

UAV ENGINES LIMITED

**DIRECTORS REPORT AND
FINANCIAL STATEMENTS**

FOR THE YEAR ENDED 31 DECEMBER 2006

Company Registration No 2691211 (England and Wales)

**Edwards Chartered Accountants
Registered Auditors**

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UAV ENGINES LIMITED

COMPANY INFORMATION

Directors	I Dvir J Gaspar S Sand
Secretary	C J Biddulph
Company number	2691211
Registered office	Lynn Lane Shenstone Lichfield Staffordshire WS14 0DT
Auditors	Edwards Harmony House 34 High Street Aldridge West Midlands WS9 8LZ
Business address	Lynn Lane Shenstone Lichfield Staffordshire WS14 0DT
Bankers	HSBC plc 49 Market Street Lichfield Staffordshire WS13 6LB

UAV ENGINES LIMITED

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UAV ENGINES LIMITED

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2006

The directors present their report and financial statements for the year ended 31 December 2006

Principal activities and review of the business

The principal activity of the company continued to be that of the design, manufacture and sale of high performance rotary engines for unmanned air vehicles

The results for the year and the financial position at the year end were considered satisfactory by the directors who expect continued growth in the foreseeable future

The market for high performance rotary engines for unmanned air vehicles, is driven by the level of conflict in the world UAV offers a unique product that controls a large percentage of sales within the unmanned air vehicles market If all conflict in the world were to cease, the directors' are of the opinion that the company would still be able to operate profitably, via the sale of spare parts to maintain engines sold previously

Export sales are subject to regulation from the Department of Trade and Industry, this is an area that could provide uncertainty, although no major problems have been encountered in the recent past

Gross profit margin (gross profit as a percentage of turnover) for 2006 is 34.27% (2005 32.36%) This is in line with the levels of gross profit achieved by the company in recent years The margin is expected to remain stable in the coming year Source data is taken from the audited financial statements

Annualised sales growth (the annual increase in revenue as a percentage of revenue from the prior year) for 2006 this is 10.79% (2005 33.08%) Sales have continued to grow due to the continuing conflicts in the Middle East and around the World Source data is taken from the audited financial statements

Results and dividends

The results for the year are set out on page 5

The directors do not recommend payment of an ordinary dividend

Future developments

The company shall continue in its policy of investing in the development of new engines

Directors

The following directors have held office since 1 January 2006

I Dvir
J Gaspar
S Sand

Directors' interests

There are no directors' interests requiring disclosure under the Companies Act 1985 Their interests in the shares of the other companies within the group, are disclosed on the financial statements of those entities

	Ordinary shares of £ 1 each	
	31 December 2006	1 January 2006
I Dvir	-	-
J Gaspar	-	-
S Sand	-	-

UAV ENGINES LIMITED

DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006

Auditors

In accordance with section 385 of the Companies Act 1985, a resolution proposing that Edwards be reappointed as auditors of the company will be put to the Annual General Meeting

Directors' responsibilities

The directors are responsible for preparing the financial statements in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice

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

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

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

Statement of disclosure to auditor

(a) so far as the directors are aware, there is no relevant audit information of which the company's auditors are unaware, and

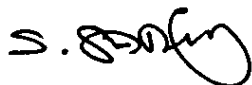
(b) they have taken all the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information

On behalf of the board



I Dvir

Director



UAV ENGINES LIMITED

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF UAV ENGINES LIMITED

We have audited the financial statements of UAV Engines Limited for the year ended 31 December 2006 set out on pages 5 to 16. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of the directors and auditors

As described in the Statement of Directors' Responsibilities on page 2, the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985, and whether in our opinion the information given in the directors' report is consistent with the financial statements. We also report to you if, in our opinion, 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 other transactions is not disclosed.

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

Basis of audit opinion

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

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

UAV ENGINES LIMITED

INDEPENDENT AUDITORS' REPORT (CONTINUED)

TO THE SHAREHOLDERS OF UAV ENGINES LIMITED

Opinion

In our opinion

- the financial statements give a true and fair view in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the financial statements

Edwards

Chartered Accountants
Registered Auditor

Edwards 30th January 2007

Harmony House
34 High Street
Aldridge
West Midlands
WS9 8LZ

UAV ENGINES LIMITED

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £	2005 £
Turnover	2	7,217,407	6,514,492
Cost of sales		(4,743,748)	(4,406,246)
Gross profit		2,473,659	2,108,246
Administrative expenses		(1,195,860)	(785,964)
Operating profit	3	1,277,799	1,322,282
Other interest receivable and similar income	4	103,580	74,437
Interest payable and similar charges	5	(1,653)	(2,730)
Profit on ordinary activities before taxation		1,379,726	1,393,989
Tax on profit on ordinary activities	6	(424,610)	(444,774)
Profit for the year	14	955,116	949,215

The profit and loss account has been prepared on the basis that all operations are continuing operations

There are no recognised gains and losses other than those passing through the profit and loss account

UAV ENGINES LIMITED

BALANCE SHEET AS AT 31 DECEMBER 2006

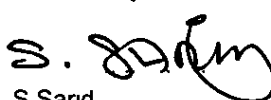
	Notes	2006 £	£	2005 £	£
Fixed assets					
Tangible assets	7		303,874		276,383
Current assets					
Stocks	8	1,361,396		1,236,235	
Debtors	9	3,323,400		2,524,590	
Cash at bank and in hand		467,951		426,514	
		<u>5,152,747</u>		<u>4,187,339</u>	
Creditors amounts falling due within one year	10	<u>(1,170,137)</u>		<u>(1,132,354)</u>	
Net current assets			<u>3,982,610</u>		<u>3,054,985</u>
Total assets less current liabilities			<u>4,286,484</u>		<u>3,331,368</u>
			<u>4,286,484</u>		<u>3,331,368</u>
Capital and reserves					
Called up share capital	13		312,500		312,500
Profit and loss account	14		<u>3,973,984</u>		<u>3,018,868</u>
Shareholders' funds	15		<u>4,286,484</u>		<u>3,331,368</u>

Approved by the Board and authorised for issue on

30th January 2007



I Dvir
Director



S Sarid
Director

UAV ENGINES LIMITED

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

	£	2006 £	£	2005 £
Net cash inflow from operating activities		555,568		117,750
Returns on investments and servicing of finance				
Interest received	103,580		74,437	
Interest paid	(1,653)		(2,730)	
Net cash inflow for returns on investments and servicing of finance		101,927		71,707
Taxation		(495,682)		(375,754)
Capital expenditure				
Payments to acquire tangible assets	(121,876)		(195,855)	
Receipts from sales of tangible assets	1,500		-	
Net cash outflow for capital expenditure		(120,376)		(195,855)
Net cash inflow/(outflow) before management of liquid resources and financing		41,437		(382,152)
Increase/(decrease) in cash in the year		41,437		(382,152)

UAV ENGINES LIMITED

NOTES TO THE CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

1	Reconciliation of operating profit to net cash inflow from operating activities	2006 £	2005 £
	Operating profit	1,277,799	1,322,282
	Depreciation of tangible assets	94,385	69,431
	Profit on disposal of tangible assets	(1,500)	-
	Increase in stocks	(125,161)	(659,279)
	Increase in debtors	(800,717)	(642,290)
	Increase in creditors within one year	110,762	27,606
	Net cash inflow from operating activities	555,568	117,750

2	Analysis of net funds	1 January 2006 £	Cash flow £	Other non-cash changes £	31 December 2006 £
	Net cash				
	Cash at bank and in hand	426,514	41,437	-	467,951
	Bank deposits	-	-	-	-
	Net funds	426,514	41,437	-	467,951

3	Reconciliation of net cash flow to movement in net funds	2006 £	2005 £
	Increase/(decrease) in cash in the year	41,437	(382,152)
	Movement in net funds in the year	41,437	(382,152)
	Opening net funds	426,514	808,666
	Closing net funds	467,951	426,514

UAV ENGINES LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006

1 Accounting policies

1.1 Accounting convention

The financial statements are prepared under the historical cost convention

1.2 Compliance with accounting standards

The financial statements are prepared in accordance with applicable United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), which have been applied consistently (except as otherwise stated)

1.3 Turnover

Turnover represents amounts receivable for goods and services net of VAT and trade discounts

1.4 Research and development

Research expenditure is written off to the profit and loss account in the year in which it is incurred. Development expenditure is written off in the same way unless the directors are satisfied as to the technical, commercial and financial viability of individual projects. In this situation, the expenditure is deferred and amortised over the period during which the company is expected to benefit.

1.5 Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less depreciation. Depreciation is provided at rates calculated to write off the cost less estimated residual value of each asset over its expected useful life, as follows:

Computer equipment	33 3% Straight line
Plant and machinery	10-20% Straight line
Fixtures, fittings & equipment	10-20% Straight line
Motor vehicles	20% Straight line

1.6 Leasing

Rentals payable under operating leases are charged against income on a straight line basis over the lease term.

1.7 Stock and work in progress

Stock and work in progress are valued at the lower of cost and net realisable value.

1.8 Long term contracts

Amounts recoverable on long term contracts, which are included in debtors, are stated at the net sales value of the work done after provision for contingencies and anticipated future losses on contracts, less amounts received as progress payments on account. Excess progress payments are included in creditors as payments on account.

1.9 Pensions

The pension costs charged in the financial statements represent the contributions payable by the company during the year in accordance with Financial Reporting Standard 17.

1.10 Deferred taxation

Deferred taxation is provided at appropriate rates on all timing differences using the liability method only to the extent that, in the opinion of the directors, there is a reasonable probability that a liability or asset will crystallise in the foreseeable future.

UAV ENGINES LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006

1 Accounting policies

(continued)

1.11 Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. All differences are taken to profit and loss account.

1.12 Warranty provision

Provision is made for the estimated future cost of carrying out warranty work on engines previously sold and still under warranty.

2 Turnover

During the year sales to Silver Arrow Partnership Limited, the immediate holding company, were £203,514 (2005 - £156,999).

Geographical market

	Turnover	
	2006	2005
	£	£
United Kingdom	439,065	58,762
United States of America	6,140,445	5,075,569
Europe	225,882	276,769
Rest of the World	412,015	1,103,392
	<u>7,217,407</u>	<u>6,514,492</u>

3 Operating profit

	2006	2005
	£	£
Operating profit is stated after charging		
Depreciation of tangible assets	94,385	69,431
Loss on foreign exchange transactions	4,121	5,681
Research and development	206,183	73,770
Operating lease rentals	64,097	56,029
Auditors' remuneration	12,770	7,200
Remuneration of auditors for non-audit work	1,214	-
and after crediting		
Profit on disposal of tangible assets	<u>(1,500)</u>	<u>-</u>

UAV ENGINES LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006

4	Investment income	2006	2005
		£	£
	Bank interest	18,085	21,242
	Other interest	85,495	53,195
		<u>103,580</u>	<u>74,437</u>
5	Interest payable	2006	2005
		£	£
	On overdue tax	<u>1,653</u>	<u>2,730</u>
6	Taxation	2006	2005
		£	£
	Domestic current year tax		
	U K corporation tax	<u>422,703</u>	<u>435,683</u>
	Current tax charge	<u>422,703</u>	<u>435,683</u>
	Deferred tax		
	Deferred tax charge/credit current year	<u>1,907</u>	<u>9,091</u>
		<u>424,610</u>	<u>444,774</u>
	Factors affecting the tax charge for the year		
	Profit on ordinary activities before taxation	<u>1,379,726</u>	<u>1,393,989</u>
	Profit on ordinary activities before taxation multiplied by standard rate of UK corporation tax of 30.00% (2005 - 30.00%)	<u>413,918</u>	<u>418,197</u>
	Effects of		
	Non deductible expenses	4,988	18,098
	Depreciation add back	28,316	20,829
	Capital allowances	(24,519)	(21,441)
		<u>8,785</u>	<u>17,486</u>
	Current tax charge	<u>422,703</u>	<u>435,683</u>

UAV ENGINES LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006

7 Tangible fixed assets

	Computer equipment	Plant and machinery	Fixtures, fittings & equipment	Motor vehicles	Total
	£	£	£	£	£
Cost					
At 1 January 2006	113,916	424,364	228,967	33,249	800,496
Additions	-	49,377	72,499	-	121,876
Disposals	-	-	-	(22,750)	(22,750)
At 31 December 2006	113,916	473,741	301,466	10,499	899,622
Depreciation					
At 1 January 2006	76,411	353,978	67,714	26,010	524,113
On disposals	-	-	-	(22,750)	(22,750)
Charge for the year	12,502	25,654	52,314	3,915	94,385
At 31 December 2006	88,913	379,632	120,028	7,175	595,748
Net book value					
At 31 December 2006	25,003	94,109	181,438	3,324	303,874
At 31 December 2005	37,505	70,386	161,253	7,239	276,383

8 Stocks and work in progress

	2006 £	2005 £
Raw materials and consumables	1,125,998	903,235
Work in progress	235,398	-
Finished goods and goods for resale	-	333,000
	1,361,396	1,236,235

UAV ENGINES LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006

9 Debtors	2006 £	2005 £
Trade debtors	1,460,199	926,136
Amounts owed by parent and fellow subsidiary undertakings	1,685,517	1,361,987
Other debtors	58,586	106,951
Prepayments and accrued income	61,279	69,790
Deferred tax asset (see note 11)	57,819	59,726
	<u>3,323,400</u>	<u>2,524,590</u>

The deferred tax asset relates to the excess of depreciation charged in the accounts, over the tax allowances claimed for corporation tax. These will be recoverable in the foreseeable future.

In addition the company has a policy for the warranty of its products sold, which is not allowable for corporation tax. As the true cost becomes known the tax relief will be recoverable.

10 Creditors: amounts falling due within one year	2006 £	2005 £
Payments received on account	-	16,322
Trade creditors	693,194	569,219
Corporation tax	182,704	255,683
Other taxes and social security costs	40,660	-
Other creditors	1,596	1,212
Accruals and deferred income	251,983	289,918
	<u>1,170,137</u>	<u>1,132,354</u>

UAV ENGINES LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006

11 Provisions for liabilities and charges

The deferred tax asset (included in debtors, note 9) is made up as follows:

	2006 £
Balance at 1 January 2006	(59,726)
Profit and loss account	1,907
	<u>(57,819)</u>
Balance at 31 December 2006	<u>(57,819)</u>

	2006 £	2005 £
Decelerated capital allowances	(11,979)	(7,009)
Other timing differences	(45,840)	(52,717)
	<u>(57,819)</u>	<u>(59,726)</u>

12 Pension costs

Defined contribution

	2006 £	2005 £
Contributions payable by the company for the year	<u>11,247</u>	<u>16,838</u>

13 Share capital

	2006 £	2005 £
Authorised		
312,500 Ordinary shares of £1 each	<u>312,500</u>	<u>312,500</u>
Allotted, called up and fully paid		
312,500 Ordinary shares of £1 each	<u>312,500</u>	<u>312,500</u>

UAV ENGINES LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006

14 Statement of movements on profit and loss account

	Profit and loss account £
Balance at 1 January 2006	3,018,868
Profit for the year	955,116
Balance at 31 December 2006	<u>3,973,984</u>

15 Reconciliation of movements in shareholders' funds

	2006 £	2005 £
Profit for the financial year	955,116	949,215
Opening shareholders' funds	<u>3,331,368</u>	<u>2,382,153</u>
Closing shareholders' funds	<u>4,286,484</u>	<u>3,331,368</u>

16 Financial commitments

At 31 December 2006 the company was committed to making the following payments under non-cancellable operating leases in the year to 31 December 2007

	Land and buildings 2006 £	2005 £
Operating leases which expire		
Between two and five years	47,816	-
In over five years	<u>-</u>	<u>47,816</u>
	<u>47,816</u>	<u>47,816</u>

UAV ENGINES LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2006

17 Employees

Number of employees

The average monthly number of employees (including directors) during the year was

	2006 Number	2005 Number
Administration	10	10
Manufacturing	25	21
	<u>35</u>	<u>31</u>

Employment costs

	2006 £	2005 £
Wages and salaries	936,607	864,769
Social security costs	100,587	91,966
Other pension costs	11,247	16,838
	<u>1,048,441</u>	<u>973,573</u>

18 Control

The immediate parent is Silver Arrow Partnership Limited, registered in Israel. The ultimate holding company is Elbit Systems, incorporated in Israel.

19 Related party transactions

During the year UAV Engines Limited made purchases of £330,714 (2005 £285,738) from Silver Arrow Limited (parent company). There was also interest received of £85,494 (2005 £53,194) from Silver Arrow, in relation to the loan due from them to UAV Engines Limited.

At the year end there was a balance of £1,685,517 (2005 £1,361,987) due from Silver Arrow Limited.