Filtronic plc
Annual Report
2004

Wireless Infrastructure
Handset Products
Integrated Products

Filtronic

Registered Number 2891064

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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 Filtronic 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:

	Sales		Operating profit	
Year ended 31 May	**2004**	2003	**2004**	2003
	£m	£m	**£m**	£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 Filtronic 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

David Staddon

Executive directors

Professor J David Rhodes CBE FRS FREng 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 FREng 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

M. Moynihan

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
		117,202	132,041
Current assets			
Stocks	21	**36,618**	34,344
Debtors	22	**54,480**	50,908
Cash at bank and in hand		**2,070**	6,522
		93,168	91,774
Creditors: amounts falling due within one year	23	**51,767**	38,821
Net current assets		**41,401**	52,953
Total assets less current liabilities		**158,603**	184,994
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		**101,113**	109,159
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		**101,113**	109,159

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)

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	**(6,538)**	5,823

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	**(5,022)**	(922)
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	**(8,046)**	3,963
Opening shareholders' funds	**109,159**	105,196
Closing shareholders' funds	**101,113**	109,159

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
		37,987	38,092
Current assets			
Debtors	22	**216,092**	227,063
Cash at bank and in hand		**5**	3,840
		216,097	230,903
Creditors: amounts falling due within one year	23	**17,044**	4,048
Net current assets		**199,053**	226,855
Total assets less current liabilities		**237,040**	264,947
Creditors: amounts falling due after one year	24	**44,000**	61,942
Provision for deferred tax	25	**–**	239
Net assets		**193,040**	202,766
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		**193,040**	202,766

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.

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.

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)
	237,203	241,268
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
	3,707	6,715
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	**101,113**	109,159

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

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.

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
	237,203	241,268

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)
	240,549	238,391
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
	70,025	70,282
Depreciation	**17,065**	19,322
Goodwill amortisation	**2,171**	2,348
Other operating charges	**36,382**	38,491
	236,842	231,676
Operating profit	**3,707**	6,715

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)

7 Exceptional closure costs

	2004 £000	2003 £000
Exceptional closure costs	–	1,812

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

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).

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
	3,369	2,893
Business segment		
Wireless Infrastructure	**1,756**	1,618
Handset Products	**861**	506
Integrated Products	**690**	691
Central Services	**62**	78
	3,369	2,893

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 Filtronic Solid State was sold. The disposal is analysed as follows:

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

The electronic warfare business of Filtronic 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.

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)
	(5,645)	(8,226)
Net interest payable and similar charges	(5,550)	(7,995)

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
	(614)	4,236

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)
	(2,498)	881

15 Taxation on (loss)/profit on ordinary activities

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

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	**(409)**	3,837
(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	**2,711**	2,462

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

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
	2.70p	2.70p	**2,015**	2,006

17 (Loss)/earnings per share

	2004 £000	2003 £000
(Loss)/profit on ordinary activities after taxation	**(3,007)**	1,084
	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	**74,508**	74,705
Basic (loss)/earnings per share	**(4.04)p**	1.46p
Diluted (loss)/earnings per share	**(4.04)p**	1.45p

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.

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.

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	2003	**2004**	2003
	£000	£000	**£000**	£000
Raw materials	**22,632**	22,826	**–**	–
Work in progress	**7,447**	5,664	**–**	–
Finished goods	**6,539**	5,854	**–**	–
	36,618	34,344	**–**	–

22 Debtors

	The group		The company	
	2004	2003	**2004**	2003
	£000	£000	**£000**	£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
	54,480	50,908	**216,092**	227,063

23 Creditors: amounts falling due within one year

	The group		The company	
	2004	2003	**2004**	2003
	£000	£000	**£000**	£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	2003	**2004**	2003
	£000	£000	**£000**	£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	2003	**2004**	2003
	£000	£000	**£000**	£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.

25 Provision for deferred tax

	The group		The company	
	2004	2003	**2004**	2003
	£000	£000	**£000**	£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	2003	**2004**	2003
	£000	£000	**£000**	£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.

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.

27 Share capital

	2004 Number	2003 Number	2004 £000	2003 £000
Authorised				
Ordinary shares of 10p each	**100,000,000**	100,000,000	**10,000**	10,000

Allotted, called up and fully paid

Ordinary shares of 10p each

	2004 Number	2003 Number	2004 £000	2003 £000
Opening share capital	**74,304,443**	74,091,382	**7,430**	7,409
Allotted during the year	**342,139**	213,061	**35**	21
Closing share capital	**74,646,582**	74,304,443	**7,465**	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
	342,139	**35**	**1,790**	**748**	**2,573**

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	**137,641**	**2,255**	**106**	**2,020**

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.

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

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
		6,489,422

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
		156,760
Total number of options outstanding at 31 May 2004		6,646,182

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
		195,271

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

33 Financial commitments

Annual commitments under non-cancellable operating leases which expire:

	The group		The company	
	2004	2003	**2004**	2003
	£000	£000	**£000**	£000
Land and buildings				
In two to five years	**866**	877	–	–
In over five years	**99**	317	–	–
	965	1,194	–	–
Other				
In two to five years	**1,300**	1,695	**31**	72

34 Capital commitments

	The group		The company	
	2004	2003	**2004**	2003
	£000	£000	**£000**	£000
Capital expenditure contracted for but not provided in the financial statements	**3,462**	3,615	**92**	44

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.

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%

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

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	**2,744**	2,143

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	**(457)**	(209)

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)	**1,465**	(6,129)

	% 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	**(11,381)**	(11,550)

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	Floating rate financial assets 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			
	Average interest rate	Average fixed period	Fixed rate	Floating rate	Interest free	Total
2004	%	Years	£000	£000	£000	£000
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.

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
	6,269	9,427

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.

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.

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.

The information on pages 51 and 52 has been audited.

Directors' emoluments

	Salary or fees	Benefits	Total emoluments excluding pension contributions	
	2004	**2004**	**2004**	2003
	£000	**£000**	**£000**	£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

	Accrued pension at 31 May 2004	Increase in accrued pension excluding inflation during the year	Increase in accrued pension including inflation during the year	New basis transfer value at 31 May 2004	Minimum funding requirement basis transfer value at 1 June 2003	Increase in transfer value less directors' contributions during the year	Transfer value of increase in accrued pension excluding inflation less directors' contributions during the year
	£000	£000	£000	£000	£000	£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.

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
	4,842,481	5,477,481

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**

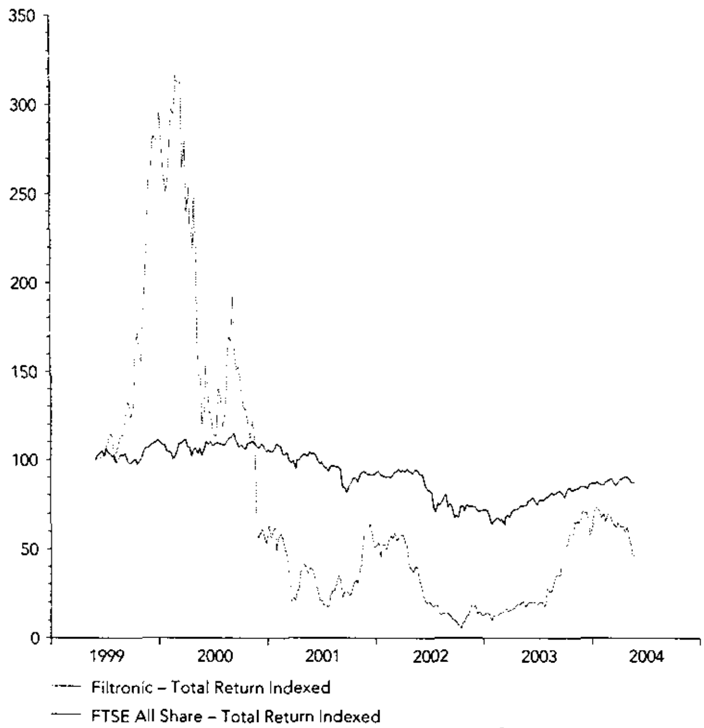
The closing middle market share price on 31 May 2004 was 301p, and on 31 May 2003 it was 140p. The range of closing middle market share prices during the year ended 31 May 2004 was 116p – 527p.

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.

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

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 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

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2891064

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