

Filtronic plc
Annual Report
2004

Wireless Infrastructure
Handset Products
Integrated Products





| | |
|----|---|
| 1 | Financial Highlights |
| 2 | Chairman's Statement |
| 5 | Operating Review |
| 6 | Financial Review |
| 8 | Directors |
| 9 | Directors' Report |
| 12 | Statement of Directors' Responsibilities |
| 13 | Independent Auditors' Report |
| 14 | Consolidated Profit and Loss Account |
| 15 | Consolidated Balance Sheet |
| 16 | Consolidated Cash Flow Statement |
| 17 | Notes to the Consolidated Cash Flow Statement |
| 18 | Consolidated Statement of Total Recognised Gains and Losses |
| 18 | Consolidated Reconciliation of Shareholders' Funds |
| 19 | Company Balance Sheet |
| 20 | Accounting Policies |
| 22 | Notes to the Financial Statements |
| 47 | Corporate Governance Statement |
| 49 | Remuneration Report |
| 54 | Subsidiaries |
| 55 | Shareholder Information |
| 56 | Corporate Directory |

Financial Highlights



| | 2004 | 2003 |
|-----------------------------------|----------------|---------|
| Sales | £237.2m | £241.3m |
| Operating profit | £3.7m | £6.7m |
| (Loss)/profit before tax | £(0.4)m | £3.8m |
| Basic (loss)/earnings per share | (4.04)p | 1.46p |
| Diluted (loss)/earnings per share | (4.04)p | 1.45p |
| Dividend per share | 2.70p | 2.70p |
| Net debt | £51.3m | £55.4m |
| Equity shareholders' funds | £101.1m | £109.2m |
| Gearing | 51% | 51% |



Financial results

Sales for the year ended 31 May 2004 were £237.2m (2003 £241.3m), and operating profit was £3.7m (2003 £6.7m). An exceptional profit on disposal of a business was £4.5m. Net interest and financing costs were £8.6m (2003 £2.9m). This change was primarily due to the early repayment of the 10% Senior Notes. This resulted in a loss before tax of £0.4m (2003 £3.8m profit), and a loss after tax of £3.0m (2003 £1.1m profit). Basic and diluted loss per share was 4.04p (2003 1.46p basic earnings, 1.45p diluted earnings).

Dividend

The Board is proposing to maintain the final dividend of 1.80p (2003 1.80p) payable on 1 November 2004 to shareholders on register at 13 August 2004.

Foreign currency and trading factors

Two consecutive years in which sterling has appreciated at greater than 10% against the US dollar inevitably creates pressure for our UK based operations. The Board has accelerated the transition of manufacturing to China such that transmit/receive modules in Wireless Infrastructure are now manufactured there in quantities exceeding UK output. Future expansion in this market will benefit from the lower cost of Chinese manufacturing and will provide a natural hedge against the strength of sterling.

Since our Handset Products group operates in dollar/euro economies, the percentage margins earned are independent of the strength of sterling. Absolute value of sales and the profit delivered suffered when translated into sterling.

Most of the operations of the Integrated Products group are located in the UK while the majority of its output operates in a market priced in dollars. This has resulted in pressure on margins in this business segment.

The global nature of the business implies exposure to currency movement. This has contributed a loss in the year as the euro, like the dollar, moved against sterling for a sustained interval. The Board will conduct a review of procedures and policy with the intention of introducing improvements in the finance and accounting areas during the year.

Operations

As advised in the interim statement, the Board implemented a management and reporting reorganisation of the business segments. This was done so that Filtronics is better positioned to address the challenges of moving from the development stage into production with a broad range of new products, including power amplifiers. Accordingly, the segmental analysis of the operating results is as follows:

| Year ended 31 May | Sales | | Operating profit | |
|------------------------------|--------------|--------------|------------------|------------|
| | 2004 £m | 2003 £m | 2004 £m | 2003 £m |
| Wireless Infrastructure (WI) | 140.9 | 151.7 | 10.4 | 20.9 |
| Handset Products (HP) | 57.4 | 51.2 | 10.4 | 10.8 |
| Integrated Products* (IP) | 37.8 | 37.5 | (13.3) | (19.3) |
| Central Services (CS) | 3.6 | 1.8 | (3.8) | (5.7) |
| Inter segment | (2.5) | (0.9) | - | - |
| | 237.2 | 241.3 | 3.7 | 6.7 |

*Includes the Filtronics Solid State Electronic Warfare business, which was sold on 31 December 2003.



Wireless Infrastructure

This business includes the traditional transmit/receive modules and new integrated power amplifiers for mobile base stations. The company is now delivering production quantities of WI products to all major original equipment manufacturers (OEMs). Additional investments were made during the second half of the year in both aspects of the business. In the transmit/receive module business, the decision to expand in China to meet the increasing demands of our existing customers and the production ramp for a new major OEM customer required additional funding. A decision was made to continue to procure materials in the UK in order to provide cover against any delays in ramping up the Chinese production. Following successful ramp-up in China, the UK operation will now focus on new product introduction for transmit/receive modules and integrated power amplifiers.

It became apparent earlier in this calendar year that the company's market opportunity in power amplifiers was for the supply of higher value integrated power amplifiers rather than power amplifier modules. Consequently, additional resources were deployed in the UK to establish a production facility for this complex integrated product and this involved an additional £2m of investment. In the full year, the cost, including this £2m has totalled £5m and following the year-end the first production contract has been secured.

Handset Products

The supply of internal antennas with higher levels of mechanical integration has dominated this year's performance. Since the proportion of our added value has decreased, the margins have fallen in line.

Taking into account the retranslation of the first half with respect to the end of year exchange rates, the effective operating margins in the second half were approximately 15% and are likely to remain at this level with the current level of product integration.

Integrated Products

Increasing sales in compound semiconductor devices have enabled the whole group to reduce losses. This trend is expected to continue. Fully automated assembly systems are now operational for incorporating high power transistors into modules for the integrated power amplifiers in WI. Operational improvements within the defence component of the business have allowed profitable operation for the year in the US and UK.

Central R&D

In addition to creating sales for DSP (Digital Signal Processing) subsystems for both commercial and defence applications, a considerable advance has been made on the development of digital predistortion techniques for 3G integrated power amplifiers.

Finance

As advised in the interim statement, the outstanding 10% Senior Notes were re-financed with a £50m term loan. The trading conditions prevailing in the latter part of the financial year and the appreciation of sterling against the dollar have led to certain breaches of the financial covenants associated with the term loan. The group's two lending banks have confirmed their continuing support, including the waiving of the covenant breaches, whilst reserving their rights. Future covenant tests will be set to a suitable level based on prevailing trading conditions. The group's overdraft facility has been renewed at £9m until July 2005.

Capital investment

The growth in demand from both our existing and new customers for wireless infrastructure transmit/receive modules caused us to commit further capital expenditure for test equipment and facilitisation, mainly in China. This investment, together with new generic manufacturing equipment and processes to service the integrated handset antenna product line with new foil technology and automated test equipment for production of integrated power amplifiers for 3G WCDMA networks will result in capital expenditure of £18m, approximately 50% more than in the 2003/4 financial year.



Outlook

In WI, production contracts have now been secured with all major OEMs. Growth will mainly occur in China for our transmit/receive modules towards the end of this calendar year and the beginning of 2005. A similar time frame also exists for the production in the UK for the first integrated power amplifiers, where production requirements are larger than initially anticipated. Start-up costs will lead to a loss of approximately £6m before a positive contribution is achieved by the year-end.

In HP, the addition of our new foil technology and the utilisation of our impact extrusion expertise should consolidate our world leading position.

IP will grow primarily due to the increase in sales of compound semiconductors and in particular, the growth in RF switch products for mobile handsets. Further growth will also be achieved in supplying the high yield large power transistors mounted in the high efficiency module units for the integrated power amplifiers. Past investment at the compound semiconductor foundry in Newton Aycliffe has equipped the Integrated Products segment with the capacity to react rapidly to increasing market demand creating strong upside potential.

By far the largest market opportunity for the company is the supply of integrated power amplifiers for 3G base stations. Uniquely in this market, Filtronic controls its own supply of GaAs transistors, which are lower cost per watt of power compared to silicon LDMOS, the technology used by our competitors. Using feed-forward linearisation, GaAs units are more efficient than LDMOS units and with the state-of-the-art digital predistortion both techniques result in lower cost and higher efficiency. Whilst GaAs units are more difficult to linearise digitally, full UMTS specifications have been met by Filtronic for both constant and pulse power conditions. The company believes that LDMOS amplifiers, linearised through digital predistortion will have difficulty in meeting this critical specification under practical pulsed-power conditions. Hence, it is likely that our technology offers a significant advantage over competing solutions particularly for multicarrier and HSDPA (high speed data packet access) applications.

The strategic alliance with BAE SYSTEMS is producing sales, at development level, with growth potential as BAE SYSTEMS moves to production with its Seaspray 7000 series of active array radars for the surveillance market. Potential exists for expansion of the agreement as a result of the proposed merger of Gallileo Avionica, part of Finmeccanica, and the Avionics Group of BAE SYSTEMS. The experience of the alliance indicates increased scope for business in the sub-system arena coupled with benefits of high reliability manufacturing at low cost. Increased emphasis and budget allocation for European homeland security projects offers additional scope for supply of infrastructure elements, including airborne active antennas for satellite communications.

Company directors

Last year a decision was made to split the roles of Chairman and CEO. Earlier this year, the position of CEO was offered to Professor John Roulston. Professor Roulston resigned from the Board of BAE Systems Avionics Limited in June and by agreement with his previous employer will take up his position at Filtronic on 6 September 2004.

Professor Christopher Snowden has accepted the prestigious position as Vice-Chancellor at the University of Surrey but will stay as a director with the company until April 2005, after which he will remain as a technical consultant in the area of compound semiconductors.

John Samuel resigned as Finance Director at the beginning of June. Christopher Schofield resigned as Company Secretary and executive director to concentrate on the Law practice, Schofield Sweeney, which he co-founded. Dr Maura Moynihan, a qualified solicitor specialising in intellectual property and a PhD graduate in biochemistry, joined Filtronic two years ago with the remit to become Company Secretary to which position she has now been appointed.

Professor J David Rhodes CBE FRS FREng

Chairman

2 August 2004



The Wireless Infrastructure division accounted for 59% (2003 63%) of the group's sales at £140.9m (2003 £151.7m) a reduction of 7%. With the inclusion this year of the costs associated with integrated power amplifiers and the continued expansion in China, it contributed £10.4m (2003 £20.9m) of operating profit, a fall of 50%.

The global wireless infrastructure market continued to decline in 2003, starting to recover at the beginning of 2004. This recovery was reflected in substantially higher sales within the division in the final quarter. The Wireless Infrastructure division remains profitable and cash generative. With the successful transition to low cost manufacturing in China and the addition of significant orders from two new OEMs, it is well positioned to capitalise on these recent improvements in the market.

Handset Products accounted for 24% (2003 21%) of the group's sales at £57.4m (2003 £51.2m), an increase of 12%, and contributed £10.4m (2003 £10.8m) of operating profit, a fall of 4%. Handset antenna sales increased by 14% to over 121 million units (2003 106m), of which nearly 50% were manufactured in our facilities in Suzhou, China.

The Integrated Products division, formed early in the financial year, includes the Defence (Electronic Warfare), Compound Semiconductors, Broadband Access, and automated assembly (Microtek) businesses. Integrated Products accounted for 16% (2003 16%) of the group's sales at £37.8m (2003 £37.5m). It made a loss of £13.3m (2003 £19.3m loss), with significant improvement in the second half of the year. The electronic warfare business at Filtronic Solid State was divested during the year. Sales in both the UK Defence and Compound Semiconductor elements increased, whilst sales in Broadband Access were lower than in 2003 following the transfer of Filtronic Sigtek Inc to Central Services.

The Defence business operated profitably in both the UK and USA, following improvements in the operational performance of all sites. New defence programme opportunities are being developed in both the UK and USA. Compound Semiconductors, won business in new high volume RF switch products for cellular handset and wireless LAN applications during the year, and re-established the transistor product line transferred from the US operation in 2003. Broadband Access has focused on the supply of transceivers for point-to-point cellular base station interconnection and the development of new products for electronically scanned radar (E-Scan radar). Additional transceiver product opportunities were secured during the year with new OEM customers. This included the company's new compact transceivers based on multi-function gallium arsenide integrated circuits, which will enter production in 2005.

At the end of the financial year, the group employed 3,590 people, an increase of 652 (22%) from May 2003. This increase has come predominantly from the Wireless Infrastructure division, 485 people, and the Handset business, 205 people, as more production moves to China. A small reduction of 27 people occurred in Integrated Products.

A R Needle, Chief Executive Officer, Wireless Infrastructure
J Anttila, Chief Executive Officer, Handset Products
Professor C M Snowden, Chief Executive Officer, Integrated Products

2 August 2004



Results

The group's sales were £237.2m (2003 £241.3m) resulting in an operating profit of £3.7m (2003 £6.7m). The loss before tax was £0.4m (2003 £3.8m profit), and the loss after tax was £3.0m (2003 £1.1m profit).

Research and development costs

The group's policy is to charge all research and development costs to the profit and loss account as they are incurred. The research and development costs were £27.9m (2003 £28.3m), which was 11.8% (2003 11.7%) of sales.

Exceptional profit on disposal of business

The sale of the electronic warfare business of Filtronic Solid State was completed on 31 December 2003. The all cash consideration after disposal costs was £6.1m, resulting in an exceptional profit on disposal of £4.5m. In the seven months prior to its disposal this business contributed sales of £3.7m and an operating loss of £34,000.

Net interest payable and similar charges

Net interest payable and similar charges was reduced to £5.5m (2003 £8.0m) primarily as a result of repaying the 10% Senior Notes.

Net financing currency exchange (loss)/gain

A net loss of £0.6m (2003 £4.2m gain) has been reported in the profit and loss account as a result of foreign currency exchange movements on cash balances and the United States dollar denominated 10% Senior Notes. In addition a gain of £4.3m (2003 £5.3m), resulting from currency exchange movements on that part of the 10% Senior Notes which hedged the group's United States dollar denominated assets, has been taken directly to reserves.

Exceptional net (loss)/gain on repayment of debt

During the year the company bought back all the remaining \$103.6m (2003 \$37.2m) 10% Senior Notes. These purchases were at a premium to par value resulting in an exceptional net loss of £2.5m (2003 £0.9m net gain).

Taxation

The taxation charge of £2.6m (2003 £2.7m) results primarily from the group's operations in China and Finland, where taxable profits cannot be relieved by losses available in other jurisdictions.

Capital expenditure

Capital expenditure was £11.4m (2003 £8.2m), which was an increase of £3.2m compared to last year. The total capital expenditure for the year to 31 May 2004 comprised Wireless Infrastructure £3.1m, Handset Products £4.6m, Integrated Products £3.3m and Central Services £0.4m.

Impairment review

In accordance with Financial Reporting Standard 11 "Impairment of Fixed Assets and Goodwill", the Board has carried out an impairment review in respect of the compound semiconductor operation at Newton Aycliffe and in California, because of the operating loss being incurred. The review was based on a series of forecasts of operating results and cash flows. A discounted cash flow forecast calculation was prepared using a discount rate of 10%. The discounted cash flow forecast was compared to the current carrying value of the assets concerned. Sensitivity analysis was applied to the key underlying assumptions including the discount rate. The most important assumptions are those related to the timing and extent of future sales, where changes in assumptions would result in material movements in the discounted cash flow calculation.



In addition a series of performance milestones, operational, technical and market-related have been determined. Progress in achieving these milestones is reviewed regularly to monitor developments, which are fundamental to the assumptions underlying the forecast operating results. If some or all of these milestones were not to be achieved as expected, then the Board may find it necessary to review and possibly change some of the assumptions used. By their nature these assumptions are subjective, and contain significant levels of judgement related to operational and technical matters as well as to broader market issues.

Having taken all of these areas of judgement and their related assumptions into account, the Board has determined that no impairment has taken place.

Deferred income

Deferred income comprised government grants and the licence fee paid by BAE SYSTEMS Avionics Limited in connection with the Supply and Development Agreement dated 30 November 2001. This agreement contains a number of terms and obligations, of which the principal ones are described in note 26 to the financial statements. The fee is being recognised in the profit and loss account in equal monthly amounts of £66,000, from 1 May 2003 until 31 December 2015. A regional selective assistance grant of £5.0m was negotiated in 1999 in respect of Newton Aycliffe. This is receivable over five years if certain employment and capital expenditure targets are met. At 31 May 2004 a total of £3.4m of this grant had been received.

Working capital

Working capital cash consumption for the year was £4.7m compared to £11.1m cash generated for the previous year. During the year stocks increased by £4.7m, and debtors increased by £6.6m, but this was offset by a £6.6m increase in creditors. Total stocks of £36.6m (2003 £34.3m) comprised raw materials £22.6m (2003 £22.8m), and work in progress and finished goods £14.0m (2003 £11.5m).

Cash flow

Cash generated from operations was £16.9m (2003 £38.5m). EBITDA was £21.6m (2003 £27.4m), which was 3.9 (2003 3.4) times net interest payable.

Financing

During the year the company repaid all the \$103.6m of 10% Senior Notes. This was financed using the £6.1m cash received from the disposal of the electronic warfare business in California, and a £50.0m bank loan. At 31 May 2004 net debt of £51.3m (2003 £55.4m) comprised the £50.0m bank loan, a £3.4m bank overdraft less £2.1m of cash.

International Financial Reporting Standards ("IFRS")

The Board has considered the effect of implementing IFRS in the year ended 31 May 2006 on its financial statements and financial reporting functions. The transition project is in progress. The areas of the financial statements that may be significantly affected by the adoption of IFRS are accounting for intangible fixed assets, research and development costs, foreign currency translation, share-based payments and the defined benefit pension scheme.

D C Staddon FCA
Group Financial Controller
2 August 2004



Executive directors

Professor J David Rhodes CBE FRS FEng BSc PhD DSc DEng (Hon) DSc (Hon) FIEE FIEEE (aged 60) has been Chairman since founding Filtronic in 1977 and also serves as Chief Executive Officer until Professor John Roulston is appointed on 6 September 2004. Professor Rhodes has been a professor of electronic and electrical engineering at Leeds University since 1975 and is an internationally recognised figure in the field of circuit theory and microwave engineering. He has written over one hundred technical papers and books on the subject and has received several international awards. In the 1992 New Year's Honours List he was made an Officer, Order of the British Empire, for his contribution to science and technology and in 1993 he was elected a Fellow of the Royal Society. In the 2000 New Year's Honours List he was made a Commander, Order of the British Empire, for his contribution to engineering, research and industry. In 2003, Professor Rhodes was awarded the Prince Phillip Medal by the Royal Academy of Engineering. Professor Rhodes is a non-executive director of Polar Capital Technology Trust PLC.

Professor Christopher Snowden FEng BSc MSc PhD CEng FIEE FIEEE (aged 48) is Chief Executive Officer of Integrated Products, having been a director since 1998. Prior to joining Filtronic in 1998, Professor Snowden was head of the school of Electronic and Electrical Engineering at Leeds University. He is leaving Filtronic on 5 April 2005 to become Vice-Chancellor and Chief Executive of the University of Surrey.

Alan Needle MBA (aged 49) is Chief Executive Officer of Wireless Infrastructure. Prior to the reorganisation of the business segments in 2003 he was Managing Director of the group's operations apart from Compound Semiconductors. He joined Filtronic in 1986.

Dr Christopher Mobbs BSc PhD MIEEE (aged 42) has been Director of Engineering since 2002. He has served as Chief Technical Officer since 1997. He joined Filtronic Components as an engineer after graduating from Leeds University in 1982.

Non-executive directors

Rhys Williams (aged 70) is the senior non-executive director. He has been a non-executive director and chairman of the remuneration committee since 1994. Mr Williams was an executive director of GEC from 1985 to 1991. He currently serves as non-executive chairman of Radstone Technology plc and as a non-executive director of Acal plc and Comunica Holdings plc.

Richard Blake (aged 68) has been a non-executive director since 1994 and has been chairman of the audit committee since 1995. Mr Blake was a partner in Baker Tilly from 1964 until his retirement in 1993. Mr Blake is a non-executive director of YooMedia plc.

Professor Stephen Burbank (aged 57) has been a non-executive director since 1994. Professor Burbank is currently the David Berger Professor for the Administration of Justice at the University of Pennsylvania. He is a director of the American Academy of Political and Social Science and the American Judicature Society.

Ian Hardington (aged 40) has been a non-executive director since 1999. Mr Hardington is a Principal with Mansfield Partners, Inc., a US based investment advisory firm.

Graham Meek (aged 57) has been a non-executive director since 1999. Previously he was a director of Beeson Gregory Limited. He is a non-executive director of ICM Computer Group plc.

The Board determines the remuneration of the non-executive directors, all of whom are independent.



The directors present their report and the audited financial statements for the year ended 31 May 2004.

Principal activities

The principal activities of the group are the design and manufacture of microwave products and compound semiconductors for wireless telecommunications systems and military applications.

Review of the business and state of the group's affairs

The Chairman's Statement, the Operating Review and the Financial Review on pages 2 to 7 inclusive contain a review of the group's business.

The directors are satisfied with the state of affairs of the company and the group and believe it is well positioned to grow through opportunities offered by the worldwide wireless telecommunications and military markets.

Financial results and dividend

The results for the year are set out in the profit and loss account on page 14. The position at the end of the year is shown in the balance sheet on page 15.

Following an interim dividend of 0.90p (2003 0.90p) per ordinary share, the directors are recommending payment of a final dividend of 1.80p (2003 1.80p), making a full year dividend of 2.70p (2003 2.70p) per ordinary share.

Research and development

Research and development costs amounted to £27.9m (2003 £28.3m). All such costs are written off to the profit and loss account as incurred.

Directors and their interests

The directors of the company during the year were as follows:

Professor J David Rhodes CBE FRS FREng BSc PhD DSc DEng(Hon) DSc(Hon) FIEE FIEEE

Professor Christopher Snowden FREng BSc MSc PhD CEng FIEE FIEEE

Alan Needle MBA

Dr Christopher Mobbs BSc PhD MIEEE

John Samuel BA FCA (resigned 10 June 2004)

Christopher Schofield MA (Cantab) (resigned 2 April 2004)

Rhys Williams BSc

Richard Blake FCA

Professor Stephen Burbank BA JD

Ian Hardington

Graham Meek

Details of their interests in the share capital of the company are set out in the remuneration report on pages 49 to 53.

Professor Stephen Burbank, Dr Christopher Mobbs, Alan Needle and Professor Christopher Snowden retire by rotation and, being eligible, offer themselves for re-election at the annual general meeting. An ordinary resolution to re-elect Professor John Roulston, who will be appointed on 6 September 2004, who retires in accordance with the company's Articles of Association, will also be proposed at the annual general meeting.



Substantial shareholdings

The following shareholders, other than the directors, have indicated a holding of 3% or more of the issued share capital as at 23 July 2004.

| | Number of 10p ordinary shares | % of issued share capital |
|---|----------------------------------|------------------------------|
| Fidelity International Limited | 10,900,366 | 14.6 |
| Prudential plc | 9,385,088 | 12.6 |
| Deutsche Bank AG | 8,330,073 | 11.2 |
| Legal & General Investment Management Limited | 2,956,443 | 4.0 |

Employees

The Board is committed to ensuring the health and safety of the group's employees worldwide and applies high standards throughout the group in the control and management of its operations. The group analyses its practices and processes using systematic health and safety management techniques and auditing regimes. A group-wide health and safety audit showed a forty per cent reduction in reportable accidents in the year ended 31 May 2004 compared with the previous year.

The group is conscious of its obligations towards disabled persons and tries to ensure that they receive equal opportunities. So far as particular disabilities permit, the group will continue to provide employment for any existing employee who becomes disabled. The group will also provide relevant training, career development and promotion for disabled employees where this is appropriate.

The group operates internationally and its employment policies are designed to meet local regulations and requirements. The group believes in keeping employees fully informed on matters which affect them through communication procedures including staff meetings, a group-wide newsletter and a culture which encourages openness and interaction between all members of staff. Employee development has been established as one of the group's key objectives. A training management system is currently being implemented globally thus underlying the group's commitment to on-going employee development and training.

Environmental, social and ethical policies

Care for the environment is an integral part of the group's business activities worldwide. It is the group's policy to ensure that its facilities throughout the world are safe and acceptable to the communities in which they operate. The group is committed to ensure that their impact on the environment is minimised. The group supports and trains its personnel to act responsibly in matters relating to the environment. The group takes account of relevant legislation and regulations and analyses its practices, processes and products to reduce their environmental impact, and works with its customers and suppliers to achieve a high standard of product stewardship. All of the group's major manufacturing sites have established environmental management systems and have achieved ISO14001 certification.

Wherever possible, components and materials are re-used or re-cycled. The re-use and the utilisation and re-cycling of packaging is subject to monitoring. The group continues to work with its customers to implement programmes to design products for disassembly and re-cycling, and in particular so as to ensure compliance with the European Union directive on waste electrical and electronic equipment and the European Union and Chinese initiatives in relation to the restriction of certain hazardous substances in electrical and electronic equipment. The group has introduced focused management teams throughout its business to ensure that compliance with these requirements is achieved within the required implementation timescales.



Political and charitable contributions

No contributions were made for political purposes. The group donated £25,000 (2003 £24,000) to various charities.

Supplier payment policy

It is the group's policy to abide by the terms of payment agreed with suppliers in respect of the goods and services properly invoiced to the group. At 31 May 2004 trade creditors of £27.8m represented 64 days' purchases, calculated in accordance with the requirements of the Companies Act.

Special business at the annual general meeting

Remuneration report

Pursuant to the Directors' Remuneration Report Regulations 2002 the Board proposes the remuneration report which is set out on pages 49 to 53, for approval (resolution 9 in the notice of annual general meeting). No entitlement of a director to remuneration is conditional on the resolution being passed but the result of the vote will be taken into account in considering the development and operation of the company's remuneration policy.

Authority to allot shares

The Companies Act 1985 requires that the authority of the directors to allot relevant securities shall be subject to the approval of shareholders in general meeting or to an authority set out in the company's Articles of Association. Accordingly, an ordinary resolution (resolution 10 set out in the notice of annual general meeting) will be proposed at the annual general meeting to renew the authority granted at the annual general meeting held on 26 September 2003 and thereby authorise the directors to allot unissued ordinary shares of the company up to a total nominal value of £2,488,219 (representing one third of the nominal value of the company's issued share capital).

The Companies Act 1985 also requires that any equity shares issued wholly for cash must be offered to existing shareholders in proportion to their existing holdings. This requirement was disapplied to a limited extent by a resolution passed at the annual general meeting held on 26 September 2003 and a special resolution (resolution 11 set out in the notice of annual general meeting) will be proposed at the annual general meeting to renew the directors' authority to allot equity shares for cash other than on a pro rata basis. This will be limited to equity shares having a nominal value of up to £373,232 (representing 5% of the issued share capital of the company). This authority will terminate no later than fifteen months after the passing of the special resolution.

Auditors

A resolution to re-appoint KPMG Audit Plc as auditors will be proposed at the annual general meeting.

Company secretary

On 2 April 2004 C E Schofield resigned as company secretary and M Moynihan was appointed as company secretary.

By order of the Board
M Moynihan
Company Secretary
2 August 2004



Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the company and the group and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- a) select suitable accounting policies and then apply them consistently;
- b) make judgements and estimates that are reasonable and prudent;
- c) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- d) prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company and group will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the accounts comply with the Companies Act. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Independent Auditors' Report

to the members of Filtronic plc



We have audited the financial statements on pages 14 to 46. We have also audited the information in the directors' remuneration report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the annual report and the directors' remuneration report. As described on page 12, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the group is not disclosed.

We review whether the statement on pages 47 and 48 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the annual report, including the corporate governance statement and the unaudited part of the directors' remuneration report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- ii) the financial statements give a true and fair view of the state of affairs of the company and the group as at 31 May 2004 and of the loss of the group for the year then ended; and
- ii) the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Leeds
2 August 2004



Consolidated Profit and Loss Account

for the year ended 31 May 2004

| | note | 2004 £000 | 2003 £000 |
|---|------|----------------|--------------|
| Sales | 4 | 237,203 | 241,268 |
| Operating profit | 5 | 3,707 | 6,715 |
| Exceptional profit on disposal of business | 11 | 4,546 | – |
| Net interest payable and similar charges | 12 | (5,550) | (7,995) |
| Net financing currency exchange (loss)/gain | 13 | (614) | 4,236 |
| Exceptional net (loss)/gain on repayment of debt | 14 | (2,498) | 881 |
| | | (8,662) | (2,878) |
| (Loss)/profit on ordinary activities before taxation | | (409) | 3,837 |
| Taxation on (loss)/profit on ordinary activities | 15 | (2,598) | (2,753) |
| (Loss)/profit on ordinary activities after taxation | | (3,007) | 1,084 |
| Dividends | 16 | (2,015) | (2,006) |
| Deficit for the year | 29 | (5,022) | (922) |
| (Loss)/earnings per share | | | |
| Basic | 17 | (4.04)p | 1.46p |
| Diluted | 17 | (4.04)p | 1.45p |
| Dividend per share | 16 | 2.70p | 2.70p |

All the results relate to continuing operations.

Consolidated Balance Sheet

at 31 May 2004



| | note | 2004 £000 | 2003 £000 |
|---|------|----------------|----------------|
| Fixed assets | | | |
| Intangible assets | 18 | 30,902 | 35,769 |
| Tangible assets | 20 | 86,300 | 96,272 |
| | | <u>117,202</u> | <u>132,041</u> |
| Current assets | | | |
| Stocks | 21 | 36,618 | 34,344 |
| Debtors | 22 | 54,480 | 50,908 |
| Cash at bank and in hand | | 2,070 | 6,522 |
| | | <u>93,168</u> | <u>91,774</u> |
| Creditors: amounts falling due within one year | 23 | <u>51,767</u> | <u>38,821</u> |
| Net current assets | | <u>41,401</u> | <u>52,953</u> |
| Total assets less current liabilities | | <u>158,603</u> | <u>184,994</u> |
| Creditors: amounts falling due after one year | 24 | 44,000 | 61,942 |
| Provision for deferred tax | 25 | 582 | 750 |
| Deferred income | 26 | 12,908 | 13,143 |
| Net assets | | <u>101,113</u> | <u>109,159</u> |
| Capital and reserves | | | |
| Called up share capital | 27 | 7,465 | 7,430 |
| Share premium account | 28 | 137,641 | 135,851 |
| Shares to be issued | 28 | 2,255 | 4,321 |
| Revaluation reserve | 28 | 106 | 106 |
| Other reserve | 28 | 2,020 | 828 |
| Profit and loss account | 29 | (48,374) | (39,377) |
| Equity shareholders' funds | | <u>101,113</u> | <u>109,159</u> |

Approved by the Board on 2 August 2004 and signed on its behalf by

Professor J D Rhodes CBE FRS FREng
Chairman



Consolidated Cash Flow Statement

for the year ended 31 May 2004

| | note | 2004 £000 | 2003 £000 |
|--|------|----------------|--------------|
| Net cash flow from operating activities | A | 16,864 | 38,528 |
| Returns on investment and servicing of finance | | | |
| Interest received | | 95 | 231 |
| Interest paid | | (4,852) | (7,638) |
| Bank loan arrangement fee paid | | (500) | – |
| Premium paid on repayment of debt | | (1,517) | – |
| Net cash flow from returns on investment and servicing of finance | | (6,774) | (7,407) |
| Tax paid | | (2,706) | (4,128) |
| Capital expenditure | | | |
| Purchase of tangible fixed assets | | (11,369) | (8,198) |
| Sale of tangible fixed assets | | 305 | 1,378 |
| Government grants received | | 1,297 | 1,319 |
| Net cash flow from capital expenditure | | (9,767) | (5,501) |
| Disposals (note 11) | | | |
| Cash consideration received | | 6,544 | – |
| Disposal costs paid | | (442) | – |
| Net cash flow from disposals | | 6,102 | – |
| Equity dividends paid | | (2,008) | (2,002) |
| Net cash flow before financing | | 1,711 | 19,490 |
| Financing | | | |
| Issue of shares | | 275 | – |
| Loans taken out | | 60,000 | – |
| Loans repaid | | (66,947) | (22,107) |
| Net cash flow from financing | | (6,672) | (22,107) |
| Decrease in cash | B | (4,961) | (2,617) |

Notes to the Consolidated Cash Flow Statement

for the year ended 31 May 2004



A Reconciliation of operating profit to net cash flow from operating activities

| | 2004 £000 | 2003 £000 |
|--|---------------|--------------|
| Operating profit | 3,707 | 6,715 |
| Goodwill amortisation | 2,171 | 2,348 |
| Share compensation | 232 | 146 |
| Depreciation | 17,065 | 19,322 |
| Profit on disposal of tangible fixed assets | (44) | (518) |
| Licence fee released | (789) | (66) |
| Government grants released | (743) | (525) |
| Movement in stocks | (4,701) | 8,734 |
| Movement in debtors | (6,644) | 3,876 |
| Movement in creditors | 6,610 | (1,504) |
| Net cash flow from operating activities | 16,864 | 38,528 |

B Reconciliation of net cash flow to movement in net debt

| | 2004 £000 | 2003 £000 |
|---|-----------------|--------------|
| Decrease in cash | (4,961) | (2,617) |
| Cash flow from debt | 6,947 | 22,107 |
| Change in net debt from cash flows | 1,986 | 19,490 |
| Non-cash movement | (1,274) | 293 |
| Currency exchange movement | 3,409 | 9,483 |
| Movement in net debt | 4,121 | 29,266 |
| Opening net debt | (55,420) | (84,686) |
| Closing net debt | (51,299) | (55,420) |

C Analysis of movement in net debt

| | At 1 June 2003 £000 | Cash flow £000 | Non-cash movement £000 | Currency exchange movement £000 | At 31 May 2004 £000 |
|-----------------------------|------------------------------|----------------------|------------------------------|--|------------------------------|
| Cash at bank and in hand | 6,522 | (1,592) | – | (2,860) | 2,070 |
| Bank overdraft | – | (3,369) | – | – | (3,369) |
| Net cash/(overdraft) | 6,522 | (4,961) | – | (2,860) | (1,299) |
| Loans due within one year | – | (6,000) | – | – | (6,000) |
| Loans due after one year | (61,942) | 12,947 | (1,274) | 6,269 | (44,000) |
| Loans | (61,942) | 6,947 | (1,274) | 6,269 | (50,000) |
| Net debt | (55,420) | 1,986 | (1,274) | 3,409 | (51,299) |



Consolidated Statement of Total Recognised Gains and Losses

for the year ended 31 May 2004

| | 2004 £000 | 2003 £000 |
|--|-----------------------|---------------------|
| (Loss)/profit on ordinary activities after taxation | (3,007) | 1,084 |
| Currency exchange movement arising on consolidation | (7,780) | (590) |
| Currency exchange movement on loan (note 38) | 4,249 | 5,329 |
| Total recognised gains and losses for the year | <u>(6,538)</u> | <u>5,823</u> |

Consolidated Reconciliation of Shareholders' Funds

for the year ended 31 May 2004

| | 2004 £000 | 2003 £000 |
|--|-----------------------|-----------------------|
| (Loss)/profit on ordinary activities after taxation | (3,007) | 1,084 |
| Dividends | (2,015) | (2,006) |
| Deficit for the year | <u>(5,022)</u> | <u>(922)</u> |
| Currency exchange movement arising on consolidation | (7,780) | (590) |
| Currency exchange movement on loan (note 38) | 4,249 | 5,329 |
| Issue of shares | 2,573 | 2,507 |
| Shares to be issued – shares issued | (2,298) | (2,507) |
| Shares to be issued – share compensation | 232 | 146 |
| Movement in shareholders' funds | <u>(8,046)</u> | <u>3,963</u> |
| Opening shareholders' funds | 109,159 | 105,196 |
| Closing shareholders' funds | <u>101,113</u> | <u>109,159</u> |

Company Balance Sheet

at 31 May 2004



| | note | 2004 £000 | 2003 £000 |
|---|------|----------------|----------------|
| Fixed assets | | | |
| Tangible assets | 20 | 9,711 | 9,816 |
| Investments | 19 | 28,276 | 28,276 |
| | | <u>37,987</u> | <u>38,092</u> |
| Current assets | | | |
| Debtors | 22 | 216,092 | 227,063 |
| Cash at bank and in hand | | 5 | 3,840 |
| | | <u>216,097</u> | <u>230,903</u> |
| Creditors: amounts falling due within one year | 23 | <u>17,044</u> | <u>4,048</u> |
| Net current assets | | <u>199,053</u> | <u>226,855</u> |
| Total assets less current liabilities | | <u>237,040</u> | <u>264,947</u> |
| Creditors: amounts falling due after one year | 24 | 44,000 | 61,942 |
| Provision for deferred tax | 25 | – | 239 |
| Net assets | | <u>193,040</u> | <u>202,766</u> |
| Capital and reserves | | | |
| Called up share capital | 27 | 7,465 | 7,430 |
| Share premium account | 28 | 137,641 | 135,851 |
| Shares to be issued | 28 | 2,255 | 4,321 |
| Profit and loss account | 29 | 45,679 | 55,164 |
| Equity shareholders' funds | | <u>193,040</u> | <u>202,766</u> |

Approved by the Board on 2 August 2004 and signed on its behalf by

Professor J D Rhodes CBE FRS FREng
Chairman



Basis of accounting

The financial statements have been prepared on the historical cost basis of accounting and in accordance with applicable United Kingdom accounting standards. The following accounting policies have been applied consistently in accounting for material items in the financial statements.

Consolidation

The financial statements consolidate the profit and loss accounts, balance sheets and cash flow statements of the company and all of its subsidiaries.

The profit and loss accounts, balance sheets and cash flow statements of overseas subsidiaries are translated at the rate of exchange ruling at the balance sheet date. Currency exchange movements arising on overseas subsidiaries' net assets, long term intra group loans and intra group dividends are taken directly to reserves.

Sales

Sales represents amounts receivable, excluding value added tax and overseas sales taxes, in respect of goods provided in the ordinary course of business.

Research and development expenditure

Research and development expenditure is charged to the profit and loss account as incurred.

Operating leases

Operating lease rentals are charged to the profit and loss account on a straight line basis over the lease term.

Share compensation

Share compensation due to employees is charged to the profit and loss account over the vesting period of the shares.

Debt issue costs

Costs incurred in issuing debt are amortised over the term of the loan.

Government grants

Government grants which are related to revenue expenditure are recognised in the profit and loss account so as to match the expenditure to which they relate. Capital grants are shown as deferred income and credited to the profit and loss account over the expected useful economic life of the related asset in line with the depreciation policy set out below.

Foreign currency

Sales and purchases in foreign currencies are translated at the rate of exchange ruling at the time of the transaction. Monetary assets and liabilities are translated at the balance sheet date rate of exchange.

Currency exchange movements are included in the profit and loss account for the year, except for those arising on long term loans. The currency exchange movements on long term loans are taken directly to reserves to the extent that they are offset by the currency exchange movements arising on the net assets of overseas subsidiaries and long term intra group loans that they finance. Any currency exchange movements which are not offset are included in the profit and loss account for the year.



Goodwill

Goodwill arising on acquisitions is capitalised in the consolidated balance sheet as intangible fixed assets. Goodwill is amortised in equal instalments over the lower of 20 years or its estimated economic life. Goodwill is reviewed for impairment at the end of the first full financial year following the acquisition, and in other periods if there are indications that the carrying value may not be recoverable. Goodwill that arose on acquisitions prior to 1 June 1998 was set off directly against reserves.

Tangible fixed assets

Fixed assets are included in the financial statements at cost less accumulated depreciation.

Depreciation is provided in order to write off the cost of tangible fixed assets in equal instalments over their useful lives as follows:

| | |
|-----------------------|-----------------|
| Freehold land | Not depreciated |
| Freehold buildings | 50 years |
| Plant and machinery | 2–10 years |
| Fixtures and fittings | 2–10 years |
| Motor vehicles | 3–5 years |

The carrying values of tangible fixed assets are reviewed for impairment if there are indications that the carrying values may not be recoverable.

Stocks and work in progress

Stocks and work in progress are stated at the lower of cost and estimated net realisable value. Cost comprises the weighted average cost of raw materials and components together with direct labour and attributable overheads. Estimated net realisable value is based on the estimated selling price less further costs expected to be incurred to completion and sale.

Deferred taxation

Deferred tax is recognised as a liability or an asset if the transactions or events that give rise to an obligation to pay more tax in the future or a right to pay less tax in the future have occurred by the balance sheet date. Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the underlying timing differences can be deducted. Deferred tax is not provided on unremitted earnings of overseas subsidiaries where there is no commitment to remit these earnings. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Pension schemes

The company operates a defined benefits pension scheme for United Kingdom employees. The contributions to the scheme are charged to the profit and loss account so as to spread the cost over the employees' working lives with the company. The company's overseas subsidiaries operate defined contribution pension schemes for their employees. Contributions are charged to the profit and loss account as they become payable.



Notes to the Financial Statements

for the year ended 31 May 2004

1 Basis of preparation

Accounting policies

The financial statements have been prepared in accordance with the accounting policies set out on pages 20 and 21.

Financial position and market conditions

The group has experienced increases in demand from both existing and new customers in the group's Wireless Infrastructure business, including greater than expected demand for the power amplifier products, as further referred to in the Chairman's Statement.

Global markets, particularly the technology and telecoms sector, continue to experience a high degree of volatility. It remains difficult to predict total volumes and timing with certainty. Securing lower costs of production, through greater output from the group's Chinese facility and other cost reduction programmes, remain critical. The group's increasing exposure to currency movements represents further uncertainty.

The increased demand has resulted in the requirement for additional capital expenditure and working capital investment, which was previously unplanned, but has now been included in the group's working capital forecasts.

The early stages of this investment, together with the poorer than expected operating results in the second half of the year ended 31 May 2004, arising from increased costs related to establishing manufacturing in China and the effects of currency translation, resulted in the group breaching certain financial covenants relating to its term loan.

The group's lending banks have confirmed their continuing support, including the waiving of the covenant breaches referred to above, whilst reserving their rights. Future covenant tests will be set to a suitable level based on prevailing trading conditions. The group's overdraft facility has been renewed at £9,000,000 until July 2005.

The Board has built all of these circumstances into their working capital forecasts and has modelled various business scenarios. Whilst recognising the uncertainties referred to above, the Board has concluded, based on these scenarios, that the group's funding remains adequate and therefore that it is appropriate for the financial statements to be prepared on a going concern basis.

Notes to the Financial Statements

for the year ended 31 May 2004



2 Geographical origin segment analysis

| | 2004 £000 | 2003 £000 |
|-------------------------------|----------------|----------------|
| Sales | | |
| United Kingdom | 92,486 | 102,807 |
| Finland | 61,221 | 64,954 |
| United States of America | 49,310 | 56,967 |
| Australia | 4,953 | 5,490 |
| China | 47,927 | 21,791 |
| Inter segment | (18,694) | (10,741) |
| | <u>237,203</u> | <u>241,268</u> |
| Operating profit | | |
| United Kingdom | (15,896) | (4,768) |
| Finland | 2,136 | 5,960 |
| United States of America | 2,853 | 716 |
| Australia | (1,340) | (2,004) |
| China | 15,954 | 6,811 |
| | <u>3,707</u> | <u>6,715</u> |
| Net operating assets | | |
| United Kingdom | 66,062 | 63,775 |
| Finland | 48,166 | 56,756 |
| United States of America | 26,616 | 30,466 |
| Australia | 4,716 | 6,031 |
| China | 10,079 | 10,922 |
| Net operating assets | 155,639 | 167,950 |
| Non-operating net liabilities | (3,227) | (3,371) |
| Net debt | (51,299) | (55,420) |
| Net assets | <u>101,113</u> | <u>109,159</u> |

The operating profit in the United States of America is after charging £nil (2003 £1,812,000) of exceptional closure costs (note 7).



Notes to the Financial Statements

for the year ended 31 May 2004

3 Business segment analysis

| | 2004 £000 | 2003 £000 |
|-------------------------------|-----------------|--------------|
| Sales | | |
| Wireless Infrastructure | 140,933 | 151,715 |
| Handset Products | 57,352 | 51,242 |
| Integrated Products | 37,783 | 37,443 |
| Central Services | 3,621 | 1,771 |
| Inter segment | (2,486) | (903) |
| | 237,203 | 241,268 |
| Operating profit | | |
| Wireless Infrastructure | 10,401 | 20,962 |
| Handset Products | 10,420 | 10,834 |
| Integrated Products | (13,351) | (19,344) |
| Central Services | (3,763) | (5,737) |
| | 3,707 | 6,715 |
| Net operating assets | | |
| Wireless Infrastructure | 72,384 | 73,841 |
| Handset Products | 42,074 | 51,723 |
| Integrated Products | 42,199 | 42,707 |
| Central Services | (1,018) | (321) |
| Net operating assets | 155,639 | 167,950 |
| Non-operating net liabilities | (3,227) | (3,371) |
| Net debt | (51,299) | (55,420) |
| Net assets | 101,113 | 109,159 |

The operating loss of Integrated Products is after charging £nil (2003 £1,812,000) of exceptional closure costs (note 7).

The Board has decided to reorganise the business into four segments. This is to ensure that the company is best positioned to address the challenges of moving from the development stage into production with a broad range of new products.

The 2003 comparative figures have been re-analysed to be consistent with the current year.

Notes to the Financial Statements

for the year ended 31 May 2004



4 Sales analysis by destination

| | 2004 £000 | 2003 £000 |
|----------------|----------------|----------------|
| United Kingdom | 15,584 | 12,875 |
| Europe | 123,367 | 131,800 |
| North America | 33,368 | 48,180 |
| Asia Pacific | 64,884 | 48,413 |
| | <u>237,203</u> | <u>241,268</u> |

5 Operating profit

| | 2004 £000 | 2003 £000 |
|--|----------------|----------------|
| Income | | |
| Sales | 237,203 | 241,268 |
| Increase/(decrease) in stocks of finished goods and work in progress | 3,346 | (2,877) |
| | <u>240,549</u> | <u>238,391</u> |
| Costs | | |
| Raw materials and consumables | 111,199 | 101,233 |
| Staff costs: | | |
| Wages and salaries | 59,679 | 60,455 |
| Social security costs | 6,112 | 5,811 |
| Other pension costs | 4,002 | 3,870 |
| Share compensation (note 8) | 232 | 146 |
| | <u>70,025</u> | <u>70,282</u> |
| Depreciation | 17,065 | 19,322 |
| Goodwill amortisation | 2,171 | 2,348 |
| Other operating charges | 36,382 | 38,491 |
| | <u>236,842</u> | <u>231,676</u> |
| Operating profit | <u>3,707</u> | <u>6,715</u> |



Notes to the Financial Statements

for the year ended 31 May 2004

6 Profit and loss account items

| | 2004 £000 | 2003 £000 |
|---|-------------------|-------------------|
| Operating profit is stated after charging/(crediting): | | |
| Exceptional closure costs (note 7) | – | 1,812 |
| Research and development costs | 27,899 | 28,323 |
| Profit on disposal of tangible fixed assets | (44) | (518) |
| Auditors' remuneration – audit services – statutory audit | 202 | 163 |
| – audit related regulatory reporting | 50 | 15 |
| – tax compliance services | 26 | – |
| – further assurance services | 10 | – |
| Operating lease rentals – land and buildings | 957 | 1,345 |
| – other | 1,898 | 2,266 |
| Licence fee released | (789) | (66) |
| Government grants released | (743) | (525) |
| | <u> </u> | <u> </u> |

7 Exceptional closure costs

| | 2004 £000 | 2003 £000 |
|---------------------------|-------------------|-------------------|
| Exceptional closure costs | – | 1,812 |
| | <u> </u> | <u> </u> |

The exceptional closure costs relate to the closure of the compound semiconductor fabrication facility at Filtronic Solid State, Santa Clara, California.

8 Share compensation

| | 2004 £000 | 2003 £000 |
|--------------------|-------------------|-------------------|
| Share compensation | 232 | 146 |
| | <u> </u> | <u> </u> |

As a result of the acquisition of Filtronic Sigtek, Inc. on 22 August 2000, a maximum cumulative charge of £4,285,000, comprising the issue to certain employees of Filtronic Sigtek, Inc. of a maximum of 364,067 ordinary shares of 10p each in Filtronic plc, could arise over the four year period following the acquisition. This share compensation is contingent on Filtronic Sigtek, Inc. maintaining the number and quality of its engineers over that period. The cumulative charge at 31 May 2004 was £4,241,000 (2003 £4,009,000).

Notes to the Financial Statements

for the year ended 31 May 2004



9 Employees

The monthly average number of people, including executive directors, employed by the group comprised:

| | 2004 Number | 2003 Number |
|-----------------------------|----------------|----------------|
| Geographical segment | | |
| United Kingdom | 1,315 | 1,282 |
| Finland | 543 | 557 |
| United States of America | 443 | 520 |
| Australia | 107 | 131 |
| China | 960 | 402 |
| Japan | 1 | 1 |
| | <u>3,369</u> | <u>2,893</u> |
| Business segment | | |
| Wireless Infrastructure | 1,756 | 1,618 |
| Handset Products | 861 | 506 |
| Integrated Products | 690 | 691 |
| Central Services | 62 | 78 |
| | <u>3,369</u> | <u>2,893</u> |

10 Directors' remuneration

Details of the remuneration, pension entitlements and share options of the directors are set out in the remuneration report on pages 49 to 53.

11 Exceptional profit on disposal of business

On 31 December 2003 the electronic warfare business of Filtronics Solid State was sold. The disposal is analysed as follows:

| | |
|---|--------------|
| | £000 |
| Consideration | |
| Cash | 6,544 |
| Disposal costs | (442) |
| | <u>6,102</u> |
| Net assets disposed | |
| Tangible fixed assets | 811 |
| Stocks | 502 |
| Debtors | 636 |
| Creditors | (393) |
| | <u>1,556</u> |
| Exceptional profit on disposal of business | <u>4,546</u> |
| | <u>6,102</u> |

The electronic warfare business of Filtronics Solid State was located in the United States of America and formed part of the Integrated Products business segment. For the seven months up to its disposal on 31 December 2003 the disposed business had sales of £3,653,000 resulting in an operating loss of £34,000.



Notes to the Financial Statements

for the year ended 31 May 2004

12 Net interest payable and similar charges

| | 2004 £000 | 2003 £000 |
|---|----------------|----------------|
| Interest receivable | | |
| Interest on bank deposits | 95 | 231 |
| Interest payable and similar charges | | |
| Interest on bank borrowings | (1,233) | (51) |
| Interest on other loans | (3,619) | (7,587) |
| Bank loan arrangement fee | (500) | – |
| Debt issue costs – amortisation | (293) | (588) |
| | <u>(5,645)</u> | <u>(8,226)</u> |
| Net interest payable and similar charges | <u>(5,550)</u> | <u>(7,995)</u> |

13 Net financing currency exchange (loss)/gain

| | 2004 £000 | 2003 £000 |
|--|--------------|--------------|
| Currency exchange (loss)/gain on cash balances | (2,634) | 138 |
| Currency exchange gain on loan (note 38) | 2,020 | 4,098 |
| | <u>(614)</u> | <u>4,236</u> |

14 Exceptional net (loss)/gain on repayment of debt

| | 2004 £000 | 2003 £000 |
|--|----------------|--------------|
| (Loss)/profit on repayment of debt | (1,517) | 1,443 |
| Debt issue costs – loss on repayment of debt | (981) | (562) |
| | <u>(2,498)</u> | <u>881</u> |

Notes to the Financial Statements

for the year ended 31 May 2004



15 Taxation on (loss)/profit on ordinary activities

| | 2004 £000 | 2003 £000 |
|---|--------------|--------------|
| Current tax | | |
| United Kingdom | 27 | 37 |
| Overseas | 2,684 | 2,425 |
| | <u>2,711</u> | <u>2,462</u> |
| Deferred tax | | |
| Overseas origination and reversal of timing differences | (113) | 291 |
| | <u>2,598</u> | <u>2,753</u> |

The United Kingdom current tax charge arises from taxes paid overseas on income paid to the United Kingdom which cannot be fully relieved against United Kingdom taxes. The overseas tax charge for the year arises primarily from the group's operations in China and Finland, where taxable profits cannot be relieved by losses available in other jurisdictions.

The current tax charged for the period is higher than the standard rate of corporation tax in the United Kingdom. The difference is analysed below:

| | 2004 £000 | 2003 £000 |
|---|--------------|--------------|
| (Loss)/profit on ordinary activities before taxation | <u>(409)</u> | <u>3,837</u> |
| (Loss)/profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2003 30%) | (123) | 1,151 |
| Effect of: | | |
| Disallowable items | 252 | 196 |
| Disallowable goodwill amortisation | 580 | 624 |
| Depreciation in advance of capital allowances | 2,782 | 1,880 |
| Tax allowance on impaired goodwill | (470) | (526) |
| Other timing differences | (500) | 303 |
| Tax losses carried forward | 7,311 | 2,196 |
| Tax losses brought forward | (1,513) | (102) |
| Start-up years profit exemption and rate reduction in China | (1,339) | (1,357) |
| Overseas tax rate differences | (2,636) | (247) |
| Foreign exchange differences | (1,633) | (1,656) |
| Current tax | <u>2,711</u> | <u>2,462</u> |

The group tax charge is expected to be primarily the tax charge on profits arising in China and Finland.



Notes to the Financial Statements

for the year ended 31 May 2004

16 Dividends

| | 2004 per share | 2003 per share | 2004 £000 | 2003 £000 |
|---------------------------|-------------------|-------------------|--------------|--------------|
| Interim dividend – paid | 0.90p | 0.90p | 671 | 669 |
| Final dividend – proposed | 1.80p | 1.80p | 1,344 | 1,337 |
| | <u>2.70p</u> | <u>2.70p</u> | <u>2,015</u> | <u>2,006</u> |

17 (Loss)/earnings per share

| | 2004 £000 | 2003 £000 |
|---|----------------|---------------|
| (Loss)/profit on ordinary activities after taxation | <u>(3,007)</u> | <u>1,084</u> |
| | 000 | 000 |
| Weighted average number of shares in issue | 74,508 | 74,245 |
| Dilution effect of share options | – | – |
| Dilution effect of contingently issuable shares | – | 460 |
| Diluted weighted average number of shares | <u>74,508</u> | <u>74,705</u> |
| Basic (loss)/earnings per share | <u>(4.04)p</u> | <u>1.46p</u> |
| Diluted (loss)/earnings per share | <u>(4.04)p</u> | <u>1.45p</u> |

Notes to the Financial Statements

for the year ended 31 May 2004



18 Intangible fixed assets

The group

| | Goodwill £000 |
|--------------------------------------|-------------------------|
| Cost | |
| At 1 June 2003 | 81,028 |
| Currency exchange movement | (7,165) |
| At 31 May 2004 | 73,863 |
| Amortisation | |
| At 1 June 2003 | 45,259 |
| Charge for the year | 2,171 |
| Currency exchange movement | (4,469) |
| At 31 May 2004 | 42,961 |
| Net book value at 31 May 2004 | 30,902 |
| Net book value at 31 May 2003 | 35,769 |

The net book value of goodwill at 31 May 2004 comprises £28,123,000 (2003 £32,439,000) relating to the Handset Products operations of Filtronic LK Oy in Finland and £2,779,000 (2003 £3,330,000) relating to the Integrated Products operations of Sage Laboratories, Inc. in the United States of America. The goodwill is being amortised over its estimated economic life of 20 years.

19 Investments

The company

| | Subsidiaries £000 |
|---------------------------------------|-----------------------------|
| Cost | |
| At 1 June 2003 and 31 May 2004 | 36,006 |
| Amount provided | |
| At 1 June 2003 and 31 May 2004 | 7,730 |
| Net book value | |
| At 31 May 2004 and 31 May 2003 | 28,276 |

The amount provided of £7,730,000 is against the cost of the investment in Filtronic Sigtek, Inc.

A complete list of the company's subsidiaries, all of which are wholly owned, can be found on page 54.



Notes to the Financial Statements

for the year ended 31 May 2004

20 Tangible fixed assets

| | Freehold land & buildings £000 | Plant & machinery £000 | Fixtures & fittings £000 | Motor vehicles £000 | Total £000 |
|--------------------------------------|--------------------------------------|------------------------------|--------------------------------|---------------------------|----------------|
| The group | | | | | |
| Cost | | | | | |
| At 1 June 2003 | 49,408 | 133,524 | 11,339 | 363 | 194,634 |
| Additions | 148 | 9,981 | 1,180 | 60 | 11,369 |
| Disposals | (292) | (15,690) | (214) | (65) | (16,261) |
| Currency exchange movement | (1,720) | (5,308) | (722) | (23) | (7,773) |
| At 31 May 2004 | 47,544 | 122,507 | 11,583 | 335 | 181,969 |
| Depreciation | | | | | |
| At 1 June 2003 | 6,244 | 84,814 | 6,971 | 333 | 98,362 |
| Charge for the year | 934 | 14,646 | 1,457 | 28 | 17,065 |
| Disposals | (292) | (14,629) | (203) | (65) | (15,189) |
| Currency exchange movement | (306) | (3,803) | (438) | (22) | (4,569) |
| At 31 May 2004 | 6,580 | 81,028 | 7,787 | 274 | 95,669 |
| Net book value at 31 May 2004 | 40,964 | 41,479 | 3,796 | 61 | 86,300 |
| Net book value at 31 May 2003 | 43,164 | 48,710 | 4,368 | 30 | 96,272 |
| The company | | | | | |
| Cost | | | | | |
| At 1 June 2003 | 10,749 | 590 | 61 | 59 | 11,459 |
| Additions | 118 | 114 | 23 | 60 | 315 |
| Group transfers | – | (72) | – | – | (72) |
| Disposals | – | – | – | (59) | (59) |
| At 31 May 2004 | 10,867 | 632 | 84 | 60 | 11,643 |
| Depreciation | | | | | |
| At 1 June 2003 | 1,204 | 336 | 48 | 55 | 1,643 |
| Charge for the year | 266 | 81 | 5 | 14 | 366 |
| Group transfers | – | (18) | – | – | (18) |
| Disposals | – | – | – | (59) | (59) |
| At 31 May 2004 | 1,470 | 399 | 53 | 10 | 1,932 |
| Net book value at 31 May 2004 | 9,397 | 233 | 31 | 50 | 9,711 |
| Net book value at 31 May 2003 | 9,545 | 254 | 13 | 4 | 9,816 |

An impairment review has been carried out in respect of certain of the group's tangible fixed assets. Following this review, the Board has concluded that no impairment has taken place.

Notes to the Financial Statements

for the year ended 31 May 2004



20 Tangible fixed assets (continued)

In carrying out an impairment review under Financial Reporting Standard 11 "Impairment of Fixed Assets and Goodwill", the Board has reviewed value in use calculations for the compound semiconductor activities at Newton Aycliffe and in California. In these calculations a discount rate of 10% has been applied to the projected cash flows. The period over which discounted cash flows were calculated was 6 years. No cash flows were assumed from that point forward. This is deemed appropriate as the sales revenue projections were based upon both internally generated forecasts and independent data extending through that period.

21 Stocks

| | The group | | The company | |
|------------------|---------------|---------------|--------------|--------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| Raw materials | 22,632 | 22,826 | - | - |
| Work in progress | 7,447 | 5,664 | - | - |
| Finished goods | 6,539 | 5,854 | - | - |
| | <u>36,618</u> | <u>34,344</u> | <u>-</u> | <u>-</u> |

22 Debtors

| | The group | | The company | |
|----------------------------------|---------------|---------------|----------------|----------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| Trade debtors | 48,978 | 44,492 | - | - |
| Amounts due from group companies | - | - | 216,025 | 226,885 |
| Current tax | 420 | 320 | - | - |
| Other taxation | 1,683 | 1,151 | 25 | 6 |
| Prepayments and accrued income | 3,399 | 4,945 | 42 | 172 |
| | <u>54,480</u> | <u>50,908</u> | <u>216,092</u> | <u>227,063</u> |



Notes to the Financial Statements

for the year ended 31 May 2004

23 Creditors: amounts falling due within one year

| | The group | | The company | |
|------------------------------------|---------------|---------------|---------------|--------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| Bank overdraft | 3,369 | – | 3,643 | – |
| Bank loan (note 24) | 6,000 | – | 6,000 | – |
| Trade creditors | 27,817 | 20,595 | – | – |
| Amounts due to group companies | – | – | 3,096 | 318 |
| Current tax | 1,721 | 1,604 | 1,487 | 1,437 |
| Other taxation and social security | 1,313 | 1,559 | 847 | 764 |
| Accruals and deferred income | 10,203 | 13,726 | 627 | 192 |
| Dividend payable | 1,344 | 1,337 | 1,344 | 1,337 |
| | 51,767 | 38,821 | 17,044 | 4,048 |

24 Creditors: amounts falling due after one year

| | The group | | The company | |
|----------------------------|---------------|---------------|---------------|---------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| Loans falling due between: | | | | |
| one and two years | 11,000 | – | 11,000 | – |
| two and three years | 33,000 | 61,942 | 33,000 | 61,942 |
| | 44,000 | 61,942 | 44,000 | 61,942 |

Loans comprise:

| | The group | | The company | |
|---|---------------|---------------|---------------|---------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| \$103,573,000 10% Senior Notes repaid during the year | – | 63,216 | – | 63,216 |
| Less deferred debt issue costs | – | (1,274) | – | (1,274) |
| | – | 61,942 | – | 61,942 |
| Bank loan | 50,000 | – | 50,000 | – |
| | 50,000 | 61,942 | 50,000 | 61,942 |
| Loans due within one year | 6,000 | – | 6,000 | – |
| Loans due after one year | 44,000 | 61,924 | 44,000 | 61,924 |
| | 50,000 | 61,924 | 50,000 | 61,924 |

The bank loan and the bank overdraft are secured by a fixed charge over the group's freehold property in the United Kingdom and a floating charge over the group's other United Kingdom assets.

Notes to the Financial Statements

for the year ended 31 May 2004



25 Provision for deferred tax

| | The group | | The company | |
|---|--------------|--------------|--------------|--------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| Capital allowances in advance of depreciation | 582 | 750 | – | 239 |
| At 1 June 2003 | 750 | | 239 | |
| Deferred tax credit | (113) | | (239) | |
| Currency exchange movement | (55) | | – | |
| At 31 May 2004 | 582 | | – | |

Deferred tax assets which have not been recognised:

| | The group | | The company | |
|--|---------------|--------------|--------------|--------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| Depreciation in advance of capital allowances | | | | |
| – United Kingdom | 7,928 | 5,482 | – | – |
| Amortisation in advance of tax allowances | | | | |
| – Overseas | 6,023 | 7,458 | – | – |
| Other timing differences | | | | |
| – Overseas | 752 | 2,562 | – | – |
| Trading losses available for relief against future trading profits | | | | |
| – United Kingdom | 8,710 | 2,380 | 3,976 | – |
| – Overseas | 13,658 | 15,623 | – | – |
| | 37,071 | 33,505 | 3,976 | – |

The deferred tax assets have not been recognised as the directors consider that it is unlikely that the underlying timing differences will reverse in the foreseeable future.



Notes to the Financial Statements

for the year ended 31 May 2004

26 Deferred income

| | The group | | |
|--------------------------|------------------------------|------------------------------------|-------------------------------|
| | Deferred licence fee £000 | Deferred government grants £000 | Total deferred income £000 |
| At 1 June 2003 | 9,934 | 3,209 | 13,143 |
| Received during the year | – | 1,297 | 1,297 |
| Released during the year | (789) | (743) | (1,532) |
| At 31 May 2004 | 9,145 | 3,763 | 12,908 |

Deferred licence fee comprises the cash fee paid by BAE SYSTEMS Avionics Limited ("BAE") to Filtronic Compound Semiconductors Limited ("FCSL") under the terms of a Supply and Development Agreement dated 30 November 2001 between Filtronic plc, FCSL (together "Filtronic") and BAE. The whole fee was paid during the year ended 31 May 2002. The fee revenue is being recognised in the profit and loss account in equal monthly amounts from 1 May 2003 until 31 December 2015.

The fee has been paid by BAE in consideration of Filtronic entering into the agreement to enable BAE to utilise the Newton Aycliffe facility by inter alia maintaining the availability of the Newton Aycliffe facility for the supply of gallium arsenide ("GaAs") products for defence applications and performing the other obligations of Filtronic under the agreement. The agreement provides for its continuance until 31 December 2015 but may be extended at the option of BAE until 31 December 2025.

In the event that BAE is unable, other than for reasons within the control of BAE, to utilise the Newton Aycliffe facility as described above, the agreement provides that Filtronic will repay the fee. If such an event occurs, the fee becomes repayable pro rata on a declining linear scale between 1 May 2003 and 1 May 2008. The agreement makes no provision for the repayment of the fee beyond that date.

The agreement contains a number of obligations on both parties including obligations upon Filtronic to accept and perform purchase orders from BAE in accordance with a schedule of agreed commercial terms, to supply GaAs products to BAE, to maintain the availability of the Newton Aycliffe facility for the continuance of the agreement, to develop and qualify certain processes between March 2003 and July 2004 and to make such processes available to BAE for the design and supply of certain GaAs products for defence applications. All of the product supply obligations within the agreement will be fulfilled on normal commercial terms.

As part of the agreement, Filtronic agreed to supply, and has supplied to BAE, generic design data for the creation of GaAs products for defence applications using the Newton Aycliffe facility. Filtronic has granted to BAE a worldwide, royalty free, irrevocable, sole, non-transferable licence to use this intellectual property. The intellectual property over which the licence has been granted remains the property of Filtronic.

The agreement also contains other obligations on the parties including some relating to collaboration on the development and production of T/R Modules for application in active array radar, some relating to the manufacture of microwave modules for BAE's defence requirements and some relating to the development of other new compound semiconductor materials and processes which are considered to be appropriate for military applications.

Notes to the Financial Statements

for the year ended 31 May 2004



27 Share capital

| | 2004 Number | 2003 Number | 2004 £000 | 2003 £000 |
|---|--------------------|----------------|---------------|--------------|
| Authorised | | | | |
| Ordinary shares of 10p each | <u>100,000,000</u> | 100,000,000 | <u>10,000</u> | 10,000 |
| Allotted, called up and fully paid | | | | |
| Ordinary shares of 10p each | | | | |
| Opening share capital | 74,304,443 | 74,091,382 | 7,430 | 7,409 |
| Allotted during the year | <u>342,139</u> | 213,061 | <u>35</u> | 21 |
| Closing share capital | <u>74,646,582</u> | 74,304,443 | <u>7,465</u> | 7,430 |

The ordinary shares of 10p each allotted during the year comprised:

| | Shares allotted Number | Share capital £000 | Share premium £000 | Profit and loss account £000 | Total consideration £000 |
|--------------------------------|------------------------------|--------------------------|--------------------------|------------------------------------|--------------------------------|
| Executive Share Option Schemes | 146,876 | 15 | 260 | – | 275 |
| Acquisition consideration | 131,146 | 13 | 1,530 | – | 1,543 |
| Share compensation | 64,117 | 7 | – | 748 | 755 |
| | <u>342,139</u> | <u>35</u> | <u>1,790</u> | <u>748</u> | <u>2,573</u> |

28 Reserves

| | The group and the company | | The group | |
|---------------------------------------|----------------------------------|--------------------------------|--------------------------------|--------------------------|
| | Share premium account £000 | Shares to be issued £000 | Revaluation reserve £000 | Other reserve £000 |
| At 1 June 2003 | 135,851 | 4,321 | 106 | 828 |
| Issue of shares | 1,790 | (2,298) | – | – |
| Share compensation | – | 232 | – | – |
| Transfer from profit and loss account | – | – | – | 1,280 |
| Currency exchange movement | – | – | – | (88) |
| At 31 May 2004 | <u>137,641</u> | <u>2,255</u> | <u>106</u> | <u>2,020</u> |

Shares to be issued comprises acquisition contingent consideration of £1,544,000 and charges made to the profit and loss account for share compensation of £711,000. To the extent that compensation shares are issued £705,000 will be released to the profit and loss account reserve and £6,000 will be credited to share capital.

The other reserve is an undistributable surplus reserve of the Chinese subsidiary, Filtronic (Suzhou) Telecommunications Products Co. Limited.



Notes to the Financial Statements

for the year ended 31 May 2004

29 Profit and loss account

| | The group £000 | The company £000 |
|---|-------------------|---------------------|
| At 1 June 2003 | (39,377) | 55,164 |
| Deficit for the year | (5,022) | (10,233) |
| Issue of shares – share compensation | 748 | 748 |
| Transfer to other reserve | (1,280) | – |
| Currency exchange movement arising on consolidation | (7,692) | – |
| Currency exchange movement on loan (note 38) | 4,249 | – |
| At 31 May 2004 | (48,374) | 45,679 |

Of the loss on ordinary activities after taxation for the year, a loss of £8,218,000 (2003 £27,920,000 profit) is dealt with in the profit and loss account of Filtronic plc. A profit and loss account for the company alone has not been presented in accordance with the exemptions allowed under S230 of the Companies Act 1985.

The cumulative goodwill set off directly against reserves at 31 May 2004 was £11,917,000 (2003 £11,917,000).

30 Reconciliation of shareholders' funds

| | The group | | The company | |
|--|----------------|--------------|-----------------|--------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| (Loss)/profit on ordinary activities after taxation | (3,007) | 1,084 | (8,218) | 27,920 |
| Dividends | (2,015) | (2,006) | (2,015) | (2,006) |
| (Deficit)/profit retained for the year | (5,022) | (922) | (10,233) | 25,914 |
| Currency exchange movement arising on consolidation | (7,780) | (590) | – | – |
| Currency exchange movement on loan (note 38) | 4,249 | 5,329 | – | – |
| Issue of shares | 2,573 | 2,507 | 2,573 | 2,507 |
| Shares to be issued – shares issued | (2,298) | (2,507) | (2,298) | (2,507) |
| Shares to be issued – share compensation | 232 | 146 | 232 | 146 |
| Movement in shareholders' funds | (8,046) | 3,963 | (9,726) | 26,060 |
| Opening shareholders' funds | 109,159 | 105,196 | 202,766 | 176,706 |
| Closing shareholders' funds | 101,113 | 109,159 | 193,040 | 202,766 |

Notes to the Financial Statements

for the year ended 31 May 2004



31 Share options

The share options outstanding at 31 May 2004 were:

Executive Share Option Schemes

| Exercise period | Exercise price | Number of Options |
|------------------------|----------------|-------------------|
| 9/9/1999 – 9/9/2006 | 231p | 7,014 |
| 30/9/1999 – 30/9/2006 | 181p | 14,930 |
| 1/10/2000 – 2/12/2006 | 250p | 400,000 |
| 30/4/2000 – 30/4/2007 | 309p | 55,000 |
| 4/8/2000 – 4/8/2007 | 375p | 488,150 |
| 1/10/1999 – 23/1/2008 | 439p | 170,000 |
| 1/10/1999 – 26/6/2008 | 291p | 20,798 |
| 1/10/1999 – 26/6/2008 | 318p | 1,560 |
| 1/10/1999 – 26/6/2008 | 399p | 42,883 |
| 1/10/1999 – 3/8/2008 | 413p | 173,500 |
| 1/10/1999 – 3/8/2008 | 414p | 867,950 |
| 1/10/1999 – 7/8/2008 | 459p | 60,000 |
| 1/10/1999 – 10/8/2008 | 537p | 60,000 |
| 1/10/1999 – 17/9/2008 | 149p | 58,205 |
| 1/10/1999 – 17/9/2008 | 450p | 646,000 |
| 1/10/1999 – 5/10/2008 | 383p | 895,000 |
| 1/10/1999 – 9/11/2008 | 461p | 65,000 |
| 1/10/2000 – 1/1/2009 | 612p | 45,000 |
| 1/10/2000 – 4/3/2009 | 805p | 75,000 |
| 1/10/2000 – 10/5/2009 | 602p | 40,000 |
| 1/10/2000 – 1/6/2009 | 732p | 10,000 |
| 1/10/2000 – 14/6/2009 | 727p | 117,415 |
| 1/10/2000 – 1/7/2009 | 745p | 125,000 |
| 1/10/2000 – 18/7/2009 | 827p | 20,000 |
| 1/10/2000 – 2/8/2009 | 823p | 339,000 |
| 1/10/2000 – 27/8/2009 | 831p | 40,000 |
| 1/10/2000 – 13/9/2009 | 903p | 15,000 |
| 1/10/2000 – 24/9/2009 | 909p | 35,000 |
| 1/10/2000 – 27/9/2009 | 897p | 15,000 |
| 1/10/2000 – 4/10/2009 | 899p | 15,000 |
| 1/10/2000 – 11/10/2009 | 953p | 15,000 |
| 1/10/2000 – 1/11/2009 | 1131p | 45,300 |
| 1/10/2001 – 21/1/2010 | 1758p | 65,000 |
| 1/10/2001 – 15/5/2010 | 1020p | 58,021 |
| 1/10/2001 – 1/6/2010 | 946p | 29,598 |
| 1/10/2001 – 4/12/2010 | 346p | 378,011 |
| 1/10/2002 – 30/3/2011 | 149p | 20,000 |
| 1/10/2003 – 14/3/2012 | 404p | 717,487 |
| 1/10/2004 – 5/6/2012 | 191p | 30,000 |
| 1/10/2004 – 7/4/2013 | 346p | 3,600 |
| 1/10/2005 – 1/3/2014 | 451p | 210,000 |
| | | <hr/> |
| | | 6,489,422 |



Notes to the Financial Statements

for the year ended 31 May 2004

31 Share options (continued)

Savings Related Share Option Schemes

| Exercise period | Exercise price | Number of Options |
|--|----------------|-------------------|
| 1/4/2004 – 1/10/2004 | 270p | 2,311 |
| 1/4/2004 – 1/10/2004 | 680p | 18,339 |
| 1/10/2004 – 1/4/2005 | 354p | 8,262 |
| 1/10/2004 – 1/4/2005 | 655p | 114,069 |
| 1/4/2005 – 1/10/2005 | 429p | 1,635 |
| 1/10/2005 – 1/4/2006 | 412p | 757 |
| 1/4/2006 – 1/10/2006 | 680p | 10,211 |
| 1/10/2006 – 1/4/2007 | 655p | 1,176 |
| | | <hr/> |
| | | 156,760 |
| | | <hr/> |
| Total number of options outstanding at 31 May 2004 | | <u>6,646,182</u> |

32 Contingently issuable shares

The contingently issuable shares outstanding at 31 May 2004 were:

| | Vesting period | Number |
|--------------------------------------|---------------------|---------|
| Acquisition contingent consideration | 22/8/2000–22/8/2004 | 131,149 |
| Share compensation | 22/8/2000–22/8/2004 | 64,122 |
| | | <hr/> |
| | | 195,271 |

Vesting of the shares is conditional upon Filtronic Sigtek, Inc. maintaining the number and quality of its engineers over the vesting period.

Notes to the Financial Statements

for the year ended 31 May 2004



33 Financial commitments

Annual commitments under non-cancellable operating leases which expire:

| | The group | | The company | |
|---------------------------|--------------|--------------|--------------|--------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| Land and buildings | | | | |
| In two to five years | 866 | 877 | - | - |
| In over five years | 99 | 317 | - | - |
| | <u>965</u> | <u>1,194</u> | <u>-</u> | <u>-</u> |
| Other | | | | |
| In two to five years | <u>1,300</u> | <u>1,695</u> | <u>31</u> | <u>72</u> |

34 Capital commitments

| | The group | | The company | |
|---|--------------|--------------|--------------|--------------|
| | 2004 £000 | 2003 £000 | 2004 £000 | 2003 £000 |
| Capital expenditure contracted for but not provided in the financial statements | <u>3,462</u> | <u>3,615</u> | <u>92</u> | <u>44</u> |

35 Related party transactions

The following related party transactions occurred during the year and were all on an arm's length basis.

The company and some of its UK subsidiaries incurred professional charges, totalling £46,000 (2003 £46,000), with Schofield Sweeney, a firm of solicitors, in which C E Schofield is a partner. C E Schofield resigned as a director on 2 April 2004.

Filtronic Components Limited subleases premises to Techceram Limited, a company in which Professor J D Rhodes and his family have a material interest. Rents charged amounted to £26,000 (2003 £10,000). At 31 May 2004 £13,000 (2003 £7,000) was outstanding.

Filtronic Comtek (UK) Limited incurred costs of £22,000 (2003 £20,000) for the rental of an executive box and the provision of refreshments with Bradford City A.F.C. (1983) Limited, a company of which Professor J D Rhodes is a director.

Filtronic Components Limited earned royalties of £6,000 (2003 £8,000) from Photarc Surveys Limited, a company in which J Samuel has a material interest. At 31 May 2004 £3,000 (2003 £1,000) was outstanding. J Samuel resigned as a director on 10 June 2004.



Notes to the Financial Statements

for the year ended 31 May 2004

36 Pension schemes

For United Kingdom employees, the company operates a funded pension scheme providing benefits based on final pensionable pay. The assets of the scheme are held in a separate trustee fund administered by independent professional investment managers. Contributions to the scheme are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the company. The contributions are determined by a qualified actuary on the basis of annual valuations using the projected unit method and are met in the ratio of two thirds by the company and one third by the employee. The most recent valuation was at 1 July 2003. The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It was assumed that the investment returns would be 2% per annum in excess of future salary increases and 4.5% per annum in excess of future pension increases.

The pension cost for the year was £2,294,000 (2003 £1,793,000). The pension cost allowed for a deficit variation to be amortised over the working lifetimes of the active members. The amortisation was calculated to be £242,000. The accrual at 31 May 2004 was £388,000 (2003 £nil).

The most recent actuarial valuation showed that the market value of the scheme's assets was £14,400,000 and that the actuarial value of those assets represented 80% of the benefits that had accrued to members after allowing for expected future increases in earnings. In accordance with the actuary's recommendations, contributions to the scheme will remain at 15% of pensionable salaries, two thirds of which is payable by the company.

For employees in Finland, Filtronic LK Oy contributes to a defined contribution pension plan in accordance with Finnish regulations and practices. The pension cost for the year, based on insurance companies' charges, was £1,255,000 (2003 £1,402,000).

For employees in the United States of America, contributions are made to a defined contribution plan under section 401(k) of the Internal Revenue Code. The pension cost for the year was £246,000 (2003 £396,000).

For employees in Australia, Filtronic Pty Limited contributes to a defined contribution superannuation fund operated by an independent insurance company. The pension cost for the year was £192,000 (2003 £265,000).

37 Financial Reporting Standard 17

The company has accounted for pension costs in accordance with Statement of Standard Accounting Practice 24 ("SSAP24"). Financial Reporting Standard 17 ("FRS17") requires certain transitional disclosures, which are set out below.

The calculations have been based on the findings of the actuarial valuation carried out with effect from 1 July 2003. The results of that valuation have been projected to 31 May 2004 and then recalculated based on the following assumptions, which the directors consider to be appropriate.

| | 2004 | 2003 | 2002 |
|-----------------------------------|-------|-------|-------|
| Rate of inflation | 3.10% | 2.40% | 2.75% |
| Salary increase rate | 4.60% | 3.80% | 4.25% |
| Increases for pensions in payment | 2.90% | 2.40% | 2.50% |
| Revaluation of deferred pensions | 3.10% | 2.40% | 2.75% |
| Liability discount rate | 5.80% | 5.10% | 6.00% |

Notes to the Financial Statements

for the year ended 31 May 2004



37 Financial Reporting Standard 17 (continued)

The fair value of the pension scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the pension scheme's liabilities, which are derived from cash flow projections over long periods and are thus inherently uncertain, are set out below:

| | Long term expected return | | | Value | | |
|---|------------------------------|-------|-------|-----------------|--------------|--------------|
| | 2004 | 2003 | 2002 | 2004 £000 | 2003 £000 | 2002 £000 |
| Equities | 7.50% | 6.50% | 7.00% | 14,639 | 11,205 | 10,793 |
| Bonds | 5.50% | 4.50% | 5.00% | 3,375 | 2,476 | 1,837 |
| Property | 7.50% | 6.50% | 7.00% | – | – | 308 |
| Cash | 5.00% | 4.50% | 5.00% | 288 | 255 | 695 |
| Market value of pension scheme assets | | | | 18,302 | 13,936 | 13,633 |
| Present value of pension scheme liabilities | | | | (29,683) | (25,486) | (18,500) |
| FRS17 pension scheme deficit | | | | (11,381) | (11,550) | (4,867) |
| Related deferred tax asset | | | | 3,414 | 3,465 | 1,460 |
| Net FRS17 pension liability | | | | (7,967) | (8,085) | (3,407) |

The pension scheme assets, the majority of which are equities, are potentially subject to significant market movements. FRS17 disclosures measure the value of these assets at a single point in time, namely 31 May each year. The pension scheme's liabilities are measured by reference to long-term AA corporate bond yields that can also move significantly and according to market conditions. FRS17 indicates a deficit in relation to the pension scheme at 31 May 2004. The Minimum Funding Requirement valuation at 1 July 2003 indicated a surplus with a funding level of 114%.

If the group had adopted FRS17 early, the consolidated profit and loss account reserve and net assets would have been as follows:

| | 2004 £000 | 2003 £000 |
|---|-----------------|--------------|
| Profit and loss account reserve excluding FRS17 pension liability | (48,374) | (39,377) |
| SSAP24 accrual | 388 | – |
| Net FRS17 pension liability | (7,967) | (8,085) |
| Profit and loss account reserve including FRS17 pension liability | (55,953) | (47,462) |
| Net assets excluding FRS17 pension liability | 101,113 | 109,159 |
| SSAP24 accrual | 388 | – |
| Net FRS17 pension liability | (7,967) | (8,085) |
| Net assets including FRS17 pension liability | 93,534 | 101,074 |



Notes to the Financial Statements

for the year ended 31 May 2004

37 Financial Reporting Standard 17 (continued)

If the group had adopted FRS17 early, the amounts recognised in the consolidated profit and loss account would have been as follows:

The amount that would have been charged to operating profit:

| | 2004 £000 | 2003 £000 |
|------------------------|--------------|--------------|
| Current service cost | 2,744 | 2,143 |
| Total operating charge | <u>2,744</u> | <u>2,143</u> |

The amount that would have been charged as other financial costs:

| | 2004 £000 | 2003 £000 |
|--|--------------|--------------|
| Expected return on pension scheme assets | 928 | 979 |
| Interest on pension scheme liabilities | (1,385) | (1,188) |
| Net financial return | <u>(457)</u> | <u>(209)</u> |

If the group had adopted FRS17 early the amounts recognised in the consolidated statement of total recognised gains and losses would have been as follows:

| | 2004 £000 | 2003 £000 |
|--|--------------|----------------|
| Actual return less expected return on pension scheme assets | 933 | (2,935) |
| Experience gain on pension scheme liabilities | 805 | 478 |
| Impact of changes in assumptions relating to the present value of pension scheme liabilities | (273) | (3,672) |
| Actuarial gain/(loss) | <u>1,465</u> | <u>(6,129)</u> |

| | % pension scheme assets/liabilities | |
|--|--|--------------|
| | 2004 £000 | 2003 £000 |
| Actual return less expected return on pension scheme assets | 5% | (21%) |
| Experience gain on pension scheme liabilities | 3% | 2% |
| Impact of changes in assumptions relating to the present value of pension scheme liabilities | (1%) | (14%) |
| Actuarial gain/(loss) | 5% | (24%) |

The movement in FRS17 pension scheme deficit during the year:

| | 2004 £000 | 2003 £000 |
|--|-----------------|-----------------|
| FRS17 pension scheme deficit brought forward | (11,550) | (4,867) |
| Current service cost | (2,744) | (2,143) |
| Contributions | 1,905 | 1,798 |
| Net financial return | (457) | (209) |
| Actuarial gain/(loss) | 1,465 | (6,129) |
| FRS17 pension scheme deficit carried forward | <u>(11,381)</u> | <u>(11,550)</u> |

Notes to the Financial Statements

for the year ended 31 May 2004



38 Financial instruments

Interest rate risk and currency profile of financial assets

The interest rate risk and currency profile of the group's financial assets, excluding short term debtors, was as follows:

| | Floating rate financial assets | |
|-------------------|-----------------------------------|--------------|
| | 2004 £000 | 2003 £000 |
| Sterling | 5 | 4,149 |
| US dollar | 514 | 1,105 |
| Euro | 734 | 963 |
| Australian dollar | 156 | 123 |
| Chinese yuan | 640 | 170 |
| Japanese yen | 21 | 12 |
| | 2,070 | 6,522 |

Floating rate financial assets comprise overnight money market deposits and bank deposit accounts.

Interest rate risk and currency profile of financial liabilities

The interest rate risk and currency profile of the group's financial liabilities, excluding short term creditors, was as follows:

| | Fixed rate | | Financial liabilities | | | Total £000 |
|-------------|-------------------------------|----------------------------------|-----------------------|--------------------------|--------------------------|---------------|
| | Average interest rate % | Average fixed period Years | Fixed rate £000 | Floating rate £000 | Interest free £000 | |
| 2004 | | | | | | |
| Sterling | – | – | – | 53,369 | 7,833 | 61,202 |
| 2003 | | | | | | |
| Sterling | – | – | – | – | 9,833 | 9,833 |
| US dollar | 10.0 | 2.5 | 63,216 | – | – | 63,216 |
| | | | 63,216 | – | 9,833 | 73,049 |

Floating rate financial liabilities comprise a £50,000,000 bank loan that bears interest at LIBOR plus 2.25% and a £3,369,000 bank overdraft that bears interest at LIBOR plus 1.25%.

The maturity profile of financial liabilities is shown in note 24.

The company's policy is not to hedge the interest rate risk on the bank loan.

Borrowing facilities

At 31 May 2004 the company had a bank overdraft facility of £9,000,000 of which £5,631,000 was undrawn. This facility was renewed in July 2004 and is due for review again in July 2005.

The bank loan and the bank overdraft facility are secured by a fixed charge over the group's freehold property in the United Kingdom and a floating charge over the group's other United Kingdom assets.



Notes to the Financial Statements

for the year ended 31 May 2004

38 Financial instruments (continued)

Currency exposures

| Functional currency of operations | US dollar monetary liabilities | |
|-----------------------------------|--------------------------------|--------------|
| | 2004 £000 | 2003 £000 |
| Sterling | – | 30,390 |

Currency exchange movements arising on the Senior Notes that were offset by currency exchange movements on the net assets, including goodwill, of overseas subsidiaries and intra group loans, that they financed, were taken directly to reserves. Currency exchange movements on the Senior Notes which were not offset were taken through the profit and loss account. The Senior Notes were repaid during the year.

The currency exchange movement arising during the year on the Senior Notes comprised:

| | 2004 £000 | 2003 £000 |
|--|--------------|--------------|
| Currency exchange gain taken directly to reserves | 4,249 | 5,329 |
| Currency exchange gain taken through the profit and loss account | 2,020 | 4,098 |
| | <u>6,269</u> | <u>9,427</u> |

Fair values of financial assets and liabilities

| | 2004 \$000 | 2003 \$000 | 2004 £000 | 2003 £000 |
|------------------------------|---------------|---------------|--------------|--------------|
| Book value of Senior Notes | – | 103,573 | – | 63,216 |
| Market value of Senior Notes | – | 104,609 | – | 63,848 |

The fair values of other financial assets and liabilities were not materially different to their book values.

Foreign currency risk

The company's policy is not to hedge against transactions which occur in any of the functional currencies of any of the company's subsidiaries. These currencies are sterling, US dollars, euro, Australian dollars and Chinese yuan. Forward foreign exchange contracts may be used to hedge material sales and purchases which may occur in other currencies. The company does not hedge against currency translation risk related to the translation of the profit and loss accounts and balance sheets of its overseas subsidiaries.



The Combined Code on Corporate Governance

The Board supports the highest standards of corporate governance. During the year the Financial Reporting Council approved a revised Combined Code on Corporate Governance which became effective for companies' financial periods beginning on or after 1 November 2003. For the year ended 31 May 2004 the directors confirm that the company has been in compliance with the provisions of section 1 of the Combined Code effective for that accounting period except in respect of Professor J D Rhodes' combined role as Chairman and Chief Executive Officer. Professor John Roulston will be appointed as Chief Executive Officer on 6 September 2004 and from that date the company will be compliant with section 1 of the code.

Internal control

The Board has adopted the published guidance by the Turnbull Committee on the implementation of the internal control requirements of the Combined Code and accepts that the Board has overall responsibility for establishing and maintaining the company's system of internal control. Internal control systems are designed to be relevant to the company and the risks to which it is exposed and by their nature can provide reasonable but not absolute assurance against material misstatement or loss. The key procedures established by the directors with a view to providing effective internal control are as follows:

(a) Control environment and monitoring systems

The Board meets each month and has adopted a schedule of matters which are required to be brought to it for decision, thus ensuring that it maintains full and effective control over appropriate strategic, financial, operational and compliance issues. The Board has put in place an organisational structure with clearly defined lines of responsibility and delegation of authority. Additionally, the Board has established an Executive Management Board which is responsible for operational matters within the company.

The audit committee, which comprises all of the non-executive directors, reviews the effectiveness of the system of internal control. The external auditors are engaged to express an opinion on the company's annual financial statements. They test the system of internal financial control and the information contained within the annual report and financial statements to the extent necessary for expressing their opinion.

(b) Major information systems

The directors have delegated to executive management implementation of the system of internal control throughout the company. This includes financial controls which enable the Board to meet its responsibilities for the integrity and accuracy of the company's accounting records.

The Board approves, in aggregate, budgets and other performance targets, the components of which form the financial objectives for individual operating units. Performance against these targets is reported monthly. Financial forecasts are updated and reviewed monthly and include cash flow forecasts.

(c) Main control procedures

In addition to matters reserved for Board decisions, the company has established a system whereby authority to take decisions is distributed throughout the company. This distribution of authority defines procedures for authorisation and approval and sets appropriate levels of responsibility.

An accounting policies and procedures manual sets out the company's declared statement of policy in all financial areas and establishes the control procedures, including segregation of duties, to ensure that these policies are implemented.

(d) Identification and evaluation of business risks

The company has clear principles and procedures which are appropriate to a multinational electronics business. These principles are designed to provide an environment of central leadership but with devolved operating responsibility as the framework for the exercise of accountability and control by the Board, its committees and executive management. The Board directs activities in and allocates resources to the key areas of business development, product strategy, research and development, manufacture and financial practice. The Board has appointed a Technology Advisory Board to provide strategic technical advice to the company. This board comprises leading, internationally respected electronics experts together with outstanding engineering talent from within the company. Through these ongoing procedures, the Board is able to identify, evaluate and manage the significant risks which the group faces from time to time.



The Board confirms that it has carried out a review of the effectiveness of the system of internal control as it operated during the year. The Board undertakes, on an ongoing basis, a review of all aspects of the company's internal control procedures, and is able to report that the company has complied fully with the guidance of the Turnbull Committee during the financial year ending 31 May 2004. This review is undertaken by the Board through the receipt and consideration of regular monthly and other reports prepared by management on operational, strategic, organisational and financial issues. A system of financial internal audit has been established whereby a programme of internal audit work is carried out at the company's various locations by staff employed at other locations. The programme is designed to focus on key controls and procedures in the financial system. Additionally, areas of operations other than finance are audited periodically either by external agencies or through peer review to ensure compliance with group policies.

Constitution of the Board

The Board comprises four executive and five independent, non-executive directors. Short biographies of all of the directors are set out on page 8. Professor John Roulston will be appointed as a director and Chief Executive Officer on 6 September 2004. The Board is engaged in selecting a suitable person to fill the position of Finance Director. The Board considers that the balance of its constitution brings both independence and an appropriate balance of experience in judging matters of strategy, performance, resources, investor relations, internal control and corporate governance. R J Williams is the senior non-executive director. Each of the directors is proposed for re-election at the annual general meeting at least every three years.

Board committees

The Board has established an audit committee, a remuneration committee and a nominations committee. The audit and remuneration committees comprise all of the non-executive directors. The nominations committee comprises the Chairman and all of the non-executive directors and is chaired by Professor J D Rhodes. Each of these committees operates under terms of reference which have been established by the Board.

The audit committee meets at least three times a year to review the adequacy of the company's system of internal control, accounting policies and financial reporting. The Finance Director and the auditors attend these meetings with all other directors being invited to attend. Further, the audit committee meets with the auditors without executive directors being present at least once during the year. The audit committee requires the auditors to report specifically on any non-audit assignments which they have undertaken. This work is primarily assistance with United States income tax compliance. The auditors do not carry out any consulting work for the company. Any non-audit work carried out by the auditors requires the advance approval of the audit committee.

The remuneration committee's responsibilities include ensuring that the remuneration and service contract terms of the executive directors and senior management are appropriate. The committee determines the allocation of all executive share options.

The nominations committee's duties are confined to the approval, support or otherwise of appointments, re-appointments and termination of employment or engagement of directors and the secretary of the company.

Relations with investors

Communications with investors are given high priority. The Chairman's statement on pages 2 to 4 includes a review of the business and future developments. Further information is included in the operating review on page 5. There is regular dialogue with institutional investors including presentations after the company's preliminary announcement of the year end results and at the half year.

The Board uses the annual general meeting to communicate with private and institutional investors and welcomes their participation. The Chairman aims to ensure that the chairmen of the audit and remuneration committees are available at the annual general meeting to answer questions. Information is also available to all investors by way of the company's web site at www.filtronic.com

Going concern

As explained in note 1 to the financial statements, the directors have reviewed the budgeted cash flow and other relevant information and have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason the directors continue to adopt the going concern basis in preparing these financial statements.

Remuneration Report

for the year ended 31 May 2004



Composition of the remuneration committee

During the period 1 June 2003 to 31 May 2004 the remuneration committee consisted of the following non-executive directors:

R J Williams (Chairman)
R J B Blake
Professor S B Burbank
I J Hardington
E G Meek

The committee receives advice in its deliberations concerning the remuneration of the executive directors from Professor J D Rhodes. The committee's recommendations have been accepted by the Board without amendment.

Compliance

The company has complied with the provisions in the Code of Best Practice relating to Directors' Remuneration. In preparing this report, the provisions in Schedule B to the Combined Code have been followed.

Policy on remuneration of executive directors and senior executives

(a) Total level of remuneration

The committee aims to ensure that remuneration packages offered are competitive and designed to attract, retain and motivate executive directors and senior executives.

(b) The main components

The company's policy is to structure remuneration packages so that an appropriate element comprises the grant of share options which enables the company to align the interests of employees with those of shareholders.

The main components of remuneration payable are:

(i) Salary

Salary for each executive is determined by the remuneration committee taking into account the performance and responsibilities of the individual. Electronic and electrical engineering is an international industry within which there is a clear market in executive talent. The overriding factor in determining executive remuneration is market forces. Salaries are normally reviewed on 1 July each year. No bonuses are paid to any of the company's executive directors.

(ii) Share options

The directors believe that the opportunity to participate in the company's shareholding is a key factor in attracting and retaining executives of the right calibre and that share ownership by executive directors and senior executives strengthens the link between their personal interests and those of the shareholders. The company's policy is to grant options at the point of recruitment or promotion. All grants of options are determined by the committee. The committee takes account of guidelines issued by the Association of British Insurers and the National Association of Pension Funds when making awards of options. Pursuant to resolutions of the shareholders passed at the extraordinary general meeting held on 17 February 1999, the committee is authorised in exceptional cases to grant options to a value of up to eight times an executive's salary.

The remuneration committee has determined that the vesting of options granted under the Approved, Unapproved and 1997 Schemes will be conditional upon adjusted operating profit targets for the five financial years following the grant of options being achieved. These targets will be determined by the remuneration committee annually, principally by reference to the budget set for the relevant year, and will be set at a level which the remuneration committee determines will be challenging to those concerned. Adjusted operating profit for this purpose is defined as operating profit before goodwill amortisation and share compensation. The adjusted operating profit target for the financial year ended 31 May 2004 was not achieved and accordingly no options vested.



Remuneration Report

for the year ended 31 May 2004

Details of directors' share options are set out on page 52. The terms of vesting and exercise of directors' share options are the same as those which apply to all option holders under the Approved, Unapproved and 1997 Schemes.

(c) Company policy on contracts of service

All the executive directors have rolling service contracts under which the notice period for termination by either party is 6 months. There are no specific compensation commitments for early termination. The non-executive directors have rolling agreements for services with the company. These are terminable by the company or the non-executive director, as the case may be, on three months notice and are reviewed annually by the Board.

(d) Company pensions policy

The company's policy is to offer UK executives membership of the Filtronic plc Retirement Benefits Scheme. UK executive directors who participate in the scheme do so on the same basis as all other employees of the company. The scheme is a funded, Inland Revenue approved, final salary, occupational pension scheme. Its main features are:

- (i) a normal pension age of 65;
- (ii) pension at normal pension age of 1/60th of final pensionable salary for each complete year of service;
- (iii) death in service benefit of four times pensionable salary;
- (iv) pensions payable in the event of ill health;
- (v) spouse's pension on death;
- (vi) long term disability insurance.

Pensionable salary is defined as the member's basic annual salary excluding all bonuses and benefits.

All scheme benefits are subject to Inland Revenue limits.

For Finnish employees including executives, Filtronic LK Oy contributes to defined contribution plans in accordance with Finnish regulations and practices.

For US employees including executives, the US subsidiaries contribute to a defined contribution plan under section 401(k) of the Internal Revenue Code.

For Australian employees including executives, Filtronic Pty Ltd contributes to a defined contribution superannuation fund.

The company paid into a pension scheme nominated by J Samuel an amount equal to the pension contribution which would have been payable by the company if he had been a member of the Filtronic plc Retirement Benefits Scheme.

(e) Company policy on external appointments

The remuneration committee reviews any request by an executive director with regard to a proposed external appointment and deals with each request on its individual merits. The overriding requirement is for each executive, as a term of his contract, to devote the whole of his time and attention to the affairs of the company. The terms of C E Schofield's service contract were varied with effect from 1 October 2002 such that he was required to devote 70% of his time and attention to the affairs of the company during the period of his employment with the company.

Remuneration Report

for the year ended 31 May 2004



The information on pages 51 and 52 has been audited.

Directors' emoluments

| | Salary or fees | Benefits | Total emoluments excluding pension contributions | |
|---------------------------------------|-------------------|--------------|--|--------------|
| | 2004 £000 | 2004 £000 | 2004 £000 | 2003 £000 |
| Executives | | | | |
| Prof J D Rhodes | 189 | 25 | 214 | 207 |
| Prof C M Snowden | 151 | 16 | 167 | 159 |
| A R Needle | 162 | 14 | 176 | 173 |
| Dr C I Mobbs | 141 | 1 | 142 | 140 |
| J Samuel | 152 | 10 | 162 | 155 |
| C E Schofield (resigned 2 April 2004) | 72 | 1 | 73 | 104 |
| Non-executives | | | | |
| R J Williams | 24 | – | 24 | 24 |
| R J B Blake | 24 | – | 24 | 24 |
| Prof S B Burbank | 24 | – | 24 | 24 |
| I J Hardington | 24 | – | 24 | 24 |
| E G Meek | 24 | – | 24 | 24 |
| Total 2004 | 987 | 67 | 1,054 | 1,058 |
| Total 2003 | 979 | 79 | 1,058 | |

Benefits incorporate all assessable tax benefits arising from employment by the company and relate in the main to the provision of a fully expensed company car and private medical insurance. The figures above represent emoluments earned during the relevant financial year. Such emoluments are paid in the same financial year.

Directors' pension benefits

| | Defined benefits scheme | | | | | Transfer value of increase in accrued pension excluding inflation less directors' contributions | |
|--|--|---|---|---|--|--|------|
| | Accrued pension at 31 May 2004 £000 | Increase in accrued pension excluding inflation during the year £000 | Increase in accrued pension including inflation during the year £000 | New basis transfer value at 31 May 2004 £000 | Minimum funding requirement transfer value at 1 June 2003 £000 | Increase in transfer value less directors' contributions during the year £000 | £000 |
| Prof J D Rhodes | 82 | 5 | 7 | 1,541 | 765 | 766 | 78 |
| Prof C M Snowden | 14 | 3 | 3 | 105 | 47 | 50 | 11 |
| A R Needle | 45 | 5 | 6 | 399 | 183 | 208 | 30 |
| Dr C I Mobbs | 45 | 3 | 4 | 270 | 145 | 118 | 11 |
| C E Schofield (resigned 2 April 2004) | 15 | 2 | 2 | 88 | 45 | 40 | 7 |

The company paid contributions of £15,000 (2003 £14,000) into a defined contribution scheme for J Samuel, who is not a member of the defined benefits scheme. Non-executive directors are not entitled to any pension benefits.



Remuneration Report

for the year ended 31 May 2004

Directors' shareholdings

| | 31 May 2004 | 31 May 2003 |
|---------------------------------------|-------------------------|------------------|
| Prof J D Rhodes | 3,730,001 | 4,230,001 |
| Prof C M Snowden | – | – |
| A R Needle | 257,202 | 257,202 |
| Dr C I Mobbs | 295,617 | 295,617 |
| J Samuel | 370,459 | 450,459 |
| C E Schofield (resigned 2 April 2004) | 2,193 | 7,193 |
| R J Williams | 102,609 | 102,609 |
| R J B Blake | 8,500 | 8,500 |
| Prof S B Burbank | 900 | 900 |
| I J Hardington | – | – |
| E G Meek | 75,000 | 125,000 |
| | <u>4,842,481</u> | <u>5,477,481</u> |

All of the above shareholdings are held beneficially.

The following directors or persons connected with them sold shares:

| | | |
|-----------------|------------------|-----------------|
| Prof J D Rhodes | 10 February 2004 | 500,000 at 470p |
| J Samuel | 10 February 2004 | 80,000 at 470p |
| C E Schofield | 10 February 2004 | 5,000 at 470p |
| E G Meek | 19 April 2004 | 50,000 at 390p |

Directors' interests in share options

| | Exercise period | Option price | 31 May 2003 | Granted during the year | Exercised during the year | 31 May 2004 |
|---------------------------------------|---------------------|--------------|-------------|-------------------------|---------------------------|----------------|
| Prof C M Snowden | | | | | | |
| Executive Share Option Schemes | 1/10/1999–5/10/2008 | 383p | 240,000 | – | – | 240,000 |
| C E Schofield (resigned 2 April 2004) | | | | | | |
| Executive Share Option Schemes | 1/10/1999–7/8/2008 | 459p | 60,000 | – | – | 60,000 |
| Total all directors | | | 300,000 | – | – | 300,000 |

The closing middle market share price on 31 May 2004 was 301p, and on 31 May 2003 it was 140p. The range of closing middle market share prices during the year ended 31 May 2004 was 116p – 527p.

There were no changes to the directors' interests between 31 May 2004 and 2 August 2004. The company's register of directors' interests which is open to inspection at the registered office contains full details of directors' shareholdings and share options.

Remuneration Report

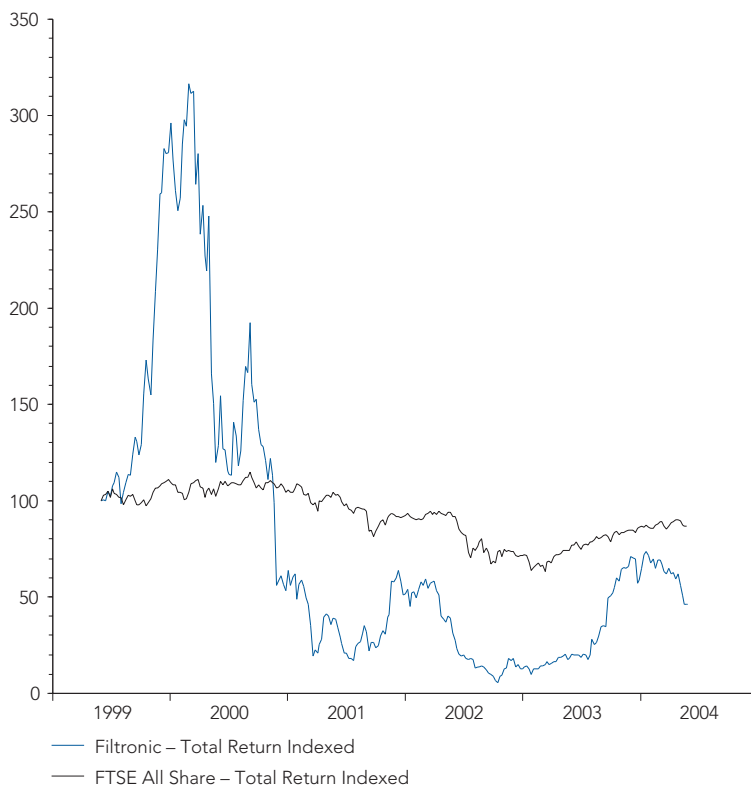
for the year ended 31 May 2004



Performance graph

This graph illustrates the performance of the company's shares measured by Total Shareholder Return (TSR) relative to a broad equity market index over the past five years. The FTSE All Share is considered to be the most appropriate index against which to measure performance, as the company has been a constituent of the FTSE All Share throughout the five-year period and the index is widely used. TSR is the measure of the returns that a company has provided for its shareholders, reflecting share price movements and assuming reinvestment of dividends.

Total Shareholder Return
1 June 1999 to 31 May 2004 Weekly Indexed



Source: Datastream

Approved by the Board on 2 August 2004 and signed on its behalf by

M Moynihan
Company Secretary



Subsidiaries

at 31 May 2004

| Name of subsidiary | Country of incorporation or registration | Description of equity held | Proportion held | Activity |
|--|--|----------------------------|-----------------|--|
| Owned by Filtronic plc | | | | |
| Filtronic Comtek (UK) Limited | England & Wales | 12.2787p ordinary shares | 100% | Design and manufacture of microwave products |
| Filtronic Compound Semiconductors Limited | England & Wales | £1 ordinary shares | 100% | Design and manufacture of compound semiconductors |
| Filtronic Microtek Limited | England & Wales | £1 ordinary shares | 100% | Manufacture of microwave products |
| Filtronic Broadband Limited | England & Wales | 1p ordinary shares | 100% | Design and manufacture of microwave products |
| Filtronic Components Limited | England & Wales | £1 ordinary shares | 100% | Design and manufacture of microwave products |
| Filtronic Properties Limited | England & Wales | £1 ordinary shares | 100% | Property company |
| Filtronic QUEST Trustees Limited | England & Wales | £1 ordinary shares | 100% | QUEST trustee company |
| Filtronic Executive Share Option Trustees Limited | England & Wales | £1 ordinary shares | 100% | Dormant company |
| Filtronic Cable Communications Limited | England & Wales | 1p ordinary shares | 100% | Dormant company |
| Filtronic (Overseas Holdings) Limited | England & Wales | £1 ordinary shares | 100% | Holding company |
| Filtronic Sigtek, Inc. | USA | \$1 common stock | 100% | Design and manufacture of digital signal processing products |
| Owned by subsidiaries | | | | |
| Filtronic LK Oy | Finland | €3,364 ordinary shares | 100% | Design and manufacture of microwave products |
| Filtronic Pty Limited | Australia | A\$1 ordinary shares | 100% | Design and manufacture of microwave products |
| Filtronic (Suzhou) Telecommunication Products Co Limited | China | £1 ordinary shares | 100% | Manufacture of microwave products |
| Filtronic (Japan) K.K. | Japan | Y50,000 ordinary shares | 100% | Representative office |
| Filtronic Holdings, Inc. | USA | \$1 common stock | 100% | Holding company |
| Filtronic Comtek, Inc. | USA | \$1 common stock | 100% | Design and manufacture of microwave products |
| Filtronic Comtek (Barbados), Limited | Barbados | BD\$1 ordinary shares | 100% | USA foreign sales corporation |
| Filtronic Compound Semiconductors, Inc. | USA | \$1 common stock | 100% | Design and sale of compound semiconductors |
| Sage Laboratories, Inc. | USA | \$0.10 common stock | 100% | Design and manufacture of microwave products |
| Sage Laboratories Active Microwave, Inc. | USA | \$1 common stock | 100% | Design and manufacture of microwave products |
| Sage Laboratories Investment Corporation | USA | \$1 common stock | 100% | Investment company |



Annual general meeting

The annual general meeting of Filtronic plc will be held at the Marriott Hollins Hall Hotel, Hollins Hill, Baildon, Shipley, BD17 7QW on Friday 24 September 2004 at 11 am. The notice of meeting, together with details of business to be conducted at the meeting and a form of proxy, is being circulated to shareholders with this report.

Financial calendar

Provisional dates for the announcement of results:

| | |
|-------------------------------------|-----------------|
| Interim results to 30 November 2004 | 31 January 2005 |
| Final results to 31 May 2005 | 1 August 2005 |

Dividends

| | |
|------------------|----------|
| Interim dividend | April |
| Final dividend | November |

Unsolicited mail

The company is obliged by law to make its share register available to other organisations. Therefore, some shareholders may receive unsolicited mail. Any shareholder who wishes to limit the receipt of such mail should contact:

The Mailing Preference Service
Freepost 22
London
W1E 7EZ

giving their name and full address, including postcode.

Share price listings

The share price of Filtronic plc is listed in the following newspapers:

| | |
|-----------------|----------------------------|
| Financial Times | Yorkshire Post |
| The Times | Glasgow Herald |
| The Independent | Bradford Telegraph & Argus |
| Daily Telegraph | The Scotsman |

It is also available by calling the Financial Times Cityline on 0906 003 4706. Calls are charged at premium rate. The company receives no income from this service which is provided by a third party.

Website

The company's website address is www.filtronic.com

The website includes company news and investor sections. The interim and annual reports of the company can be downloaded from the website. The company's share price is also available on the website.

**Company secretary**

M Moynihan

Company number

2891064

Registered office

Filtronic plc
The Waterfront
Salts Mill Road
Saltaire
ShIPLEY
West Yorkshire
BD18 3TT
Tel: 01274 530622
Fax: 01274 531561

Registrars

Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU
Tel: 0870 162 3100

Stockbrokers

Cazenove
20 Moorgate
London
EC2R 6DA
Tel: 020 7588 2828

Auditors

KPMG Audit Plc
Chartered Accountants
1 The Embankment
Neville Street
Leeds
LS1 4DW

Bankers

Barclays Bank PLC
10 Market Street
Bradford
BD1 1NR

Financial public relations

Binns & Co Public Relations Limited
9th Floor, City Point
1 Ropemaker Street
London
EC2Y 9HT
Tel: 020 7786 9600