Press information

MEGGITT

2 March 2010

"Strong response to downturn"

Meggitt PLC ("Meggitt" or "the Group"), a leading international company specialising in aerospace equipment, sensing and defence systems, today announces preliminary audited results for the year ended 31 December 2009.

FINANCIAL HIGHLIGHTS

£m	**2009**	2008	% change
Revenue	**1,150.5**	1,162.6	-1%
Underlying[1]:			
EBITDA	**343.4**	343.4	-
Operating profit	**286.2**	296.4	-3%
Profit before tax	**234.2**	243.3	-4%
Earnings per share	**25.3p**	26.5p	-5%
Statutory:			
Operating profit	**232.8**	172.4	+35%
Profit before tax	**180.8**	119.3	+52%
Earnings per share	**20.5p**	15.0p	+37%
Net debt	**808.6**	1047.9	-23%
Dividend	**8.45p**	8.45p	-

(1) Underlying profit and EPS are used by the Board to measure the trading performance of the Group and exclude certain items, principally amortisation of acquired intangibles, revaluation of inventory to selling price on acquisition, operating exceptional items and the marking to market of financial instruments, as set out in notes 3 and 8.

- Increased military sales and currency effects offset impact of economic downturn on civil aerospace revenues.
- EBITDA margin increased due to prompt action to reduce costs; on track to meet or exceed 2011 savings target of £50m - £34m savings already achieved in 2009.
- R&D investment increased to fund pipeline of new programmes and technologies.
- Record net cash generation up 68% to £126.0m (2008: £75.0m).
- Net debt reduced by 23% to £808.6m (2008: £1047.9m)
- Dividend maintained.
- Transformation programme positions Meggitt to benefit from civil upturn, expected to begin in 2010.

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Terry Twigger, Chief Executive, commented:

"The Group's response to the unprecedented economic conditions unfolding through 2009 has been comprehensive and successful. Our end markets developed very much as expected, although the impact of destocking was more severe than anticipated. Offsetting this, we significantly exceeded our cost reduction targets and, as a result, achieved profits close to last year's record levels. This, together with the record net cash generation of £126m underline the robustness of Meggitt's business.

With the actions taken in 2009, the Group is very well placed to take advantage of an upturn in its civil aerospace markets, which is expected to commence in 2010."

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STRATEGIC POSITIONING

The Group has a robust business model which has delivered a strong set of results in an extremely challenging environment. Specifically:

- Meggitt's portfolio is well balanced, with 41% of Group revenues generated from the civil aerospace market, 45% from the military market and 14% from other markets, primarily energy. In total, aftermarket revenues were 49% of the Group total and original equipment (OE) revenues were 51%.
- Our proprietary technology, predominantly sole source positions and large installed fleet enables Meggitt to generate significant aftermarket revenues for many years after the sale of the original equipment.

Meggitt also has a successful track record of managing through previous downturns, with resilient margins and strong cash flow. During 2009:

- Our cost reduction programme delivered results ahead of schedule with savings of £34m. We are on track to achieve or exceed our targeted £50m run rate of savings by the end of 2010.
- EBITDA margin improved to 29.8% (2008: 29.5%)
- Meggitt generated record net cash of £126m and, at the same time, increased gross investment in R&D to 7.4% of sales (2008: 6.8%).

Some of our recent cost reductions have been driven by transforming the way we manage the Group. Going forward, we will organise our businesses into five capability groupings which will each manage a number of production units. We will further standardise processes and systems throughout the Group. Together, this will not only cut costs but will also make us more responsive to the demands of our customers.

All of this leaves Meggitt well placed to respond to any upturn in air traffic, which most commentators expect to commence in 2010.

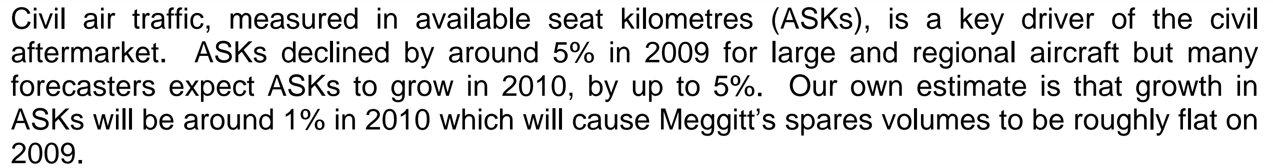
MARKET BACKGROUND

Civil

Meggitt operates in three main segments of the civil aerospace market: large jets, regional aircraft and business jets. The large jet fleet size is over 16,000; the regional aircraft fleet is about 6,000 and business jets over 13,000. The Group has products on most of these aircraft and hence a very large, and growing, installed base. The split of civil revenues, which account for 41% of the Group total, is circa two thirds aftermarket and one third OE.

From around the middle of 2008, the civil aircraft market moved progressively into a downturn, initially with reduced aircraft utilisation impacting the aftermarket and subsequently reduced demand for new aircraft. As a result, there has been a negative impact on the Group's civil revenues, compounded by significant customer destocking. Destocking and cancellations, which affected both OE and aftermarket businesses, slowed in the second half and are expected to continue in the early months of 2010.

Manufacturers of large jets are still projecting deliveries at close to 2009 levels, whilst regional and business jet manufacturers, which have already implemented cuts of up to 30% in 2009, are planning further cuts of around 10% in 2010.



Civil air traffic, measured in available seat kilometres (ASKs), is a key driver of the civil aftermarket. ASKs declined by around 5% in 2009 for large and regional aircraft but many forecasters expect ASKs to grow in 2010, by up to 5%. Our own estimate is that growth in ASKs will be around 1% in 2010 which will cause Meggitt's spares volumes to be roughly flat on 2009.

Encouragingly, business jet usage, which decreased by 17% during 2009, returned to growth at the end of the year. We anticipate further increases in utilisation in 2010, especially against the weaker comparatives in the earlier months of 2009. This will lead to increased demand for our products, albeit with some time lag.

Military

Military markets remained robust in 2009 as governments continued to support operations in Iraq and Afghanistan. The global military market is dominated by the US (circa 50% of total market spend) which is by far the most important military market for Meggitt. The US Department of Defense (DoD) budget for fiscal years (FY) 2010 and 2011 suggests spending increases of 4% in each year, excluding Overseas Contingency Operations (OCO – previously described as "supplementals"). The recently published Quadrennial Defence Review (QDR) suggests increases of around 3% thereafter in the baseline budget to 2015. OCO expenditure for FY12 and beyond will be defined in due course and will likely decline with reduced overseas troop deployment.

The QDR also highlights the DoD's spending priorities for the next four years, based on Secretary Gates' plans for the reshaping of the US defence budgets to reflect changing requirements in modern warfare. We believe that the focus on modernising and extending the life of existing platforms where Meggitt has an established aftermarket should lead to more opportunities for the Group. The new products and technologies we are developing for new platforms can also be retrofitted onto existing platforms, which would potentially accelerate revenue streams for the Group given the significant existing fleet sizes involved.

This market is therefore expected to remain robust over coming years since, even when the various conflicts end, there is a significant amount of worn and damaged equipment that will need repairing and a pent up demand for training. Our revenues are generated from a broad range of platforms for all branches of the military, with a healthy split between OE and aftermarket. Whilst we are well positioned on the current growth platforms, we are not overly exposed to any single one.

Other countries' military budgets are not rising as quickly and may come under pressure along with other government departments. Within Europe, international commitments make cuts in existing programmes harder to achieve and political pressure remains to ensure forces serving in conflict areas are suitably equipped. This is expected to result in continued modest growth in investment items whilst savings are achieved in other areas.

With its significant installed base and content on new programmes, the Group expects its military business to continue to grow by around 3% to 4% in the medium term.

Other

Other revenues (14% of Group total) come from various end markets such as energy (approximately 50%), automotive, test, consumer goods and medical.

Within the energy market, demand for power generation products remained robust, but the offshore gas segment was hit by cuts in capital expenditure as a result of the fall in gas prices, significantly reducing demand for our compact printed circuit heat exchangers. Demand in automotive, test equipment and consumer goods was significantly down. For 2010 we expect the energy market to remain mixed but anticipate some stabilisation in our other specialist markets. Revenues overall in this segment are expected to remain broadly flat.

REVENUES AND ORDERS

Increased military sales and currency effects largely offset the decline in civil market revenues, leaving total revenues 1% down at £1,150.5m (2008: £1,162.6m).

Civil aerospace revenues declined 11% as a result of the downturn in the global economy. Excluding the favourable impact of exchange rates, civil revenues decreased by 21%. We estimate approximately two thirds of the constant currency decline was due to cancellations and destocking, which impacted both OE and aftermarket revenues.

In the military market, the US Department of Defense (DoD), our largest customer, continued to spend significant sums both on new equipment and upgrading and replacing equipment which has seen heavy use in the current conflicts. In Europe, the Eurofighter programme revenues grew through a combination of fleet increases and growing aftermarket revenues. Meggitt's military revenues increased by 14% (2% excluding the favourable currency impact).

Energy revenues decreased 3% (11% at constant exchange rates). Within this, industrial revenues were up but this was more than offset by reduced demand for our compact printed circuit heat exchangers due to the impact of the depressed gas price on capital spending by our customers.

Meggitt's other specialist markets had a difficult year reflecting the general economic downturn. Sales for this segment were down 18% (26% at constant exchange rates). Businesses exposed to the automotive and consumer goods sectors found trading particularly tough.

Our order book remained roughly flat in the second half after declining in the first half as a result of both exchange rate movements and order cancellations resulting from the civil downturn. Our closing order book was over £700m. Adjusting for cancellations which were in the order book at the start of the year, order intake was 2% lower year on year.

PROFIT AND DIVIDENDS

The Board's preferred measure of the Group's trading performance is underlying profit. Underlying EBITDA for the year was unchanged at £343.4m (2008: £343.4m) and underlying EBITDA margin increased to 29.8% (2008: 29.5%) with currency impacts and significant cost reductions offsetting the lower civil sales.

Underlying operating profit fell by 3% to £286.2m (2008: £296.4m), reflecting the impact of a growing amortisation charge on capitalised R&D and programme participation costs.

Net finance costs excluding pension costs decreased to £39.8m (2008: £48.4m) as a result of our strong cash generation and lower interest rates. Pension interest charges increased to £12.2m (2008: £4.7m). Underlying profit before tax decreased by 4% to £234.2m (2007: £243.3m).

After a tax charge of 27.0% (2008: 28.0%), and after taking account of the increased share count due to strong take up of scrip dividends during the year, underlying earnings per share decreased by 5% to 25.3 pence (2008: 26.5 pence).

On a statutory basis, profit before tax increased by 52% to £180.8m (2008: £119.3m) and earnings per share increased by 37% to 20.5p (2008: 15.0p). The principal adjustments between underlying profit and statutory profit are described in notes 3 and 8.

The recommended final dividend is maintained at 5.75p (2008: 5.75p) and represents a total dividend for the year of 8.45p (2008: 8.45p), unchanged on last year.

CASH FLOW AND BORROWINGS

Cash inflow from operations before exceptional operating items was a very healthy £341.7m, which was 119% of underlying operating profit (2008: £295.4m and 100%).

The business generated £126.0m of net cash, a 68% increase on 2008 at a time when we increased investment in our development programmes. As a result, net borrowings decreased from £1,047.9m at 31 December 2008 to £808.6m at 31 December 2009, helped by a favourable translation impact of £115.5m on our mainly US dollar denominated debt. There were also unfavourable non-cash movements of £2.2m.

The financial position of the Group is strong, and no new bank financing will be required before March 2012.

COVENANTS

The Group's bank covenant ratios are measured in sterling and use frozen UK GAAP, with average exchange rates used for translating both profit and debt. This ensures that the key ratios are relatively insensitive to exchange rate movements.

There are two main covenants. The net debt/EBITDA ratio, which must not exceed 3.5x, was 2.4x at 31 December 2009 (2008: 2.4x) and interest cover, which must be not less than 3.0x, was 8.0x (2008: 6.6x). The Group therefore has significant headroom against both key covenant ratios and, at 31 December 2009, had more than £380m of undrawn headroom, net of cash, against committed bank facilities.

K&F INTEGRATION UPDATE

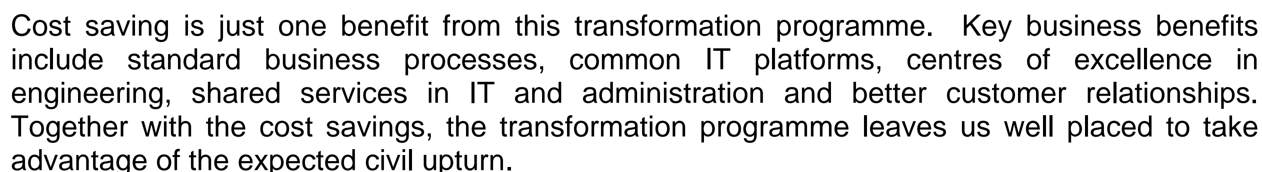
The Group has continued to drive through the synergies of our largest ever acquisition, K&F. Total synergies of £19.5m outperformed our 2009 target of £18m by £1.5m, with good progress being achieved in moving manufacturing to lower cost locations. Our new factory in Mexico is operational and the transfer of some activities from Akron, Ohio to Danville, Kentucky is now complete. The final activities in the integration programme will deliver the remaining £2.5m of synergies in 2010. We expect to achieve the revised 2010 synergy target of £22.0m per annum at less than the target one-off cost of £29m.

TRANSFORMATION PROGRAMME

In addition to its on-going procurement and low cost manufacturing programmes, the Group's response to the economic downturn has been to speed up our ongoing initiative to achieve a higher level of efficiency across all functions in the business. As a result we targeted a further £50m per annum of cost savings. We originally announced that we intended to save £20m in 2009 with the full £50m run rate being achieved by the end of 2010.

The £50m identified savings comprised three elements:

- £25m is volume-related and will be achieved through reductions in factory direct and indirect headcount and related costs.
- £20m is permanent and will be achieved through transforming the way the business is managed, effectively removing a layer of management.
- £5m saved through freezing executive pay and reducing pension and other benefits.



Cost saving is just one benefit from this transformation programme. Key business benefits include standard business processes, common IT platforms, centres of excellence in engineering, shared services in IT and administration and better customer relationships. Together with the cost savings, the transformation programme leaves us well placed to take advantage of the expected civil upturn.

With £34m savings achieved during the year, we significantly exceeded our initial £20m savings target for 2009 and remain highly confident of achieving or exceeding our targeted £50m per annum run rate by the end of 2010.

The operating exceptional cost of achieving these savings was estimated to be £25m, of which £16.9m was charged in 2009. This figure will probably increase if savings exceed the targeted £50m.

To date, our cost reduction initiatives (including K&F integration) have reduced headcount by 1,058 from July 2008 with over 100 further full time equivalents temporarily removed through short time working during the year (resulting in an effective 14% reduction in headcount since July 2008).

INVESTING FOR THE FUTURE

Developing and owning intellectual property is an important part of Meggitt's successful strategy. Total product development expenditure in 2009 has increased by 8% to £85.2m (2008: £78.8m), of which 23% was funded by customers.

As a proportion of revenues, the largest relative investment was once again in Sensing Systems at £31.7m (12.3% of segment revenues), followed by Defence Systems at £11.2m (7.6% of segment revenues) and, finally Aerospace Equipment at £42.3m (5.7% of segment revenues).

Strategic technology investment continues to add competitive advantage to our energy market products, such as condition monitoring for industrial gas turbines. As well as investing in improved product offerings we have increased our sales presence in India, which will enable us to support a widening industrial customer base in the region. Both investments support our strategy to continue to increase our market share in this important segment.

Meggitt also invested £23.9m (2008: £35.7m) in supplying free of charge equipment to new aircraft coming into the fleet and in making programme participation contributions, mostly in the braking systems business.

Capital expenditure on property, plant and equipment and other intangible assets reduced to £25.6m (2008: £40.9m).

As part of the Group's low cost manufacturing strategy, Meggitt continued to expand the range of products manufactured at its facility in Xiamen, China. We also opened and began to transfer certain production activities to our second Mexican factory at Queretaro. This is part of a continuing process of seeking out opportunities to reduce our cost base and win new business.

RETIREMENT BENEFIT SCHEMES

At the year end, Meggitt's pension deficit and healthcare costs deficit had increased to £280.5m (2008: £241.2m). This reflects increases in long term inflation assumptions, lower returns on AA corporate bonds used to discount liabilities and improvements in life expectancy assumptions which have all had a significant adverse impact on scheme liabilities in 2009. The increase in scheme liabilities arising from these changes in actuarial assumptions more than offset the impact of strong asset returns, deficit reduction payments and currency translation gains. The Group made deficit reduction payments of £21.8m in 2009 (2008: £22.5m).

Operational highlights

MEGGITT AEROSPACE EQUIPMENT (MAE)

FINANCIAL HIGHLIGHTS

- Revenues down 2% to £745.3m (2008: £763.7m)
- Underlying operating profit of £220.8m, down 4% (2008: £230.6m)
- Return on sales[2] 29.6% (2008: 30.2%)

(2) Underlying operating profit as a percentage of revenue.

DIVISIONAL OVERVIEW

This division represents 65% of total Group revenue, generating 62% of its revenues from the aftermarket and 38% from the OE market. Its significant, profitable civil aftermarket has been impacted by the decline in air traffic, cancellations and destocking (which impacted both our OE and aftermarket businesses) and the parking of older aircraft such as the DC9/10 and MD80s. With growth in the military segment and significant cost cutting, as well as the benefit of a stronger dollar, the overall impact on revenue and profit was limited to declines of 2% and 4% respectively.

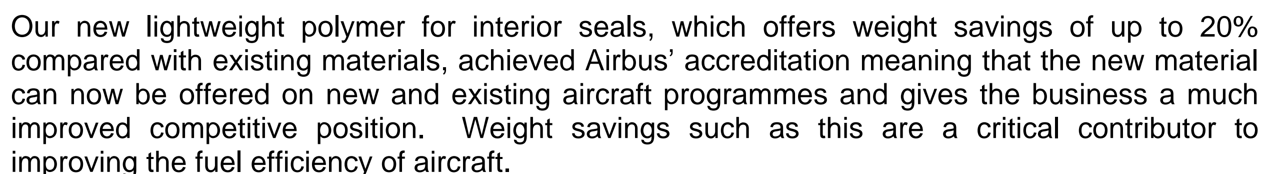
In civil aerospace the Group continued its successful relationship with Bombardier, concluding agreements to supply the all-electric braking system for Bombardier's CSeries family of 110 to 149 seat aircraft, as well as our longer life NuCarb® carbon brakes for the Bombardier CRJ 1000 NextGen regional jet.

Additionally we were awarded the wheels, brakes, brake control and landing gear control system for Tranche 3 of the Eurofighter Typhoon programme, as well as the new braking system for the next generation Saab Gripen.

Among the other highlights for the military segment of the business was Engineered Fabrics Corporation booking over $100m in orders for the fourth consecutive year, including orders for the ballistically resistant and crashworthy fuel tanks and ice guards for the V22 Osprey and UH60M Blackhawk for the US Marine Corps and the US Army respectively. They also received initial orders for interiors and ice guards for the CH53K Super Stallion heavy lift helicopter commissioned by the US Marine Corps. Deliveries of the fuel tank bladders for the KC-135 air-to-air refuelling tanker were at record levels. This business, which we acquired with K&F, continues to exceed our expectations, is a key supplier to US defence programmes and has a very exciting prospect list.

Our Controls businesses won contracts for electro-mechanical fans on the Stryker platform and additional content on the V-22 aircraft. We also won follow-on production contracts worth around £15m for engine components on the Ariane 5 space launcher. Important R&D milestones for the businesses included completing the design and development of a gearbox and brake assembly targeted at the next generation of unmanned military ground vehicles, and continuing the development of our high performance brushless permanent magnet motors and motor controllers for the next generation of military ground and airborne vehicles. These are exciting enabling technologies for the all/more electric vehicles which are the technology of the future.

Our Safety Systems business won a contract for the integrated fire detection and extinguishing system on the Learjet 85 aircraft, Bombardier's new all-composite business jet. Orders from the US and international customers for in excess of $17m to replace the canopy actuators on the F-16 fleet with an upgraded version with significant reliability improvements were also received.



Our new lightweight polymer for interior seals, which offers weight savings of up to 20% compared with existing materials, achieved Airbus' accreditation meaning that the new material can now be offered on new and existing aircraft programmes and gives the business a much improved competitive position. Weight savings such as this are a critical contributor to improving the fuel efficiency of aircraft.

Development activity on programmes awarded in prior years made good progress, with the Phenom 300 business jet achieving type certification in Brazil and the US and continued flight testing activity on the ARJ-21, China's new regional aircraft which is expected to enter service later in 2010. Initial flight testing activity took place on two new Gulfstream models, the G250 and G650, both featuring our wheels, brakes and brake control systems, as well as multiple components in the Rolls Royce BR725 engine powering the G650.

The division had a difficult year in other specialist markets. Heatric's compact printed circuit heat exchangers (PCHE's) struggled to win new orders as most gas majors and contractors postponed new development projects in the light of the downturn and low gas price forecasts. However, it has proven its ability to manufacture PCHE's from tougher alloys that can withstand the higher levels of hydrogen sulphide found in sour gas deposits arising from increasingly challenging gas exploration. This will allow us to market the technology to an extended range of gas extraction opportunities as gas prices and demand recover.

MEGGITT SENSING SYSTEMS (MSS)

FINANCIAL HIGHLIGHTS

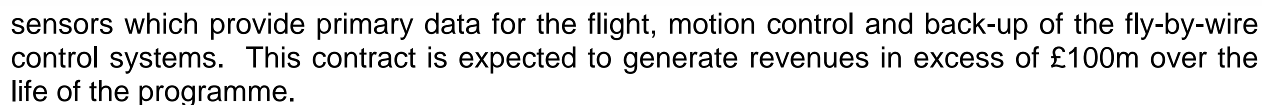
- Revenues down 4% to £258.1m (2008: £267.8m)
- Underlying operating profit of £45.0m, down 4% (2008: £46.7m)
- Return on sales 17.4% (2008: 17.4%)

DIVISIONAL OVERVIEW

This division represents 22% of total Group revenue and generates 72% of its revenues from the OE market and 28% from the aftermarket. Its civil aerospace markets were impacted by the same factors which influenced the MAE businesses, although this was partly offset by continued growth in military sales. The largest part of the revenue reduction came from the consumer goods and automotive sectors of our specialised markets businesses which were particularly hard hit by the global downturn. Revenues in these sectors were down 26% (35% at constant exchange rates). Significant cost cutting, combined with currency benefits, reduced the decline in revenues and underlying operating profits to only 4%.

In civil aerospace the division reinforced its strong engine monitoring credentials by winning a contract to supply Rolls Royce with engine health monitoring systems on the Airbus A350 XWB engine programme. This continues our excellent record of being specified on all western large passenger aircraft in production today for our engine condition monitoring systems. We also have a strong pedigree on military health monitoring systems, particularly in helicopters. 2009 saw continued strong sales on the Black Hawk platform, and we extended our capability with products to be used on the CH53K Super Stallion and mid-size helicopters such as the Sikorsky S-76D and Eurocopter's UH-72A.

A further important win was a broad package of sensors for Hamilton Sundstrand in support of the Pratt & Whitney PurePower™ geared turbofan engine, which has been selected to power the Bombardier CSeries, the Mitsubishi Regional Jet and the Russian Irkut MC-21 aircraft. This award secures a key position for the division on this engine platform as the industry considers the next generation of single aisle aircraft. Also on the A350 XWB, we won a package of smart



sensors which provide primary data for the flight, motion control and back-up of the fly-by-wire control systems. This contract is expected to generate revenues in excess of £100m over the life of the programme.

The division, in partnership with our braking systems business, created a tyre pressure monitoring system for integration into Meggitt wheels and brakes. This responds to operators' growing interest in performance data and represents an important step forward in extending Meggitt's condition monitoring technology from engines to the airframe.

Development and flight testing activity made good progress on programmes we have previously won. Most notably, we delivered our first integrated sensor and ignition package for the Rolls Royce BR725 engine which performed flawlessly on the Gulfstream 650's maiden flight in November. We launched our iSFD, an integrated secondary flight display, which has been well received by customers and has been selected for the HondaJet and LearJet 85 business jets, as well as several new helicopter build programmes including Korea Aerospace Industries' Surion helicopter. The iSFD can also be used in military applications, and has been selected by Boeing for the AH-64 Block 3 upgrade.

Our energy business grew sales in spite of the global downturn, helped by building our presence in India where we have raised Meggitt's profile and customer awareness of our capabilities. This has resulted in approved supplier status being achieved from a number of key partners and condition-monitoring contracts with several power projects. Other contract wins in this segment included a $2.5m contract for advanced VM600 on-line machinery monitoring and protection systems for a major Middle East offshore oil and gas project. We also launched the first version of our InSight® range of upgraded condition monitoring systems for land based turbines. Initial customer feedback has been very positive, highlighting the systems class leading performance, and unique combustion analysis capabilities.

Although the automotive and consumer goods sectors experienced extremely tough trading conditions through 2009, there were some signs of improvement in the automotive sector towards the end of the year.

MEGGITT DEFENCE SYSTEMS (MDS)

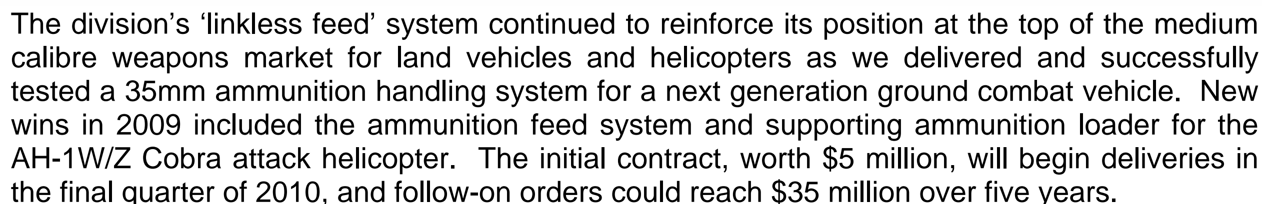
FINANCIAL HIGHLIGHTS

- Revenues up 12% to £147.1m (2008: £131.1m)
- Underlying operating profit of £20.4m, up 7% (2008: £19.1m)
- Return on sales 13.9% (2007: 14.6%)

DIVISIONAL OVERVIEW

Meggitt's Defence Systems division represents 13% of Group revenues and generates 77% of its revenues from the OE market and 23% from the aftermarket. The division, which represents 28% of Group military revenues, saw revenues in constant currency reduce by less than 1%. This reduction occurred largely in the Training Systems business which recorded most of the revenue on the integrated tactical training centre in Singapore during 2008. Operating margins fell slightly, reflecting the constant currency revenue decline.

The division, which represents the Group's non-aerospace defence-related businesses, continued to lead its market segments in special-purpose military electronics cooling, automatic ammunition handling and live and simulated training for weapons-handling, convoy movement, forward air control, coastguard and other patrol disciplines.



The division's 'linkless feed' system continued to reinforce its position at the top of the medium calibre weapons market for land vehicles and helicopters as we delivered and successfully tested a 35mm ammunition handling system for a next generation ground combat vehicle. New wins in 2009 included the ammunition feed system and supporting ammunition loader for the AH-1W/Z Cobra attack helicopter. The initial contract, worth $5 million, will begin deliveries in the final quarter of 2010, and follow-on orders could reach $35 million over five years.

New electronic cooling contract wins included an initial contract for the forward array cooling system on the P-8 Poseidon, Boeing's multi mission maritime aircraft, and we continued to deliver against the $45m contract for new and repaired M1A2 SEP Abrams main battle tanks, as well as the thermal management system for the infrared search and track capability on the F-18 Hornet fighter jet. Customer funded development activity progressed a lightweight yet powerful electronics cooling system for a next generation unmanned ground vehicle platform.

The division's Training Systems business concluded its largest single integration project in 2009 with the commissioning of a $19m integrated tactical training centre for the Singapore police coast guard. This was followed by winning a further contract in South East Asia to upgrade existing marksmanship trainers and provide additional weapons for an existing training centre worth $7 million. The business also continues to support Lockheed Martin's reconfigurable vehicle system simulator, the US Army standard for virtual convoy training, and received orders worth $4m to develop key weapons training modules for the system's convoy training scenarios. This can simulate up to six military ground vehicles, developing leadership and teamwork, while instilling a set of procedural responses to events such as ambush, IED and other convoy situations. The business also launched, and made initial sales of, an innovative new product for the law enforcement market, a high performance plug-and-play system designed to be an affordable, convenient and cost effective way to train police forces both in the US and internationally.

BOARD OF DIRECTORS

Following Peter Hill's appointment as a non-executive director of the Cookson Group plc on 1 February 2010, Peter has confirmed to the Board that he will be standing down as an independent non-executive director on 31 March 2010.

NEW BUSINESS GROUPINGS

The Group is creating five new divisions to align our core capabilities and provide the management focus required to optimise performance and deliver long-term growth. We expect to complete this restructuring in 2010 and to report our results under this new structure from that date. Further details on the capabilities of these new divisions are provided in the 2009 Preliminary Results presentation on the Group's website.

GROUP OUTLOOK

The outlook for our civil markets remains mixed. Civil OE production is expected to decline, modestly for large jets and by larger amounts for regional and business jets. Air traffic growth is expected to turn positive in 2010 and the utilisation of business jets to increase. If this happens, our civil aftermarket will return to growth in 2010 although, due to continuing destocking, any pick up will be weighted towards the second half. In military markets, the US DoD base budget is predicted to grow by around 4% in 2010 and we expect our military business to continue to grow at a similar rate. Our energy and other specialist markets are expected to remain broadly flat.

The Group has already taken significant action to cut costs, with savings of £34m achieved in 2009. We expect this to rise to an annual run rate of at least £50m by the end of 2010. Cash generation and the balance sheet should remain strong.

As a consequence, based on current market indicators and at constant exchange rates, the Group expects a relatively flat first half and to return to growth in the second half of 2010.

With the actions we have taken, with our large installed fleet spread across both military and civil platforms, our ongoing transformation programme and our sound financial position, the Group is responding effectively to current challenges and is also well positioned for the longer term.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2009

	Notes	2009 £m	2008 £m
Continuing operations			
Revenue	2	**1,150.5**	1,162.6
Cost of sales		**(656.3)**	(637.8)
Gross profit		**494.2**	524.8
Net operating costs		**(261.4)**	(352.4)
Operating profit*	3	**232.8**	172.4
Finance income	6	**28.1**	33.9
Finance costs	7	**(80.1)**	(87.0)
Net finance costs		**(52.0)**	(53.1)
**Profit before tax ** **		**180.8**	119.3
Tax		**(42.0)**	(20.2)
Profit for the year from continuing operations attributable to equity holders		**138.8**	99.1
Earnings per share - basic	8	**20.5p**	15.0p
Earnings per share - diluted	8	**20.5p**	15.0p

	Notes	2009 £m	2008 £m
* Underlying operating profit	3	**286.2**	296.4
** Underlying profit before tax	3	**234.2**	243.3

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2009

	Notes	**2009 £m**	2008 £m
Profit for the year		**138.8**	99.1
Other comprehensive (expense)/income for the year:			
Actuarial losses	15	**(67.6)**	(60.9)
Currency translation differences		**(81.4)**	201.2
Cash flow hedge movements		**10.7**	(18.5)
Other comprehensive (expense)/income before tax		**(138.3)**	121.8
Related tax movements		**11.2**	38.5
Other comprehensive (expense)/income for the year		**(127.1)**	160.3
Total comprehensive income for the year attributable to equity holders		**11.7**	259.4

CONSOLIDATED BALANCE SHEET
As at 31 December 2009

	Notes	2009 £m	2008 £m
Non-current assets			
Goodwill	12	**1,261.9**	1,382.7
Development costs	12	**119.0**	97.8
Programme participation costs	12	**174.9**	180.4
Other intangible assets	12	**754.5**	901.6
Property, plant and equipment	13	**215.9**	245.2
Trade and other receivables		**36.2**	19.3
Derivative financial instruments		**1.9**	1.6
Deferred tax assets		**170.6**	112.4
		2,734.9	2,941.0
Current assets			
Inventories		**236.5**	273.1
Trade and other receivables		**211.3**	286.9
Derivative financial instruments		**4.5**	1.0
Current tax recoverable		**0.2**	0.7
Cash and cash equivalents	20	**62.9**	67.3
		515.4	629.0
Total assets	2	**3,250.3**	3,570.0
Current liabilities			
Trade and other payables		**(239.2)**	(314.6)
Derivative financial instruments		**(17.2)**	(26.4)
Current tax liabilities		**(34.6)**	(37.1)
Obligations under finance leases	20	**(0.8)**	(1.0)
Bank and other borrowings	20	**(9.7)**	(13.5)
Provisions	14	**(35.8)**	(45.3)
		(337.3)	(437.9)
Net current assets		**178.1**	191.1
Non-current liabilities			
Trade and other payables		**(9.2)**	(9.3)
Derivative financial instruments		**(24.5)**	(70.6)
Deferred tax liabilities		**(393.2)**	(359.9)
Obligations under finance leases	20	**(4.6)**	(6.2)
Bank and other borrowings	20	**(856.4)**	(1,094.5)
Provisions	14	**(71.0)**	(64.0)
Retirement benefit obligations	15	**(280.5)**	(241.2)
		(1,639.4)	(1,845.7)
Total liabilities		**(1,976.7)**	(2,283.6)
Net assets		**1,273.6**	1,286.4
Equity			
Share capital		**34.3**	33.3
Share premium		**825.9**	798.8
Other reserves		**14.1**	14.1
Hedging and translation reserves		**117.3**	195.7
Retained earnings		**282.0**	244.5
Total equity attributable to equity holders		**1,273.6**	1,286.4

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2009

	Share capital	Share premium	Other reserves	Hedging and translation reserves	Retained earnings	Total equity
	£m	£m	£m	£m	£m	£m
At 1 January 2008	32.9	781.6	14.1	(6.8)	241.6	1,063.4
Profit for the year	-	-	-	-	99.1	99.1
Actuarial losses	-	-	-	-	(60.9)	(60.9)
Currency translation differences:						
Arising in the year	-	-	-	200.2	-	200.2
Transferred to income statement	-	-	-	1.0	-	1.0
Cash flow hedge movements:						
Movement in fair value	-	-	-	(23.9)	-	(23.9)
Transferred to income statement	-	-	-	5.4	-	5.4
Other comprehensive income/(expense) before tax	-	-	-	182.7	(60.9)	121.8
Related tax movements	-	-	-	19.8	18.7	38.5
Other comprehensive income/(expense) for the year	-	-	-	202.5	(42.2)	160.3
Total comprehensive income for the year	-	-	-	202.5	56.9	259.4
Employee share option schemes:						
Value of services provided	-	-	-	-	3.1	3.1
Own shares purchased	-	-	-	-	(1.3)	(1.3)
Proceeds from shares issued	0.1	2.0	-	-	-	2.1
Dividends	0.3	15.2	-	-	(55.8)	(40.3)
At 31 December 2008	33.3	798.8	14.1	195.7	244.5	1,286.4
Profit for the year	**-**	**-**	**-**	**-**	**138.8**	**138.8**
Actuarial losses	-	-	-	-	(67.6)	(67.6)
Currency translation differences:						
Arising in the year	-	-	-	(81.4)	-	(81.4)
Cash flow hedge movements:						
Movement in fair value	-	-	-	(5.6)	-	(5.6)
Transferred to income statement	-	-	-	16.3	-	16.3
Other comprehensive expense before tax	-	-	-	(70.7)	(67.6)	(138.3)
Related tax movements	-	-	-	(7.7)	18.9	11.2
Other comprehensive expense for the year	**-**	**-**	**-**	**(78.4)**	**(48.7)**	**(127.1)**
Total comprehensive (expense)/income for the year	**-**	**-**	**-**	**(78.4)**	**90.1**	**11.7**
Employee share option schemes:						
Value of services provided	-	-	-	-	4.0	4.0
Proceeds from shares issued	0.1	1.2	-	-	-	1.3
Dividends	0.9	25.9	-	-	(56.6)	(29.8)
At 31 December 2009	**34.3**	**825.9**	**14.1**	**117.3**	**282.0**	**1,273.6**

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2009

	Notes	**2009 £m**	2008 £m
Cash inflow from operations before exceptional operating items		**341.7**	295.4
Cash outflow from exceptional operating items	4	**(21.9)**	(16.5)
Cash inflow from operations	19	**319.8**	278.9
Interest received		**0.9**	1.6
Interest paid		**(42.9)**	(47.8)
Tax paid		**(27.1)**	(30.3)
Tax equalisation swap paid*		**(11.8)**	-
Cash inflow from operating activities		**238.9**	202.4
Purchase of subsidiaries	11	**(1.0)**	(9.2)
Proceeds from disposal of subsidiaries		**0.3**	19.9
Capitalised internal development costs	12	**(35.1)**	(23.7)
Capitalised programme participation costs		**(23.9)**	(35.7)
Purchase of other intangible assets	12	**(7.1)**	(5.8)
Purchase of property, plant and equipment		**(18.5)**	(35.1)
Proceeds from disposal of property, plant and equipment		**0.7**	0.4
Cash outflow from investing activities		**(84.6)**	(89.2)
Dividends paid to Company's shareholders		**(29.6)**	(40.3)
Issue of equity share capital		**1.3**	2.1
Proceeds from borrowings		**256.2**	10.2
Debt issue costs		**-**	(2.1)
Repayments of borrowings		**(382.4)**	(82.1)
Cash outflow from financing activities		**(154.5)**	(112.2)
Net (decrease)/increase in cash and cash equivalents	20	**(0.2)**	1.0
Cash and cash equivalents at start of year		**67.3**	64.9
Exchange (losses)/gains on cash and cash equivalents		**(4.2)**	1.4
Cash and cash equivalents at end of year	20	**62.9**	67.3

* Represents the settlement paid under a tax equalisation swap designed to hedge the Group's tax exposure on foreign exchange movements.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2009

1. Basis of preparation

This document contains abridged preliminary financial information for the year ended 31 December 2009 together with comparatives.

The information presented has been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under International Financial Reporting Standards as adopted by the European Union ("IFRSs") and in accordance with the FSA Listing Rules. It has been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative instruments) at fair value.

The financial information contained in this document does not constitute Group statutory accounts as defined in Sections 404 and 435 of the Companies Act 2006. It is based on, and is consistent with, that in the Group's statutory accounts for the year ended 31 December 2009 and those financial statements will be delivered to the Registrar of Companies following the Company's Annual General Meeting. The auditors' report on those accounts is unqualified and does not contain any statement under Section 498 of the Companies Act 2006.

Group statutory accounts for the year ended 31 December 2008 have been filed with the Registrar of Companies. The auditors' report on those accounts was unqualified and did not contain any statement under Section 237 of the Companies Act 1985.

2. Segmental analysis

	Aerospace Equipment £m	**Sensing Systems £m**	**Defence Systems £m**	**Total £m**
Year ended 31 December 2009:				
Gross segment revenue	747.6	262.6	147.1	1,157.3
Inter-segment revenue	(2.3)	(4.5)	-	(6.8)
Revenue from external customers	**745.3**	**258.1**	**147.1**	**1,150.5**
Underlying operating profit*	**220.8**	**45.0**	**20.4**	**286.2**
Year ended 31 December 2008:				
Gross segment revenue	765.9	271.0	131.1	1,168.0
Inter-segment revenue	(2.2)	(3.2)	-	(5.4)
Revenue from external customers	763.7	267.8	131.1	1,162.6
Underlying operating profit*	230.6	46.7	19.1	296.4

* A reconciliation of underlying operating profit to operating profit is shown in note 3.

2. Segmental analysis (continued)

	31 December 2009 £m	31 December 2008 £m
Aerospace Equipment	**2,513.1**	2,813.9
Sensing Systems	**324.6**	364.3
Defence Systems	**165.8**	206.1
Total segmental operating assets	**3,003.5**	3,384.3
Centrally managed operating assets*	**6.7**	2.7
Deferred tax assets	**170.6**	112.4
Derivative financial instruments	**6.4**	2.6
Current tax recoverable	**0.2**	0.7
Cash and cash equivalents	**62.9**	67.3
Total assets	**3,250.3**	3,570.0

* Centrally managed operating assets include amounts recoverable under tax equalisation swaps and property, plant and equipment of central companies.

At the date of these financial statements, the information provided internally to the Chief Operating Decision Maker ("CODM") continues to reflect the current divisional structure reported above. As part of the transformation programme the Group is in the process however, of re-organising its businesses into five new divisions. During 2010 the information reported to the CODM is expected to change to reflect this new structure. Accordingly the Group expects its operating segment reporting in 2010 to be on the basis of the five new divisions and reconciliations to the current segments reported will be provided at that time.

3. Reconciliations between profit and underlying profit

Underlying profit is used by the Board to measure and monitor the underlying trading performance of the Group. It excludes certain items as shown below:

	Notes	**2009 £m**	2008 £m
Operating profit		**232.8**	172.4
Exceptional operating items (note 4)		**20.8**	15.8
Amortisation of intangibles acquired in business combinations	a	**69.2**	61.8
Disposal of inventory revalued in business combinations		**-**	0.3
Financial instruments	b	**(36.6)**	46.1
Adjustments to operating profit		**53.4**	124.0
Underlying operating profit		**286.2**	296.4
Profit before tax		**180.8**	119.3
Adjustments to operating profit per above		**53.4**	124.0
Underlying profit before tax		**234.2**	243.3
Profit for the year		**138.8**	99.1
Adjustments to operating profit per above		**53.4**	124.0
Tax effect of adjustments to operating profit		**(21.2)**	(47.9)
Adjustments to profit for the year		**32.2**	76.1
Underlying profit for the year		**171.0**	175.2

3. Reconciliations between profit and underlying profit (continued)

a. The Group excludes from its underlying profit the amortisation of intangible assets acquired in business combinations (note 11).

b. Although the Group uses foreign currency forward contracts to hedge against foreign currency exposures, it has decided that the costs of meeting the extensive documentation requirements to be able to apply hedge accounting under IAS 39 ("Financial Instruments: Recognition and Measurement") are not merited. The Group's underlying profit figures exclude amounts which would not have been recorded if hedge accounting had been applied.

   Where interest rate derivatives do not qualify to be hedge accounted, movements in the fair value of these derivatives are excluded from underlying profit. Where interest rate derivatives do qualify to be accounted for as fair value hedges, any difference between the movement in the fair values of the derivatives and in the fair value of fixed rate borrowings is excluded from underlying profit (note 5).

4. Exceptional operating items

Items which are significant by virtue of their size or nature and which are considered non-recurring are classified as exceptional items.

	Notes	**2009 £m**	2008 £m
Transformation programme	a	**16.9**	-
Integration of K&F Industries Holdings Inc ("K&F")	b	**3.7**	10.2
Integration of Firearms Training Systems Inc ("FATS")	c	**-**	2.9
Integration of other businesses	d	**0.3**	4.6
Profit on disposal of businesses	e	**(0.1)**	(1.9)
Exceptional operating items		**20.8**	15.8

a. The Group announced as part of its 2008 annual results that, in response to the economic downturn, it would take appropriate action to reduce costs. The actions involve reductions in factory direct and indirect headcount and related costs arising from volume reductions, transforming the way the business is managed, effectively removing a layer of management, freezing executive pay and reducing pension and other benefits. The programme is progressing well and is on track to deliver the expected savings of £50 million annually by the end of 2010 at a one-off cost of £25 million.

b. Costs incurred during the year include rationalisation costs and the transfer of certain production processes into our Mexico facility. Further exceptional operating costs of £2.7 million are expected to arise over the next year as the integration is completed.

c. During the prior year the consolidation of our two US training systems facilities at a new site in Atlanta was completed.

d. During the year other business integration costs were also incurred, principally the completion of the integration of the Avery Hardoll business, commenced in 2008, into other businesses in the Group.

e. In January 2009 the Group sold a small product line from its Aerospace Equipment segment and recorded a profit of £0.1 million. On 3 January 2008 the Group completed the disposal of S-Tec Corporation for a net consideration of £17.2 million.

Cash expenditure on all exceptional operating items above was £21.9 million (2008: £16.5 million), including £14.6 million in respect of the transformation programme (2008: £Nil) and £6.4 million in respect of K&F (2008: £9.5 million).

5. Movement on derivative financial instruments

	2009 £m	2008 £m
Movement in the fair value of foreign currency forward contracts	**(41.1)**	49.6
Impact of retranslating net foreign currency assets and liabilities at spot rate	**3.7**	(4.2)
Movement in the fair value of interest rate derivatives not hedge accounted	**(2.9)**	2.9
Movement in the fair value of fixed interest rate borrowings	**3.7**	(2.2)
Financial instruments – (gain)/loss	**(36.6)**	46.1

6. Finance income

	2009 £m	2008 £m
Interest on bank deposits	**0.4**	0.6
Unwinding of interest on other receivables	**1.1**	1.0
Expected return on retirement benefit scheme assets (note 15)	**26.1**	31.3
Other finance income	**0.5**	1.0
Finance income	**28.1**	33.9

7. Finance costs

	2009 £m	2008 £m
Interest on bank borrowings	**30.5**	39.0
Interest on USD 250 million senior notes	**8.6**	7.4
Interest on finance lease obligations	**0.3**	0.3
Unwinding of interest on provisions (note 14)	**1.2**	1.9
Unwinding of interest on retirement benefit scheme liabilities (note 15)	**38.3**	36.0
Other finance costs	**1.2**	2.4
Finance costs	**80.1**	87.0

8. Earnings per ordinary share

The calculation of earnings per ordinary share ("EPS") is based on profits of £138.8 million (2008: £99.1 million) and on the weighted average of 676.4 million (2008: 661.9 million) ordinary shares in issue during the year ended 31 December 2009.

The calculation of diluted EPS is based on the same profits as used in the calculation of basic EPS. The weighted average number of ordinary shares of 676.9 million (2008: 663.0 million) used in the calculation is based on the weighted average number used in the calculation of basic EPS adjusted to reflect the assumption that all potentially dilutive ordinary shares convert.

8. Earnings per ordinary share (continued)

Underlying EPS is based on underlying profit (note 3) and is calculated below:

	2009 Pence	2008 Pence
Basic EPS	**20.5**	15.0
Add back effects of:		
Exceptional operating items	**2.1**	1.8
Amortisation of intangibles acquired in business combinations	**6.5**	4.7
Financial instruments	**(3.8)**	5.0
Underlying EPS	**25.3**	26.5

9. Dividends

The Board is recommending a final dividend of 5.75p per ordinary share (2008: 5.75p). Taken with the interim dividend of 2.70p (2008: 2.70p) paid in the year this gives a total dividend of 8.45p (2008: 8.45p). Subject to approval at the Annual General Meeting to be held on 21 April 2010, the proposed dividend will be paid on 7 May 2010 to shareholders on the register at close of business on 12 March 2010. In continuation of recent practice, shareholders will be offered the opportunity to elect for shares in lieu of cash for the final dividend.

10. Related party transactions

The remuneration of the key management personnel of the Group including executive directors is set out below:

	2009 £m	2008 £m
Wages and salaries	**7.4**	7.3
Social security costs	**0.9**	1.2
Pension costs	**0.5**	0.3
Share-based payment	**1.6**	2.1
Total	**10.4**	10.9

11. Business combinations

During the year deferred consideration payments of £1.0 million were made in respect of businesses acquired in prior years.

12. Intangible assets

	Goodwill	Development costs	Programme participation costs	Other intangible assets
	£m	£m	£m	£m
At 1 January 2008	1,067.8	57.7	121.8	741.7
Exchange rate adjustments	309.3	19.9	37.0	214.8
Businesses acquired	5.6	-	-	4.3
Additions	-	23.7	35.7	5.8
Disposals	-	-	-	(0.4)
Amortisation charge	-	(3.5)	(14.1)	(64.6)*
At 31 December 2008	1,382.7	97.8	180.4	901.6
At 1 January 2009	1,382.7	97.8	180.4	901.6
Exchange rate adjustments	(120.8)	(7.5)	(15.3)	(81.6)
Additions	-	35.1	27.6	7.1
Interest capitalised	-	0.1	-	0.1
Disposals	-	-	-	(0.1)
Amortisation charge	-	(6.5)	(17.8)	(72.6)*
At 31 December 2009	**1,261.9**	**119.0**	**174.9**	**754.5**

* Of the £72.6 million amortisation (2008: £64.6 million) of other intangible assets, £69.2 million (2008: £61.8 million) relates to the amortisation of intangible assets arising in business combinations and has been excluded from underlying profit (note 3).

Goodwill is tested for impairment annually or more frequently if there is any indication of impairment. A full impairment review was conducted for the year ended 31 December 2009 and no impairment charge was required.

13. Property, plant and equipment

	2009	2008
	£m	£m
At 1 January	**245.2**	191.2
Exchange rate adjustments	**(16.4)**	44.9
Businesses acquired	**-**	0.7
Additions	**17.4**	35.9
Interest capitalised	**0.1**	-
Disposals	**(0.9)**	(0.9)
Depreciation charge	**(29.5)**	(26.6)
At 31 December	**215.9**	245.2

14. Provisions

	2009 £m	2008 £m
At 1 January	**109.3**	92.0
Exchange rate adjustments	**(9.6)**	25.7
Businesses acquired	**-**	0.1
Transfer from/(to) trade and other payables	**0.5**	(0.3)
Charge to income statement – operating profit	**21.2**	16.4
Charge to income statement – finance costs (note 7)	**1.2**	1.9
Utilised	**(15.8)**	(26.5)
At 31 December	**106.8**	109.3
Disclosed as:		
Current	**35.8**	45.3
Non-current	**71.0**	64.0
At 31 December	**106.8**	109.3

15. Retirement benefit obligations

	2009 £m	2008 £m
At 1 January	**(241.2)**	(153.3)
Exchange rate adjustments	**18.7**	(44.8)
Charge to income statement – operating profit	**(10.5)**	(13.3)
Charge to income statement – finance income (note 6)	**26.1**	31.3
Charge to income statement – finance costs (note 7)	**(38.3)**	(36.0)
Contributions	**32.3**	35.8
Actuarial losses	**(67.6)**	(60.9)
At 31 December	**(280.5)**	(241.2)
Comprising:		
Fair value of scheme assets	**504.2**	451.9
Fair value of scheme liabilities	**(784.7)**	(693.1)
At 31 December	**(280.5)**	(241.2)
Analysis of retirement benefit obligations:		
Pension schemes	**(219.5)**	(172.0)
Healthcare schemes	**(61.0)**	(69.2)
At 31 December	**(280.5)**	(241.2)

Principal financial assumptions

	2009	2008
UK schemes:		
Discount rate	**5.70%**	6.30%
Inflation rate	**3.50%**	3.00%
Current life expectancy in years: Member aged 65 (Male)	**21.8 to 24.4**	20.1 to 21.5
Overseas schemes:		
Discount rate	**5.65 to 5.85%**	6.50%
Salary increases	**4.00%**	4.00%
Current life expectancy in years: Member aged 65 (Male)	**18.9**	18.8

Healthcare cost increases are assumed to be 8.5% for 2010 trending down to 5.0% by 2017 (2008: 8.5% for 2009 trending down to 5.0% by 2016).

16. Contingent liabilities

The Company has given guarantees in respect of uncommitted credit facilities for certain of its subsidiaries, some property leases, other leasing arrangements and the performance by some current and former subsidiaries of certain contracts. Also, there are similar guarantees given by certain other Group companies. The fair value of these guarantees is not considered to be significant.

The Company and various of its subsidiaries are, from time to time, parties to legal proceedings and claims which arise in the ordinary course of business. The directors do not anticipate that the outcome of these proceedings, actions and claims, either individually or in aggregate, will have a material adverse effect upon the Group's financial position.

17. Share capital

	2009 No. m	2008 No. m
Number of shares outstanding at start of year	**665.6**	658.3
Issued on exercise of sharesave and executive share options	**0.8**	1.3
Scrip dividend	**18.9**	6.0
Number of shares outstanding at end of year	**685.3**	665.6

18. Capital commitments

	2009 £m	2008 £m
Contracted for but not incurred:		
Intangible assets	**1.2**	0.3
Property, plant and equipment	**3.4**	6.1
Total	**4.6**	6.4

19. Cash inflow from operations

	2009 £m	2008 £m
Profit for the year	**138.8**	99.1
Adjustments for:		
Tax	**42.0**	20.2
Depreciation and amortisation	**126.4**	108.8
Loss on disposal of property, plant and equipment	**0.1**	0.5
Loss on disposal of intangible assets	**0.1**	0.4
Profit on disposal of subsidiaries (note 4)	**(0.1)**	(1.9)
Finance income (note 6)	**(28.1)**	(33.9)
Finance costs (note 7)	**80.1**	87.0
Financial instruments (note 5)	**(36.6)**	46.1
Retirement benefit obligation deficit payments	**(21.8)**	(22.5)
Share-based payment expense	**5.4**	3.6
Changes in working capital	**13.5**	(28.5)
Cash inflow from operations	**319.8**	278.9

20. Net debt

	2009 **£m**	2008 £m
Movement in the year in:		
Cash and cash equivalents	**(0.2)**	1.0
Bank and other borrowings	**126.2**	74.0
Change in net debt resulting from cash flows	**126.0**	75.0
Arising on acquisition of businesses	**-**	(0.8)
Exchange differences	**115.5**	(312.0)
Other non-cash movements	**(2.2)**	5.3
Movement in net debt in the year	**239.3**	(232.5)
Net debt at 1 January	**(1,047.9)**	(815.4)
Net debt at 31 December	**(808.6)**	(1,047.9)

	2009 **£m**	2008 £m
Disclosed as:		
Cash and cash equivalents	**62.9**	67.3
Obligations under finance leases – current	**(0.8)**	(1.0)
Bank and other borrowings – current	**(9.7)**	(13.5)
Obligations under finance leases – non-current	**(4.6)**	(6.2)
Bank and other borrowings – non-current	**(856.4)**	(1,094.5)
Net debt at 31 December	**(808.6)**	(1,047.9)

RISKS AND UNCERTAINTIES

Meggitt's risk management framework includes a formal process for identifying, assessing and responding to risk in relation to the Group's strategy and business objectives.

Risk management operates at all levels throughout Meggitt, across business lines, geographies and functions. The Board is responsible for risk management including maintaining the Group's risk governance structure and an appropriate internal control framework.

We monitor risk across four broad categories – markets, operations, finance and corporate. The risks outlined below, which are not presented in any order of priority, are those the Group believes are the principal ones it faces. However, additional risks, of which the Group is unaware, or risks the Group does not consider material, could have an adverse impact.

Markets - Competition

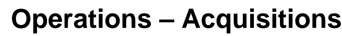
Potential impact
We compete in a highly competitive global market that has experienced significant consolidation in recent years. Losing contracts to competitors, some of whom have greater financial, technological and marketing resources, or being forced to accept lower margins, would have an adverse effect on Meggitt's results. Losing key intellectual property or failing to enforce its rights could hinder our development and provide competitor advantage. Meggitt's competitive position would suffer were it unable to invest in R&D and provide cash and equipment incentives to original equipment manufacturers. Such investments, especially in aerospace, decrease cash flow in the short term, which is recovered only through revenue streams that arise over many years.

Mitigation action
- Protecting our positions by maintaining a broad customer base.
- Maintaining diverse products and operations to reduce the effect of action by any single competitor.
- Maintaining a competitive manufacturing base.
- Developing proprietary intellectual property and products in markets that demand high levels of technology, quality and service and strong, long-term relationships with customers.
- Maintaining a robust intellectual property protection programme.
- Maintaining the highest manufacturing and quality standards and attending to individual customer certification requirements.
- Ensuring good operational cash flow and available finance.

Markets - Product demand

Potential impact
Any reduction in military spending or reordering of priorities, particularly by Meggitt's largest customer, the US government, could affect our revenues adversely. A significant or prolonged downturn due to recession, commodity prices, terrorist attack or aerospace regulations would decrease demand for the Group's products from civil aerospace customers. Since the start of the recession, several airlines have parked a number of aircraft and deferred new deliveries. This will adversely affect our revenues.

Mitigation action
- Spreading our activities across the civil aerospace, military and energy markets.
- Generating revenues from original equipment manufacturers and aftermarket services.
- Operating across different geographical regions.
- Maintaining, where practical, a flexible cost base.
- Reducing costs to partially mitigate any reduction in demand.



Operations – Acquisitions

Potential impact
Meggitt continues to pursue acquisitions as part of its growth strategy. Such acquisitions may not realise expected benefits.

Mitigation action
- Undertaking due diligence.
- Implementing comprehensive business integration processes.
- Obtaining representations, warranties and indemnities from vendors where possible.

Operations – Contracts

Potential impact
Multi-year, fixed price contracts with original equipment manufacturing customers expose us to variations in production costs. The Group is subject to contracting risks with the US government which can impose a range of sanctions in response to violations.

Mitigation action
- Ensuring estimates of cost are based on reliable historic data and, where possible, by entry into multi-year, fixed price contracts with major suppliers.
- Maintaining guidelines for doing business with the US Government as part of the Group's Ethics and Business Conduct Programme.

Operations – Equipment fault

Potential impact
Meggitt's products generally operate in extreme environments where a serious incident arising from failure could result in liabilities for personal injury or death and damage to our reputation. The Group may also be subject to material product warranty obligations to third parties for equipment it manufactures and services.

Mitigation action
- Designing manufacturing processes that ensure stringent quality and reliability standards.
- Protecting the Group from future product liability claims subject to coverage limits with liability insurance.

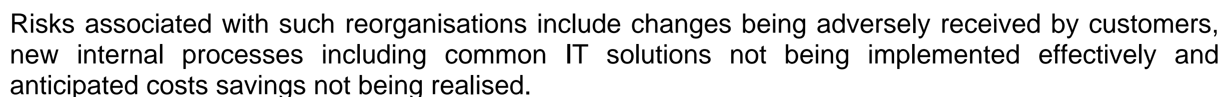
Operations – Supply chain

Potential impact
We rely on our own manufacturing operations and independent suppliers for key raw materials and components, some of which may be available from a limited number of suppliers. Any disruption to the supply chain could have an impact on our ability to meet customer requirements and adversely affect the Group's results.

Mitigation action
- Maintaining significant investment in modernising facilities and improving production processes to develop leading manufacturing operations.
- Maintaining a supplier risk assessment programme.
- Subjecting robust business continuity plans to regular testing to manage the risk of a loss of a major facility or supplier.

Operations – Transformation programme

Potential impact
The Group is in the process of a major reorganisation to ensure it emerges from the recession leaner, more competitive and better placed to respond to customers' requirements. This is being achieved by adjusting headcount in line with volumes, removing a layer of management, implementing common IT solutions to enable shared services, streamlining other back office and administrative activity and reviewing discretionary expenditure.



Risks associated with such reorganisations include changes being adversely received by customers, new internal processes including common IT solutions not being implemented effectively and anticipated costs savings not being realised.

Mitigation action

- Monitoring and responding to feedback from customers, which has been positive to date.
- Implementing proven programme management processes used in previous transformational initiatives, such as the integration of the Dunlop Aerospace and K&F businesses.
- Resourcing the programme effectively with a full-time team of senior Meggitt managers working across functions and facilities, supported by third-party specialists where appropriate.
- Phasing in systems changes and introducing shared services in a controlled manner.
- Realising run-rate savings equal to or exceeding targets.

Finance - Credit

Potential impact

Credit risk exists in relation to customers, banks and insurers.

Mitigation action

- Maintaining rigorous credit control procedures.
- Maintaining a wide customer base.
- Maintaining a wide bank group.
- Monitoring relationships with banks and other counterparty risks through our treasury function.
- Selecting insurers with good credit ratings.

Finance – Exchange rates

Potential impact

We operate in, and sell products to, a range of countries with different currencies, resulting in exchange rate exposure. Transaction risk arises where revenues are denominated in currencies different from those of the costs of manufacture. Translation risk arises on the translation of net assets and income statements of overseas subsidiaries.

Mitigation action

- Addressing longer-term risk of exposure to exchange rate fluctuations by sourcing goods and services in currencies which match the revenue exposure where cost-effective.
- Hedging short-term transaction risk.
- Managing translation risk where possible by the partial currency matching of borrowings with the net assets of overseas subsidiaries.

Finance – Financing

Potential impact

Meggitt's long-term financing is provided by shareholders in the form of equity and by banks and other institutions in the form of debt. Debt facilities are provided for finite periods of time and need to be renewed periodically, unless repaid from generated cash. Such renewal could be affected by any structural issues in the credit markets. Debt facilities contain covenants which, if breached, could result in the facilities being withdrawn.

Mitigation action

- Negotiating debt facility extensions. The Group believes it has credit facilities sufficient for our ongoing operations until at least March 2012.
- Basing covenant calculations on frozen UK GAAP to reduce volatility arising from certain fair value measurements and future accounting rule changes.
- Including covenant clauses that enable net debt and EBITDA to be retranslated to sterling at similar exchange rates to reduce exchange movement volatility.
- Monitoring actual and forecast results against covenant ratios regularly.

Finance – Interest rates

Potential impact
Fluctuations in rates affect the interest the Group pays on its external borrowings.

Mitigation action
- Using the underlying character of debt instruments and interest rate derivatives such as interest rate swaps.

Finance – Retirement benefits funding

Potential impact
The funding position of the Group's post-retirement benefit schemes may be affected adversely by poor investment performance, changes in interest and inflation rates, greater than anticipated improvements in life expectancy and changes in the regulatory environment. The income statement and the level of cash contributions that must be made to the schemes may be positively or negatively affected by the amounts we are required to record for our retirement benefit obligations.

Mitigation action
- Closing the defined benefit schemes in the UK and USA to new members, with the exception of one scheme inherited with the K&F acquisition.
- Agreeing deficit recovery plans with the trustees based on actuarial advice and scheme valuation results.
- Changing future service benefits to contain cost.

Corporate – Environmental

Potential impact
Meggitt's operations and facilities are subject to laws and regulations that govern the discharge of pollutants and hazardous substances into air and water, the handling, storage and disposal of such materials, and other environmental matters. Failing to comply with our obligations potentially exposes the Group to serious consequences, including fines, other sanctions and operational limitations. We are involved in the investigation and remediation of current and former sites for which we have been identified as a potentially responsible party under US law.

Mitigation action
- Designing processes that minimise the effect of the Group's operations on the environment.
- Commissioning independent third-party audits of our sites.
- Carrying out extensive environmental due diligence on potential acquisitions and purchasing environmental insurance for all new sites.
- Providing for the expected costs arising from these sites based on available information and establishing a receivable to the extent these costs are recoverable under the Group's environmental insurance policies.

Corporate – Legal and regulatory

Potential impact
We are subject to litigation in the ordinary course of business and provide for such costs. However, there is a risk that successful claims or costs could exceed the provisions made. For example, a number of asbestos-related claims have been made against subsidiary companies. To date, the amount connected with such claims in any year has not been material and many claims are covered fully or partly by existing insurance and indemnities. The Group is subject to the laws and regulations of the countries in which it operates, including health and safety, environmental, trade compliance and government contracting regulations. In the US, there is a system of voluntary disclosure to the relevant authorities to deal with any breach of export laws. Any reported or unreported breach may be investigated and, depending upon its seriousness, result in criminal, civil or administrative penalties, including suspension or debarment. The US authorities are investigating alleged violations of US export control laws by four US Meggitt subsidiaries and a UK business. These investigations are likely to lead to financial penalties for which provision has been made and the imposition of corrective measures. Suspension or debarment and denial of export privileges are also possible.

The aerospace industry is highly regulated so the Group would be adversely affected if a material certification, authorisation or approval were revoked or suspended.

Mitigation action
- Maintaining a legal and compliance function to oversee the management of these risks.
- Providing for claims which cannot be recovered from insurers.
- Introducing a health and safety programme across all of our businesses.
- Investing significant resources in implementing best practice trade compliance and ethics programmes which are reviewed quarterly by the Board's Ethics and Trade Compliance Committee.

Corporate – People

Potential impact
Meggitt's success depends upon certain senior and specialist employees. Failure to retain them or recruit replacements would have an adverse effect. The Group would be affected by work stoppages or slowdowns at its facilities and those of key customers or suppliers.

Mitigation action
- Maintaining development and succession programmes, competitive remuneration packages and good communications at all levels.

DIRECTORS' RESPONSIBILITIES STATEMENT

Each of the persons who is a director at the date of the approval of this report confirm that, to the best of their knowledge:

- the Group financial statements, which have been prepared in accordance with EU-adopted IFRSs, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

By order of the Board:

T Twigger Chief Executive 1 March 2010	S Young Group Finance Director 1 March 2010

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