Brush Electrical Machines Limited

Report and Financial Statements

31 March 2003

Registered No. 111849

Directors
J A Biles
M J R Porter

Secretary
M J R Porter

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

Registered Office
15-19 New Fetter Lane
London EC4A 1LY

Directors' report

The directors present their report and the audited financial statements for the year ended 31 March 2003.

Results and dividends

The audited financial statements for the year ended 31 March 2003 are set out on pages 9 to 19. The result for the year after taxation amounted to £nil (2002: £32,054,000).

The directors do not recommend the payment of a dividend for the year.

Principal activities

The principal activities of the company are the manufacture and sale of electrical machines and the refurbishment of railway locomotives.

Research and development

Product development and innovation is a continuous process. The company is committed to the development of new products to enhance the organic growth of the business.

Directors and their interests

The directors who served during the year ended 31 March 2003 and thereafter were as listed on page 1.

No directors had any interests in the shares of the company at 31 March 2003.

J A Biles is also a director of the ultimate parent undertaking, and his interests in the shares of that company are disclosed in that company's financial statements.

The interests of the remaining director in the shares of the ultimate parent undertaking are set out below:

Ordinary 10p shares	*2003 No.*	*2002 No.*
M J R Porter	417	417

Executive share option scheme	*1 April 2002 No.*	*Granted No.*	*Exercised No.*	*Lapsed No.*	*31 March 2003 No.*
M J R Porter	31,000	43,571	–	–	74,571

All options granted in the year were at an option price of 140 pence per share.

SAYE share option scheme	*1 April 2002 No.*	*Granted No.*	*Exercised No.*	*Lapsed No.*	*31 March 2003 No.*
M J R Porter	5,152	–	–	–	5,152

Directors' report (continued)

Directors and their interests (continued)

Options in existence at 31 March 2003 are exercisable between 2003 and 2012 at prices of 186.75 pence, 188 pence and 140 pence per share.

The market price of the ordinary shares of FKI plc at 31 March 2003 was 64 pence (2002: 192.5 pence) and the range during the year was 192.5 pence to 57 pence (2002: 288.25 pence to 122 pence).

All interests shown above are beneficial.

Long term incentive plan (LTIP)

The ultimate parent company operates a LTIP which was approved by its shareholders in 2001 and under which participants receive annual conditional awards of shares in FKI plc of a value equal to up to 70% of basic salary per annum, which may vest only after the achievement of certain long-term performance conditions. Participants may receive up to the maximum number of shares, three years after the award, provided the performance conditions are met. Until then, the shares are held in a trust, which is administered by a trustee company.

The level of vesting of awards under the LTIP is determined by the performance of FKI plc's total shareholder return against a comparator group of all companies which on the date of grant are constituent companies of the Engineering and Machinery Index as determined by the FTSE Actuaries Industry Classification Committee, excluding those not listed at the end of a three year performance period. No awards vest for below median performance and 50% of an award will vest for median performance. Full vesting occurs only at upper quartile performance, and 75% of an award will vest for performance above the median but below upper quartile. Accrued dividends on vested awards are paid to the executives pending transfer of the shares into the name of the respective participant.

The performance condition is based upon total shareholder return as this is considered to be the best means of aligning the interests of directors with shareholders by requiring superior total shareholder return performance compared to competitor companies. The assessment as to whether the performance conditions have been met is independently calculated by Mercer Human Resource Consulting in conjunction with Datastream and is ratified by the Remuneration Committee of FKI plc.

During the year ended 31 March 2003, the performance period relating to the 1999 award expired. The Remuneration Committee exercised its discretion, in accordance with the rules of the scheme, to include in the final peer group two companies which had been previously omitted, both having been put into receivership during the three-year performance period. The Remuneration Committee considered the change to be fair and reasonable such that, were an adjustment not made, the terms of the scheme would cease to be a fair measure of performance. As a consequence of this adjustment, 30% of the award became exercisable. As required under the rules of the scheme, Ernst & Young LLP confirmed that the adjustment was considered fair and reasonable.

Directors' report (continued)

Directors and their interests (continued)

Long term incentive plan (LTIP) (continued)

The maximum number of ordinary shares that the director could receive under the LTIP is detailed below:

	Shares allocated at 1 April 2002	*Shares allocated during year*	*Shares vested during year*	*Shares lapsed during year*	*Shares transferred during year*	*Value of award at date of grant £*	*Shares allocated at 31 March 2003*	*Earliest date for transfer*	*Value of shares vested**	*Market value***
M J R Porter										
	28,716	–	–	–	–	42,500	28,716	n/a	–	n/a
	29,037	–	29,037	–	–	45,589	29,037	28/07/02	28,747	n/a
	26,110	–	–	18,277	–	59,139	7,833	12/08/03	–	5,013
	22,345	–	–	–	–	54,075	22,345	13/06/04	–	14,301
	21,740	–	–	–	–	42,610	21,740	04/12/04	–	13,914
	–	30,500	–	–	–	43,615	30,500	08/07/05	–	19,520

*The value of the shares that vested during the year is calculated at 99 pence (2002: 197 pence), the market value on the date on which the shares were first transferable to the directors.

**Market value of LTIP shares as yet unvested at 64 pence (2002: 192.5 pence), the closing mid-market price on 31 March 2003.

There are no other interests required to be disclosed under section 234 of the Companies Act 1985.

Employment policies

The company has developed a wide range of voluntary practices and procedures for employee involvement. The company encourages this approach to provide information and consultation and believes this promotes understanding of the issues facing the individual business in which the employee works.

It is company policy to achieve and maintain a high standard of health and safety by all practical means and the active involvement of employees in matters of health and safety is encouraged.

It is the policy of the company to give full and fair consideration to applications made by disabled persons for job vacancies, where particular job requirements are within their ability and, where possible, arrangements are made for the continuing employment of employees who have become disabled.

Suppliers payment policy

The company agrees terms and conditions for its business transactions with suppliers. Payment is made on those terms subject to the terms and conditions being met by the supplier. Trade creditors of the company as at 31 March 2003 expressed in relation to the total amounts invoiced by suppliers for goods and services during the year were equivalent to 33 days (2002: 45 days).

Directors' report (continued)

Auditors

Arthur Andersen resigned as auditors on 31 July 2002 and Ernst & Young LLP were appointed in their place.

A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

By order of the Board

J A Biles
Director

2 October 2003

Statement of directors' responsibilities in respect of the financial statements

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

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report

to the members of Brush Electrical Machines Limited

We have audited the company's financial statements for the year ended 31 March 2003 which comprise the Profit and Loss Account, Balance Sheet and the related notes 1 to 21. These financial statements have been prepared on the basis of the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

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

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom 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. 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 company's circumstances, consistently applied and adequately disclosed.

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

Independent auditors' report

to the members of Brush Electrical Machines Limited (continued)

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company as at 31 March 2003 and of its result for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
London
2 October 2003

Profit and loss account

for the year ended 31 March 2003

	Notes	2003 £000	2002 £000
Turnover	2	72,284	203,824
Cost of sales		(62,756)	(160,364)
Gross profit		9,528	43,460
Distribution costs		(2,345)	(4,694)
Administrative expenses		(7,487)	(6,825)
Operating (loss)/profit	3,4	(304)	31,941
Net interest receivable	7	4	4
(Loss)/profit on ordinary activities before taxation		(300)	31,945
Tax on ordinary activities	8	300	109
Profit for the financial year	16	-	32,054

All amounts relate to continuing operations.

There are no recognised gains or losses other than the result for the financial year.

Balance sheet

at 31 March 2003

	Notes	2003 £000	2002 £000
Fixed assets			
Tangible assets	9	11,918	14,398
Current assets			
Stocks	10	20,225	11,636
Debtors – amounts falling due within one year	11	102,825	108,345
– amounts falling due after more than one year	11	1,481	-
Cash and short-term deposits		4,470	20,534
		129,001	140,515
Creditors: amounts falling due within one year	12	(57,237)	(70,920)
Net current assets		71,764	69,595
Total assets less current liabilities		83,682	83,993
Provisions for liabilities and charges	13	(1,823)	(2,134)
Net assets		81,859	81,859
Capital and reserves			
Called up share capital	14	1,000	1,000
Capital reserve	15	493	493
Profit and loss account	15	80,366	80,366
Equity shareholders' funds	16	81,859	81,859

Approved by the Board
and signed on its behalf by:

J A Biles
Director

2 October 2003

Notes to the financial statements

at 31 March 2003

1. Accounting policies

Basis of preparation

The financial statements are prepared under the historical cost convention, in accordance with applicable accounting standards.

Statement of cash flow

Under the provisions of FRS 1 "Cash Flow Statements" (Revised 1996), the company has not prepared a statement of cash flows because its ultimate parent undertaking, FKI plc, has prepared consolidated financial statements which include the financial statements of the company and which contain a statement of cash flows.

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost, less accumulated depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets at rates calculated to write off the cost, less estimated residual value, of each asset on a straight line basis over its expected useful life, as follows:

Freehold property	- over 50 years
Plant and machinery	- 7.5% to 35%

Stocks and works in progress

Stocks are stated at the lower of cost or net realisable value after making due allowance for any obsolete or slow moving items. In the case of finished goods and work in progress, cost comprises the actual cost of raw materials and an appropriate proportion of labour and overheads based on normal levels of activity. Net realisable value is based on estimated selling price, less further costs expected to be incurred to completion and disposal.

Long-term contracts

Long-term contracts are stated at costs incurred, which comprise the cost of direct materials and labour plus appropriate overhead expenses, net of amounts transferred to cost of sales and after deducting foreseeable losses and payments on account not matched with turnover. To the extent that payments on account exceed the value at which long-term contracts are stated they are included as "payments received on account" within creditors.

Research and development

Development expenditure on clearly defined projects whose outcome can be assessed with reasonable certainty is capitalised and amortisation is commenced in the year the expenditure is incurred by reference to the lesser of the life of the project or three years. All other research and development expenditure is written off in the year in which it is incurred.

Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid or recovered using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Notes to the financial statements

at 31 March 2003

1. Accounting policies (continued)

Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued asset and the gain or loss expected to arise on sale has been recognised in the financial statements. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax is measured at the average rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange ruling at the date of the transaction or at the contracted rate if the transaction is covered by a forward foreign currency contract. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rate of exchange ruling at the balance sheet date. All exchange differences are dealt with in the determination of profit for the financial year.

Turnover

Turnover comprises the invoiced value of goods and services supplied by the company exclusive of value added taxes. In respect of long-term contracts turnover is calculated on a percentage completion basis, as the cost incurred up to the accounting date plus a proportion of the profit appropriate to the percentage completion of each contract.

The amount by which recorded turnover on contracts is in excess of payments on account is recorded in debtors as "amounts recoverable on contracts". Attributable profit is recognised on long-term contracts only when the profitable outcome of the contract can be reasonably foreseen and is calculated so as to reflect the proportion of the work carried out at the year end. Full provision is made in respect of foreseeable losses on uncompleted contracts.

Operating leases

Rentals paid under operating leases are charged to the profit and loss account on a straight line basis over the lease term.

Notes to the financial statements

at 31 March 2003

1. Accounting policies (continued)

Pension costs

The company operates a defined contribution pension scheme and is a member of the FKI plc Group's defined benefit pension scheme.

The regular cost of providing pensions under a defined benefit scheme is charged to the profit and loss account over the employees' service lives on the basis of a constant percentage of earnings. Variations from regular cost, arising from periodic actuarial valuations, are allocated over the expected remaining service lives of current employees on the basis of a constant percentage of current and expected future earnings. The difference between the charge to the profit and loss account and the contributions paid to the scheme is shown as an asset or a liability in the balance sheet. The particulars of the actuarial valuation are contained in the financial statements of the ultimate parent undertaking, FKI plc.

Pension costs for the company's defined contribution pension scheme are charged to the profit and loss account in the years in which they are payable.

2. Turnover and segmental analysis

Turnover and profit before taxation are derived from a single business segment being the principal activity of the company.

An analysis of turnover by geographical destination is as follows:

	2003	*2002*
	£000	*£000*
United Kingdom	22,574	7,477
USA	29,214	148,712
Asia	1,478	3,656
Middle East	589	791
Rest of Europe	16,504	40,805
Other	1,925	2,383
	72,284	203,824

3. Operating (loss)/profit

Operating (loss)/profit is stated after charging/(crediting):

	2003	*2002*
	£000	*£000*
Auditors' remuneration – audit	30	204
Depreciation of owned tangible fixed assets	2,730	2,740
Research and development expenditure	259	108
Operating lease rentals – plant and machinery	176	153
Loss on disposal of fixed assets	9	16
Foreign exchange gains	(1,422)	(465)

Notes to the financial statements

at 31 March 2003

4. Exceptional items

Exceptional items charged within operating (loss)/profit amounted to £1,907,000 (2002: £nil) and were incurred in respect of reorganisation costs for the DeWind business, which was acquired by a fellow subsidiary undertaking during the year.

5. Directors' remuneration

All directors are remunerated by the ultimate parent undertaking. No emoluments received by the directors arose from their office as director of the company (2002: £nil).

6. Staff costs

	2003	*2002*
	£000	*£000*
Wages and salaries	20,477	26,517
Social security costs	1,692	2,281
Other pension costs	2,025	2,389
	24,194	31,187

The average monthly number of persons (including directors) employed during the year was:

	2003	*2002*
	No.	*No.*
Production	713	992
Administration and management	176	90
Sales and distribution	98	48
	987	1,130

7. Net interest receivable

	2003	*2002*
	£000	*£000*
Interest received	4	4

8. Tax on (loss)/profit on ordinary activities

The tax credit comprises:

	2003	*2002*
	£000	*£000*
Deferred taxation	(311)	(109)
Current taxation	11	-
	(300)	(109)

Notes to the financial statements

at 31 March 2003

8. Tax on (loss)/profit on ordinary activities *(continued)*

The current tax assessed for the year is substantially lower than the standard rate of corporation tax in the UK as explained below:

	2003	*2002*
	£000	*£000*
(Loss)/profit on ordinary activities before taxation	(300)	31,945
(Loss)/profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2002 – 30%)	(90)	9,584
Effects of:		
Permanent differences	14	–
Group relief from parent for nil consideration	(224)	(9,693)
Accelerated capital allowances	264	109
Short term timing differences	47	-
Current tax for the year	11	-

9. Tangible fixed assets

	Freehold property	*Plant and machinery*	*Total*
	£000	*£000*	*£000*
Cost:			
At 1 April 2002	138	44,686	44,824
Additions	–	299	299
Disposals	–	(678)	(678)
At 31 March 2003	138	44,307	44,445
Depreciation:			
At 1 April 2002	6	30,420	30,426
Charge for the year	3	2,727	2,730
Disposals	–	(629)	(629)
At 31 March 2003	9	32,518	32,527
Net book value:			
At 31 March 2003	129	11,789	11,918
At 1 April 2002	132	14,266	14,398

Notes to the financial statements

at 31 March 2003

10. Stocks

	2003 £000	2002 £000
Raw materials and consumables	8,602	7,545
Work in progress	10,116	7,626
Long-term contract work in progress	3,068	21
Finished goods and goods for resale	231	231
	22,017	15,423
Less: applicable payments on account	(1,792)	(3,787)
	20,225	11,636

There is no material difference between the balance sheet value of stocks and their replacement cost.

11. Debtors

	2003 £000	2002 £000
Trade debtors	11,397	39,363
Amounts due from other group undertakings	88,392	66,606
Other debtors	2,932	1,975
Prepayments and accrued income	1,585	401
	104,306	108,345

Included in prepayments is £1,481,000 (2002: £nil) relating to prepaid pension payments, being non current in nature.

12. Creditors: amounts falling due within one year

	2003 £000	2002 £000
Bank overdraft	5,397	-
Payments received on account	11,794	5,781
Trade creditors	5,704	20,191
Amounts due to parent and fellow subsidiary undertakings	25,671	36,927
Corporation tax	3,021	3,021
Other taxes and social security costs	281	1,105
Other creditors	2,653	3,066
Accruals and deferred income	2,716	829
	57,237	70,920

Notes to the financial statements

at 31 March 2003

13. Provisions for liabilities and charges

	Deferred tax £000
At 1 April 2002	2,134
Released in the year	(311)
At 31 March 2003	1,823

Deferred taxation, provided in the financial statements, is in respect of:

	2003 £000	*2002 £000*
Accelerated capital allowances	1,870	2,134
Short term timing differences	(47)	-
	1,823	2,134

14. Share capital

Authorised	*2003 £000*	*2002 £000*
Ordinary shares of £1 each	1,000	1,000

Allotted, called up and fully paid	*2003 £000*	*2002 £000*
Ordinary shares of £1 each	1,000	1,000

15. Reserves

	Capital reserve £000	*Profit and loss account £000*
At 1 April 2002 and 31 March 2003	493	80,366

16. Reconciliation of movements in shareholders' funds

	2003 £000	*2002 £000*
Retained profit for the financial year	-	32,054
Opening equity shareholders' funds	81,859	49,805

Notes to the financial statements

at 31 March 2003

Closing equity shareholders' funds	81,859	81,859

17. Financial commitments

(a) Capital commitments

	2003 *£000*	*2002* *£000*
Contracted but not provided for	63	19

(b) Lease commitments

Annual commitments under non-cancellable operating leases in respect of plant and machinery are as follows:

	2003 *£000*	*2002* *£000*
Expiry date:		
- between two and five years	-	16

18. Pensions

The ultimate parent undertaking and its subsidiaries (the "Group") operate pension schemes of the defined benefit type with membership offered to all permanent employees including executive directors. These schemes are funded, where the future liabilities for benefits are provided for by the accumulation of assets held externally to the Group in separate trustee administered funds. Contributions to the funds are charged to the profit and loss account so as to spread the cost of pensions over employee's working lives with the company.

Details relating to the actuarial position of the scheme and the assumptions used are set out in FKI plc's financial statements. The pension charge for the company for the year was £2,025,000 (2002: £2,389,000).

Additional disclosures regarding the Group defined benefit pension scheme are required under the transitional provisions of FRS 17 "Retirement benefits". In accordance with FRS 17, the company will account for its contributions to the scheme as if it were a defined contribution scheme because it is not possible to identify the company's share of the assets and liabilities in the scheme on a consistent and reasonable basis.

The latest actuarial valuation of the scheme, prepared for the purposes of making the transitional disclosures in accordance with FRS 17 in the consolidated financial statements of the ultimate parent undertaking, shows a deficit of £166.9 million (2002: £47.4 million). Further details of this valuation can be found in the financial statements of FKI plc.

19. Contingent liabilities

As part of a group banking arrangement, the company has entered into a multilateral cross guarantee with certain group companies in respect of group overdraft borrowings.

Outstanding bonds and guarantees at the year end amounted to £2,800,000 (2002: £11,664,000).

Notes to the financial statements

at 31 March 2003

20. Related party transactions

The company is exempt from the requirements of Financial Reporting Standard 8 "Related Party Disclosures" to include details of transactions with related parties who are fellow subsidiary undertakings.

21. Ultimate parent undertaking

The directors regard FKI plc, a company incorporated in Great Britain and registered in England and Wales, as the company's ultimate parent undertaking. The only group into which the results of the company are consolidated is that headed by FKI plc. Copies of these financial statements are available from the Company Secretary, FKI plc, 15-19 New Fetter Lane, London EC4A 1LY.