 15%.

These financial objectives are supported by two non-financial objectives which are:

- to reduce the Group's carbon dioxide emissions to revenue ratio by 15% over the period from 2006 to 2010; and
- to reduce the number of OSHA (or equivalent) recordable injury and illness cases involving days away from work by 5% per annum.

During 2007, the Group made progress in most of its strategic objectives. The aerospace businesses acquired in 2006 both performed very well in their first full year with the Group. Two further aerospace businesses were acquired in December 2007 and January 2008. Production of the new heavy duty diesel engine products ramped up and their contribution improved, as the year progressed. Operational improvements, including reductions in recordable injuries, were made at many of the Group's operations. On-time delivery performance for the Group improved to 90% (2006 – 88%) when measured as a rolling six month average.

The Group's progress against its strategic objectives can be assessed by considering the key performance indicators set out in the table below.

Key Performance Indicators

	2007 £m	2006 £m
Organic revenue growth ⁽¹⁾	+18%	+10%
Adjusted earnings per share ⁽²⁾	7.71p	4.65p
– growth	+66%	+22%
Return on revenue margin ⁽³⁾	9.6%	6.8%
Return on capital employed ⁽⁴⁾	19.2%	13.8%
CO ₂ emissions/£m revenue ⁽⁵⁾	110.3 tonnes	113.7 tonnes
Lost time injury frequency rate ⁽⁶⁾	2.55	2.77

(1) Organic revenue growth is the rate of growth of Group revenue, at constant exchange rates, excluding the effect of acquisitions and disposals.

(2) Adjusted earnings per share is the profit after taxation (adjusted for the profit or loss on disposal of fixed assets, amortisation of intangible assets arising on acquisitions and the release of a provision originally set up on a previous acquisition) divided by the average number of shares in issue in the period.

(3) Return on revenue margin is the Group's adjusted operating profit divided by its revenue.

(4) Return on capital employed is the Group's adjusted operating profit divided by the average of the capital employed at the start and end of the period. Capital employed being total assets less total liabilities, except for those of an interest bearing nature.

(5) CO₂ emissions/£m revenue is an estimate of the Group's carbon dioxide emissions in tonnes divided by the Group's revenue in £ millions.

(6) Lost time injury frequency rate is the number of OSHA (or equivalent) recordable injury and illness cases involving days away from work per 100 employees.

The table of Key Performance Indicators above shows that the Group comfortably exceeded all four of its financial goals during the year. The CO₂ emissions/£m revenue fell by 3% during 2007 with the Group on target to achieve its stated goal of reducing the ratio by 15% by 2010 (compared with 2006). Lost time injury frequency rate fell by 8% in the year, in excess of the targeted 5% per annum reduction.

Acquisitions

Since the Group last reported, two acquisitions have been completed.

Absolute was acquired on 10 December 2007 for \$14.4m (£7.0m). Absolute specialises in the machining of high tolerance and high surface finish parts in aluminium, titanium and a variety of stainless steels. Activities include machining parts for aircraft tyre pressure monitoring systems, flap and door movement sensor housings and laser guidance housings for both commercial applications and night vision defence industry equipment.

Operating and Financial Review continued

Key Performance Indicator

Return on revenue margin

9.6%

The business had sales of \$14m in 2007 and continues to be managed by one of its former owners. It is located in Arlington, north of Seattle in Washington State, USA. The purchase consideration was funded through the utilisation of the Group's existing borrowing facilities.

Capo was acquired after the year-end, on 25 January 2008. Capo is located in Chino, close to Los Angeles, California, USA. In 2007 it had sales of \$36m. Capo specialises in the 5-axis machining of titanium and steel alloys primarily for auxiliary power units on large commercial aircraft and for propulsion engines on business jets. Capo was acquired for \$85m (£42.9m) plus costs, potential deferred consideration of \$5m (£2.5m) contingent upon the operating profit achieved in 2008, and the assumption of certain acquisition-related tax liabilities. The total amount payable in respect of the acquisition, estimated at a maximum of £47.1m, is to be funded through the utilisation of the Group's existing borrowing facilities. In order to maintain a satisfactory level of headroom, a short-term £20m loan facility was entered into during January 2008. The company continues to be run by the same management team that was in place prior to its acquisition by Senior.

The two aerospace businesses acquired in 2006, Sterling Machine and AMT, both had excellent performances in 2007.

Financial Review

Summary

A summary of the Group's operating results are set out in the table below. Further detail on the performance of each Division is included in the section titled "Divisional Review".

	Revenue		Adjusted operating profit ⁽¹⁾		Margin	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 %	2006 %
Aerospace	246.2	197.0	33.4	19.2	13.6	9.7
Flexonics	225.0	191.5	17.4	11.8	7.7	6.2
Inter-segment sales	(0.5)	(0.6)	–	–	–	–
Central costs	–	–	(5.8)	(4.8)	–	–
Group total	470.7	387.9	45.0	26.2	9.6	6.8

(1) Adjusted operating profit is the profit before interest and tax and before the loss on disposal of fixed assets, amortisation of intangible assets arising on acquisitions and the release of a provision set up on a previous acquisition.

Key Performance Indicator

Return on capital employed

19.2%

The adjusted operating profit may be reconciled to the operating profit shown in the Consolidated Income Statement as follows:

	2007 £m	2006 £m
Operating profit per financial statements	41.5	24.5
Loss on sale of fixed assets	0.7	0.4
Release of provision set up on acquisition	(0.5)	–
Amortisation of acquisition intangible assets	3.3	1.3
Adjusted operating profit	45.0	26.2

With the commercial aerospace and energy markets particularly strong, Group revenue grew by 21%, aided by full year contributions from the two businesses acquired in 2006. 2007 revenue also benefited from the ramp up of the heavy duty diesel products which went into production at the end of 2006. Adjusted operating profit rose by 72% principally due to the gearing benefit of increased sales, strong performances from the newly acquired businesses and a significantly increased contribution from one of the Flexonics' operations, Pathway. Operating margins consequently increased significantly to 9.6%, nearly three percentage points higher than in the prior year (6.8%).

The Group's free cash flow and net debt for 2007 and the prior year were:

	2007 £m	2006 £m
Free cash flow	18.5	5.1
Net debt	94.8	96.7

Free cash flow is the total net cash flow generated by the Group prior to corporate activity such as acquisitions, disposals, financing and transactions with shareholders. It may be derived from the figures contained in the Financial Statements as follows:

	2007 £m	2006 £m
Net cash from operating activities	35.3	22.3
Interest received	0.8	1.3
Proceeds on disposal of tangible fixed assets	1.9	2.2
Purchases of tangible fixed assets	(19.0)	(20.1)
Purchases of intangible assets	(0.5)	(0.6)
Free cash flow	18.5	5.1

CO₂ emissions/£m revenue

Reduced by 3%

The reduction in net debt to £94.8m (£96.7m) was achieved after having funded the acquisition of Absolute (£7.0m).

Revenue

Group revenue increased by £82.8m (21%) to £470.7m (2006 – £387.9m) with the full year contribution from AMT, which was acquired on 27 October 2006, responsible for £33.1m of the increase. If the effect of acquisitions (an increase in reported revenue of £35.4m) and the adverse year-on-year exchange effect (£19.0m) are excluded then underlying revenue grew by 18% on a constant currency basis. In 2007, 60% of Group sales originated from North America, 19% from the rest of Europe, 12% from the United Kingdom and 9% from the rest of the world.

Operating profit

Group operating profit increased by 69% to £41.5m (2006 – £24.5m). Adjusted operating profit increased by £18.8m (72%) to £45.0m (2006 – £26.2m). Adjusted operating profit is that before loss on disposal of fixed assets of £0.7m (2006 – £0.4m), amortisation of intangible assets arising on acquisitions of £3.3m (2006 – £1.3m) and the release of a provision originally set up on a previous acquisition. If the effects of the acquisitions (an increase in reported operating profit of £8.2m) and foreign currency effects (£1.8m adverse) are excluded then underlying adjusted operating profit increased by 57% on a constant currency basis.

Finance costs

Finance costs, net of investment income of £1.0m (2006 – £0.9m), increased to £7.2m (2006 – £6.4m) mainly due to the average level of the Group's debt increasing, principally as a result of the acquisition of AMT in October 2006.

Profit before tax

Adjusted profit before tax increased by 91% to £37.8m (2006 – £19.8m). Reported profit before tax increased to £34.3m (2006 – £18.1m).

Tax charge

The total tax charge increased to £6.4m (2006 – £2.9m) as the taxable profits of the Group increased. The net tax benefits, arising on the loss on sale of fixed assets, amortisation of intangible assets from acquisitions and release of the provision originally set up on a previous acquisition, totalled £1.4m (2006 – £0.6m). If these are added back then the underlying tax charge of £7.8m (2006 – £3.5m) represented an underlying rate of 20.6% (2006 – 17.7%) on the adjusted profit before tax of £37.8m (2006 – £19.8m). The increase in the underlying tax rate was mainly due to the increased proportion of the Group's profits being generated in the USA, where the Group's tax rate is approximately 38%. The Group's underlying tax rate is expected to increase further in 2008 as this trend continues.

Lost time injury frequency rate

Reduced by 8%

Lost time injury frequency rate is the number of OSHA (or equivalent) recordable injury and illness cases involving days away from work per 100 employees.

Earnings per share

Largely due to the rights issue undertaken in the autumn of 2006, in connection with the acquisition of AMT, the weighted average number of shares, for the purposes of calculating diluted earnings per share, increased to 389.0 million (2006 – 349.8 million). Taking this into account, adjusted earnings per share increased by 66% to 7.71p (2006 – 4.65p). Basic earnings per share increased by 65% to 7.17p (2006 – 4.35p).

Dividends

A final dividend of 1.700p per share is proposed for 2007 (2006 final dividend – 1.381p) which would cost £6.6m (2006 final dividend cost £5.4m). This would bring the full year dividend to 2.400p per share, a 20% increase over the prior year's 2.000p per share. The cash outflow incurred in 2007, in respect of the final dividend for 2006 and the interim dividend for 2007, was £8.1m (2006 – £6.5m).

Research and development

Following the start of production of the heavy duty diesel products in late 2006, the Group's expenditure on research and development slightly reduced to £8.2m during 2007 (2006 – £8.5m). Expenditure is mainly incurred in designing and engineering products in accordance with individual customer specifications and developing specific manufacturing processes for their production.

Capital expenditure

£19.5m was invested in capital expenditure in 2007 (2006 – £20.7m) to increase capacity and capability in both the Aerospace and Flexonics Divisions. £1.9m (2006 – £2.2m) was raised through the disposal of assets no longer required. A higher level of capital expenditure is anticipated for 2008 as the Group invests in additional capacity to meet the demands of the growing aerospace market.

Capital structure

The Group's Consolidated Balance Sheet at 31 December 2007 may be summarised as follows:

	Assets £m	Liabilities £m	Net assets £m
Property, plant and equipment	93.6	–	93.6
Goodwill and intangible assets	126.2	–	126.2
Current assets and liabilities	160.5	(98.8)	61.7
Other non-current assets and liabilities	3.6	(4.1)	(0.5)
Post-retirement obligations	–	(36.3)	(36.3)
Total before net debt	383.9	(139.2)	244.7
Net debt	9.2	(104.0)	(94.8)
Total at 31 December 2007	393.1	(243.2)	149.9
Total at 31 December 2006	365.5	(238.4)	127.1

Net assets increased by 18% in the year to £149.9m (2006 – £127.1m) and net assets per share also increased by 18% to 38.4p (2006 – 32.6p). There were 390.8 million ordinary shares in issue at the end of 2007 (2006 – 389.9 million). Post-retirement obligations decreased to £36.3m (2006 – £37.5m) because of the net effect of the benefit of a higher rate of 5.9% being used to discount the UK Scheme liabilities (2006 – 5.3%) and the inclusion of an additional £7.0m of UK Scheme liabilities in respect of prior years. The additional liabilities, (which only came to light during 2007) relate to the equalisation of pension ages for men and women which took place in the early 1990s.

Cash flow

The Group's free cash flow, whose derivation is set out in the table below, increased by 263% to £18.5m (2006 – £5.1m) largely because of the increased operating profits. An investment of £9.6m (2006 – £4.5m) was made in working capital, as revenue increased, whilst net capital expenditure of £17.6m (2006 – £18.5m) remained ahead of the depreciation level of £14.6m (2006 – £12.6m), excluding £3.3m (2006 – £1.3m) of amortisation of intangible assets acquired on acquisition.

	2007	2006
	£m	£m
Operating profit	41.5	24.5
Depreciation and amortisation	17.9	13.9
Working capital movement	(9.6)	(4.5)
Pension payments above service cost	(3.0)	(3.4)
Other items	1.7	1.0
Operating cash flow	48.5	31.5
Interest paid (net)	(6.2)	(5.3)
Tax paid	(6.2)	(2.6)
Capital expenditure	(19.5)	(20.7)
Sale of fixed assets	1.9	2.2
Free cash flow	18.5	5.1
Dividends	(8.1)	(6.5)
Acquisitions and disposals	(8.1)	(79.7)
Share issues	0.2	34.8
Foreign exchange variations	(0.8)	11.7
Non-cash movements	0.2	0.3
Opening net debt	(96.7)	(62.4)
Closing net debt	(94.8)	(96.7)

Net debt

Net debt decreased by £1.9m in the year to £94.8m (2006 – £96.7m). The decrease was achieved after having paid a net £8.1m in respect of acquisitions and disposals, with the acquisition of Absolute at £7.0m being the main element. At the year end, around 75% of the Group's gross borrowings (31 December 2006 – 95%) were in US\$. Unlike 2006, when the US\$ weakened significantly against the £ causing an £11.7m reduction in net debt, the US\$ ended the year close to the level it started at, such that the effect of all exchange rate movements on net debt in 2007 was minimal.

Liquidity

As at 31 December 2007, the Group's gross borrowings, excluding finance leases, were £99.8m (2006 – £103.3m). The maturity of these borrowings, together with the maturity of the Group's committed facilities, can be analysed as follows:

	Gross borrowings ⁽¹⁾ £m	Committed facilities £m
Within one year	41.5	37.7
In the second year	–	–
In years three to five	25.0	91.5
After five years	33.3	32.7
	99.8	161.9

(1) Gross borrowings include the use of bank overdrafts, other loans and committed facilities.

Upon the acquisition of Capo in January 2008, the Group entered into a new £20m 364-day bilateral facility, with one year term out, in order to provide additional headroom under its borrowing facilities. \$75m (£37.7m) of loan notes mature in October 2008 and it is anticipated that these will be partially refinanced at their maturity.

Going concern basis

After making enquiries the Directors have formed the judgement, at the time of approving the Financial Statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Directors have continued to adopt the going concern basis in preparing the Financial Statements.

Changes in accounting policies

There have been no changes in accounting policies in the current year.



Mark Rollins, Group Finance Director

“ Trading in the first two months of 2008 has been ahead of the Board’s expectations and the Board expects 2008 to deliver further meaningful growth. ”

Divisional Review

The Group consists of two divisions, Aerospace and Flexonics, whose performances are discussed below. It should be noted that, in order to make appropriate comparisons, the results for 2006 have been translated at constant currency using 2007 average exchange rates.

Aerospace Division

	2007 £m	2006 £m	Change
Revenue	246.2	185.8 ⁽¹⁾	+33%
Adjusted operating profit	33.4	18.1 ⁽¹⁾	+85%
Operating margin	13.6%	9.7%	–

(1) 2006 results translated using 2007 average exchange rates.

The revenue of the Aerospace Division grew by £60.4m (33%) to £246.2m (2006 – £185.8m at constant currency). The year-on-year effect of acquisitions was £36.9m at constant currency, with Sterling Machine acquired January 2006, AMT acquired October 2006 and Absolute acquired December 2007. Elsewhere, the continuing aerospace businesses increased revenue by 14% over 2006.

63% of the Division’s sales are to the commercial aerospace markets, with 43% to the wide-bodied sector (namely Boeing, Airbus and the associated engine builders). The results for 2007 consequently benefited from the ongoing strong growth in the build rates of aircraft for these markets. Boeing and Airbus together delivered 7% more aircraft in 2007 (894) than in 2006 (832). More importantly, in 2007 their order intakes were at record levels (2,754 aircraft combined), such that the combined order book increased by 37% to 6,848 aircraft (31 December 2006 – 4,988) during the year. The seven-and-a-half year order book, at current delivery rates, represents a very healthy picture for the future with both Airbus and Boeing forecasting to increase build rates further in the coming years.

In the regional jet market, Embraer had higher deliveries for the first time in three years (169 aircraft against 130 in 2006) whilst Bombardier received orders (a net 250 aircraft) at twice the level of deliveries (125 aircraft). Elsewhere, the business jet market was very strong at 1,138 deliveries, some 29% higher than in 2006 (885 deliveries) whilst, overall, the military market was stable with increased volumes of helicopter parts to Sikorsky being largely offset by reduced demand for aircraft spares from the US Government.

Adjusted operating profit (that before profit/loss on disposal of fixed assets and amortisation of intangible assets arising on acquisitions) increased by £15.3m (85%) to £33.4m (2006 – £18.1m at constant currency) with acquisitions accounting for £8.5m of the increase (at constant currency). Excluding acquisitions, divisional adjusted operating profit improved by 47% compared to 2006. The divisional operating margin increased by nearly four full percentage points to 13.6% (2006 – 9.7%). This was mainly due to widespread operational improvements, the gearing benefit of having increased production in existing facilities and the fact that the acquired businesses had a higher than average operating margin.

In 2007, capital expenditure for the Aerospace Division increased to £10.9m (2006 – £7.6m), as production capacity and capability was added to meet the demands of the growing industry. This represented 1.6x (2006 – 1.4x) the depreciation level.

Flexonics Division

	2007 £m	2006 £m	Change
Revenue	225.0	183.7 ⁽¹⁾	+22%
Adjusted operating profit	17.4	11.1 ⁽¹⁾	+57%
Operating margin	7.7%	6.0%	–

(1) 2006 results translated using 2007 average exchange rates.

Revenue for the Flexonics Division grew by £41.3m (22%) to £225.0m (2006 – £183.7m at constant currency) mainly due to the ramping up of the heavy duty diesel products in North America, that had gone into production in late 2006, the strong global energy and power markets and a growing presence in the truck exhaust market in Europe. Light vehicle markets in North America and Europe were subdued, being down 2.5% and up 0.5% respectively. Whilst sales of heavy/medium trucks in North America were very weak (371,000 against 545,000 in 2006), this market was new for Senior and hence sales of the new heavy duty diesel products were mostly incremental to the Group. Senior should benefit in the future when volumes in the heavy/medium truck markets get closer to historic levels.

The additional volumes, an improving contribution from the heavy duty diesel products, improved factory performances and capacity versus demand constraints in a number of markets resulted in adjusted operating profit for the Division increasing by 57% to £17.4m (2006 – £11.1m at constant currency). All the growth was organic, as no acquisitions have been undertaken in this Division in recent years. As a result, the operating margin of the Flexonics Division for 2007 increased by 1.7 percentage points to 7.7% (2006 – 6.0%).

2005 and 2006 had seen significant levels of capital expenditure being incurred to put the heavy duty diesel products into production. With the start of production occurring in late 2006, capital expenditure for the Division decreased to £8.5m or 1.1x depreciation in 2007 (2006 – £13.0m or 1.9x depreciation).

Outlook

The commercial aerospace market (63% of the Aerospace Division's sales) goes from strength to strength. Boeing and Airbus both received record orders in 2007 and, with their order books now representing over seven times current deliveries, they are each seeking to increase the rate of production of a number of their aircraft in future years. In addition, the Airbus A380, on which the Group has a sales value of around £170k per plane, started to be delivered to customers during 2007 after a period of delay. Production is now ramping up and the Group's sales to this programme are expected to recommence in earnest around the middle of 2008. Whilst the first flight of the Boeing 787 (the "Dreamliner") has been delayed for a few months, and is now scheduled for the middle of 2008, the programme represents substantial future revenue growth for Senior. The Group has an average of £410k of revenue on each aircraft, a record for Senior, and with 817 orders already having been booked by Boeing by the end of 2007 the programme can be expected to ramp up to over 100 aircraft per year in a few years time.

Prospects for the remaining aerospace sectors are generally healthy. Production of business jets is expected to continue at least at current levels for the immediate future, the combined order book for the regional jet manufacturers is strengthening and the military market is anticipated to remain stable in the near future, with production of a number of programmes such as the Airbus A400M and Lockheed's Joint Strike Fighter (Senior has around £125k per aircraft) starting up. These are all expected to boost growth in the coming years. In addition, the Aerospace Division will benefit from the inclusion of the results of Absolute (acquired December 2007) and Capo (acquired January 2008).

The industrial markets of the Flexonics Division, such as power generation, oil and gas, chemical processing, steel processing plants, and alternative energy (such as nuclear, solar and wind) have each remained strong going into 2008 and prospects are good for another excellent year. The markets for light vehicles are generally stable, albeit well below historic highs. Whilst sales of heavy/medium trucks in North America were at low levels during 2007, this was the first full year of production of the Group's new heavy duty diesel products which consequently all represented incremental business for the Division. Our customers are expecting volumes to increase towards the later part of 2008. Increasing vehicle volumes combined with ever tighter vehicle emission legislation offer significant opportunity for the Group. In addition, a small but increasing market is developing for the Group's products in alternative energy where the Flexonics Division already supplies to the nuclear industry in North America and Europe and to the solar and wind generation industries in Europe.

The Group has many growth opportunities ahead of it, the more immediate of which are the contributions from Absolute and Capo, the general strength of the commercial aerospace market, the production ramp up of the A380 and B787 programmes, a continual improvement in the contribution from the heavy duty diesel products and the continuing strength of the general global industrial markets.

Trading in the first two months of 2008 has been ahead of the Board's expectations and the Board expects 2008 to deliver further meaningful growth. Prospects remain encouraging for subsequent periods.

Risks and Uncertainties

There are a number of potential risks and uncertainties, which could have a material impact on the Group's future performance and could cause actual results to differ materially from those expected or from historical results.

Competitors

The Group operates in competitive market sectors. The aerospace market is principally located in North America and Europe and this is where the Group's aerospace operations are situated, so enabling engineering support to be readily given to its customers. Whilst the industry is consolidating, the supplier base remains fragmented and the actions of a single competitor are unlikely to have a material impact on the results of the Group.

In the Flexonics Division, the industrial markets in which the Group operates (42% of 2007 divisional sales) are diverse both geographically and in nature with engineering skills, technical qualifications and service levels the key to success for most of them. Again the markets are competitive but no single competitor represents a material threat to the Group. In the automotive markets, products like the new North American heavy duty diesel engine products are similar in nature to those of aerospace in that engineering support and process engineering are very important to the customers' choice of supplier. However, there are other automotive products where competition is fiercer and price more the defining factor. Where this is the case, the Group is increasingly manufacturing the product in its lower cost operations in the Czech Republic, South Africa, Brazil and India, rather than in its North American and European operations.

Markets and customers

Over half of the Group's sales are derived from the aerospace market with the majority to the commercial aircraft sector where Boeing and Airbus aircraft accounted for 22% of 2007 Group sales. Whilst the commercial aerospace market is expected to remain buoyant for a number of years, should this not be the case the Group's financial performance would be adversely affected, as was the case in 2001 following the events of "9/11". The Group has a relatively balanced portfolio of aerospace customers, nearly all of whom are financially strong, with the largest representing some 6% of 2007 Group sales. The immediate and total loss of such a customer is considered to be highly improbable given that many parts are typically supplied from a number of Senior's operations to a range of customer locations, with many products on long-term agreements.

The industrial markets are diverse, fragmented and generally healthy with the largest single customer representing around 1% of 2007 Group sales. The failure of any industrial customer is, therefore, unlikely to have a material effect on the Group. Whilst the North American automotive industry is gradually improving its financial condition not all manufacturers and suppliers to the market are yet financially secure. In the event that one of the larger automotive manufacturers were to seek protection from its creditors (known as going into Chapter 11 in the USA) then the Group may not recover all of the amounts owed to it. However, production of the vehicles, and hence sales of the Group's products, would probably continue, albeit at a lower level, so rendering the impact to be of a one-off rather than ongoing nature. The largest manufacturer accounted for around 6% of 2007 Group sales, both to the manufacturer directly and/or to its supplier base.

Manufacturing

The Group's manufacturing facilities could be disrupted for reasons beyond the Group's control such as fire, workforce actions and other issues. As such, the Group prepares recovery plans for the most likely situations so that business continuity procedures are in place and staff are appropriately trained to implement them should these situations occur.

Due to the rapid advancement in manufacturing technology, facilities may become outdated affecting efficiency and product quality which in turn may have a detrimental impact on revenue, cost of sales and profit margins. Consequently, the Group has to continue to invest in new manufacturing equipment and processes in order that it remains competitive in its chosen markets.

Environmental

The Group's operations, like those of other companies engaged in similar businesses, require the handling, use, storage and disposal of certain regulated materials. As a result, the Group is subject to the requirements of environmental and occupational health and safety laws and regulations in a number of jurisdictions. These regulate such matters as waste water, storm water, solid and hazardous waste materials, and air quality. Under such laws and regulations, the Group may be liable for, amongst other things, the cost of investigating and remediating contamination (regardless of fault) and for fines and penalties for non-compliance. The Group's operations generally do not raise significant environmental risks, but the Group does use certain hazardous materials in its business.

Defined benefit pension plans

The Group operates a number of defined benefit pension plans, with the largest being a UK scheme, as well as a number of geographically based defined contribution and government sponsored arrangements. The primary liability for funding the UK defined benefit pension scheme rests with the participating employer. By virtue of legislation, there may be risks for the Group in relation to this pension scheme. These are largely generic risks associated with the operation of UK defined benefit pension schemes (including the imposition of more onerous employer contribution/funding requirements by the Pensions Regulator, the requirement to fund the winding-up of pension schemes by trustees on a "buy-out basis" and the provision of funding guarantees where required by the Pensions Regulator). Should the Pensions Regulator impose any of these requirements, they could have an adverse effect on the results of the Group's operations. In order to mitigate some of these risks the Group has chosen to close the UK defined benefit scheme to new employees from April 2008.

Capital risk management

The Group manages its capital structure to safeguard its ability to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

In considering the appropriate level of net debt the Group pays close attention to its level as compared to the cash generation potential of the Group, measured by adjusted profit before interest, tax, depreciation and amortisation ("EBITDA"). The Group also monitors capital on the basis of a gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as the total of bank and other loans, obligations under finance leases, forward exchange contract losses less cash and cash equivalents and forward exchange contract gains (as shown in Note 33c to the Financial Statements). Total capital is the equity shown in the Consolidated Balance Sheet.

All of the Group's external borrowing facilities have a requirement for the ratio of net debt to EBITDA to be less than 3.0x. Internally the Group aims for this ratio not to exceed 2.5x. As at 31 December 2007 the net debt was 1.6 times EBITDA (31 December 2006 – 2.1x).

During 2007, the Group's strategy, which was unchanged from 2006, was to target a long-term gearing ratio for the Group of less than 60%. The gearing ratio for the Group at the end of 2007 was 63% (2006 – 76%). Following a recent review by the Treasury Committee, the Group's future strategy is to maintain the long-term gearing ratio within the range 60% to 80%. However, ratios outside this range might still be considered to be acceptable, in certain circumstances e.g. following an acquisition.

In addition to the internal gearing targets, one of the Group's borrowing facilities requires consolidated net worth to exceed £175m and the ratio of net debt to consolidated net worth to be less than 100%. Consolidated net worth ("CNW") is calculated as total capital (as defined above) excluding own shares held, less other intangible assets, adding back retirement benefit obligations and goodwill previously written off. The Group comfortably met these targets throughout the periods reported, with CNW being £254m at the end of 2007 and net debt to CNW being 37%.

Financial risk management

The Group's activities expose it to a variety of financial risks including foreign exchange risk, interest rate risk, credit risk and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

The Group uses derivative financial instruments to hedge certain risk exposures. The use of financial derivatives is governed by the Group's policies approved by the Board, which provide written principles on foreign exchange risk, interest rate risk, credit risk, the use of financial derivatives and non-derivative financial instruments, and the investment of excess liquidity. Compliance with policies and exposures limits is reviewed by the Treasury Committee on a regular basis. The Group does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

Foreign exchange risk management

The Group enters into forward foreign exchange contracts to hedge the exchange risk arising on the operations' trading activities in foreign currencies and on the Group's net investments outside the UK. The following sensitivity analysis of the Group's exposure to foreign currency risk at the reporting date has been determined based on the change taking place at the beginning of the financial year and left unchanged throughout the reporting period with all other variables held constant (such as interest rates).

Translation risk

The Group derived approximately 88% of its revenue from businesses outside the United Kingdom, of which 60% related to operations in North America. Fluctuations in the value of the US dollar and other currencies in relation to the Pound Sterling have had, and may continue to have, a significant impact on the results of the Group's operations when reported in Pound Sterling. The Group has decided not to hedge this translation risk. A 5% appreciation of the US dollar against Pound Sterling would have increased 2007 Group operating profit by £1.5m.

The majority of shareholder funds are denominated in foreign currency, particularly in US dollars. The Group matches net exposures through a combination of borrowings in the same currencies and foreign exchange forward contracts. At the end of 2007, the achieved cover of the net assets, including goodwill, denominated in currencies other than Pound Sterling were: US dollar at 76% (2006 – 71%), Euro at 94% (2006 – 89%), Czech Crown at 110% (2006 – 95%) and Canadian Dollar at 57% (2006 – 100%). Net assets denominated in Indian Rupees, South African Rand, and Brazilian Real were not hedged in 2006 and 2007. A 5% appreciation of all other currencies against Pound Sterling would have increased net equity by £3.1m, £2.2m of which would have been due to the US dollar movement.

Transaction risk

The Group has a number of transaction-related foreign currency exposures; particularly the Euro with the South African Rand and the US dollar with Pound Sterling. The Group seeks to hedge between 80% and 100% of transaction related exposures for 15 months forward by applying hedge accounting where the forwards can be designated in a qualifying cash flow hedge relationship. Based on the net of the annual sales and purchase related exposures after hedging, a 5% appreciation of the Euro against the Rand would have increased operating profit by £0.2m and a 5% appreciation of the US dollar against Pound Sterling would have increased operating profit by £0.3m, offset by a increase in US dollar denominated interest payables of £0.3m. All other transaction-related foreign currency exposures after hedging are immaterial. Any impact on profit would be spread over the following 12 months and on cash flow over the following 15 months.

The impact on net equity is determined by the unrecognised portion of open forward contracts at the year end. A 5% appreciation of the Euro against the Rand and of the US dollar against Pound Sterling would have decreased net equity by £0.3m and £0.7m, respectively.

The Group's sensitivity to foreign currency has increased mainly due to the purchase of four US companies between January 2006 and January 2008.

Interest rate risk management

The Group enters into interest rate swaps to mitigate the risk of rising interest rates and to balance the structure between fixed and variable debt. The following sensitivity analysis of the Group, and Company's exposure to interest rate risk, at the reporting date has been determined based on the exposure to interest rates at the beginning of the financial year and held constant throughout the reporting period with all other variables held constant (such as foreign exchange rates).

The Group has a policy of maintaining approximately 60% of its borrowing costs at fixed rates. The Group generally borrows long-term in fixed rates, but may occasionally borrow at floating rates and swap into fixed. The Group has a policy of applying cash flow hedging in this instance. Occasionally a portion of the fixed debt interest is swapped into floating rates, when the Group would apply fair value hedging.

The Group is exposed to interest rate movements, particularly on US dollar denominated debt. If variable interest rates had been 0.5% lower, the Group and Company's net profit would have increased by £0.2m. Any fixed interest debt is held up to maturity and not fair value adjusted through profit and loss. An increase of 0.5% in the US dollar market interest rate for the fixed rate debt held up to maturity would have decreased the fair value of the Group's borrowings by £2.3m.

The Group and Company's sensitivity to interest rates has decreased during the current period mainly due to the increased proportion of fixed debt.

Credit risk management

The Group's credit risk is primarily attributable to its trade receivables. The credit quality of customers is assessed taking into their account financial position, past experience and other factors. In determining the recoverability of trade receivables, the Group considers any change in the credit quality of the trade receivable from the date credit was initially granted up to the reporting date. The Group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers. Credit risk on liquid funds and derivative financial instruments is limited because the counterparties are financial institutions with high credit-ratings assigned by international credit rating agencies. The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Group and Company's maximum exposure to credit risk.

Liquidity risk management

The Group manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

Resources

Employees

The key resource of the Group is its employees who have extensive knowledge of the Group's key markets, customers, product technology and manufacturing processes. The average number of employees employed in the Group during 2007 was 5,684 (2006 – 5,202). Of these 4,903 were in production related roles, 61 in distribution, 287 in sales and 433 in administration. Senior is a global group operating in 11 countries. At the end of 2007 the Group employed a total of 5,824 people with 51% located in North America, 15% in the United Kingdom, 21% in the rest of Europe and 13% in the rest of the world.

Manufacturing technology

A key strength of the Group is in its manufacturing technology and production processes which help maximise production efficiency and product quality. This in turn maintains and enhances the Group's reputation for delivering quality added-value products to its customers on time and at a competitive price. During 2007 the Group spent £19.5m (2006 – £20.7m) on capital expenditure to add to the Group's manufacturing capability, as well as its production capacity. This was 1.3x the depreciation level (2006 – 1.6x).

Financial

The Group funds its activities through a mixture of equity and debt financing. It obtains its equity financing from a wide range of non-related institutional investors who trade the Company's shares on the London Stock Exchange. The largest holder has an interest in around 7% of the shares of the Company. As at 31 December 2007, the Company's share price was 117.75p, giving it a market capitalisation of around £460m (31 December 2006 – £250m). In respect to the debt financing, at the end of 2007, the Group had committed borrowing facilities totalling £161.9m of which £98.4m was being utilised. The committed facilities at this time consisted of \$75m (£37.7m) of loan notes due in October 2008, \$35m (£17.6m) of loan notes due in 2014, \$30m (£15.1m) of loan notes due in 2017, an £80.0m multi-currency revolving credit facility maturing in 2012 and a \$23m (£11.5m) bi-lateral facility maturing in 2010. In addition, during January the Group entered into a £20m 364 day bi-lateral facility, with an option to extend by one year, in order to provide additional headroom following the acquisition of Capo.

Corporate Responsibility

The policy of the Board is to seek to enhance shareholder value in an ethical and socially responsible manner, taking into account the wishes of all stakeholders, and with a particular focus on health and safety and preserving the environment. Two of the Group's six KPIs, namely reductions in carbon dioxide emissions and lost time injuries, are targeted at this area. Extensive details of the Group's corporate and social responsibility principles and performance indices are set out in a separate "Corporate Social and Responsibility Report" later in this Annual Report.