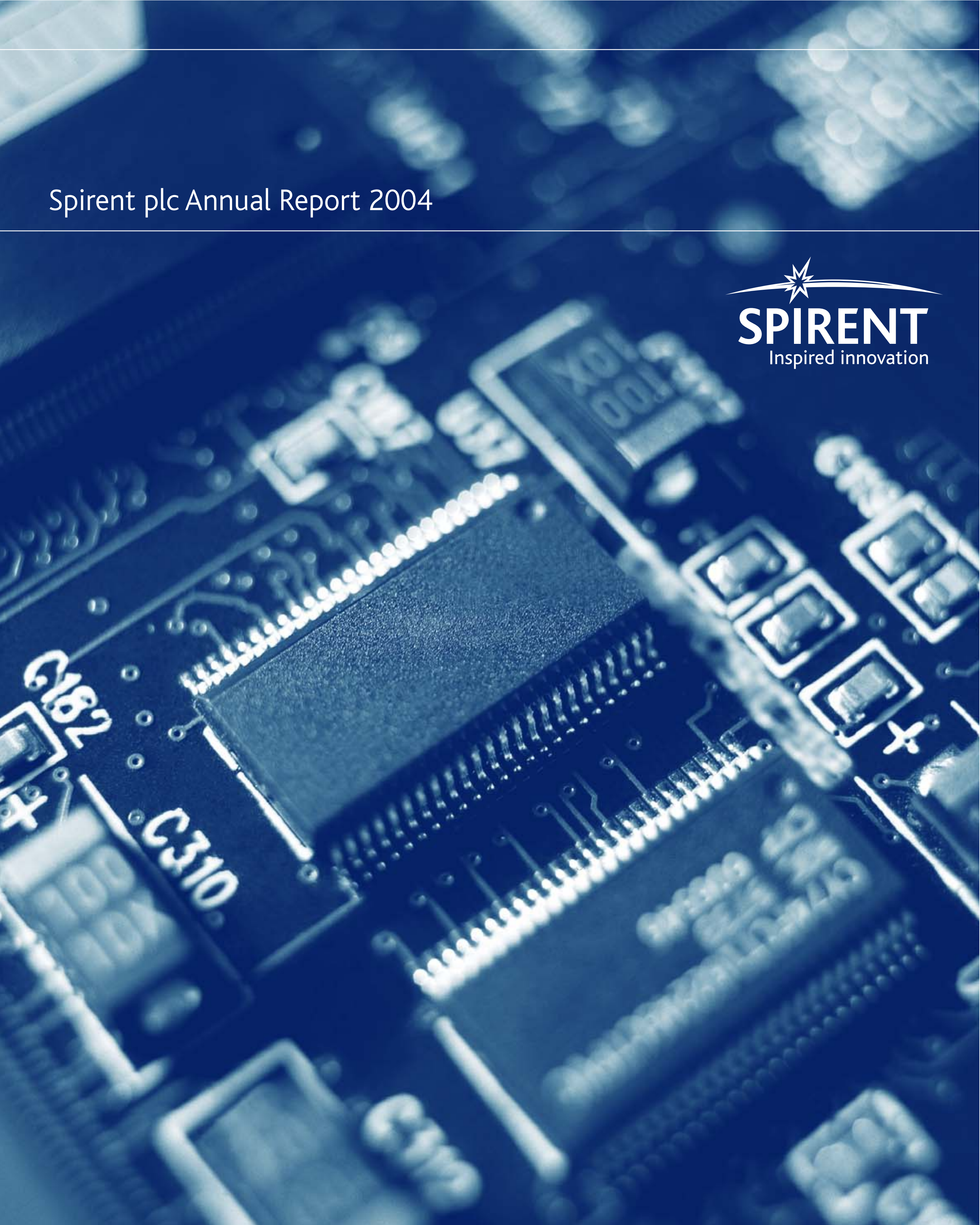
Spirent plc Annual Report 2004

SPIRENT
Inspired innovation



Spirent is a leading communications technology company focused on delivering innovative systems and services to meet the needs of customers worldwide.

Highlights

£ million	2004	2003	Change %
Turnover	475.0	466.2	2
Operating profit[1]	42.8	36.0	19
Profit before taxation and amortisation[2]	37.4	30.0	25
Profit before taxation	24.0	0.3	>100
Earnings per share[3] (pence)	2.99	2.31	29

Notes
1 Before goodwill amortisation and operating exceptional items.

2 Before exceptional items.

3 Earnings per share is based on headline earnings as set out in note 12 to the Accounts.

Contents

Spirent plc is a public limited company registered in England. Its Ordinary shares are traded on the London Stock Exchange and, in the form of American Depositary Shares, on the New York Stock Exchange.

This report is the Annual Report of Spirent plc for the year to 31 December 2004 and complies with UK regulations. The Annual Report is available on Spirent's website at www.spirent.com

A separate Annual Report on Form 20-F is being prepared to meet US regulations and will be filed with the US Securities and Exchange Commission by 30 June 2005.

Our business at a glance

Communications

Spirent Communications is a global provider of performance analysis and service assurance solutions that enable the development and deployment of next-generation networking technologies.

The Performance Analysis division develops testing solutions for a broad range of communications technologies critical to the development of equipment and deployment of next-generation networks. Our systems test wireline and wireless equipment, including core and metro terabit routers, broadband access devices, local area network switches and routers, 3G wireless handsets, Internet telephony and web applications and security. Our systems enable customers to emulate large-scale networks, introduce impairments and stress test equipment to ensure maximum performance and conformance to industry standards. We also provide a range of professional support services to assist customers with their testing needs.

The Service Assurance division provides network monitoring and management systems for telecoms service providers to assure the quality of their high bandwidth services. Our systems enable the efficient delivery of leased line, DSL and IP services. The division provides operations support systems software, remote test probes, network test access systems and support and maintenance services.

Network Products

We are a developer and manufacturer of innovative solutions for fastening, identification, protection and connectivity in electrical and communications networks marketed under the global brand HellermannTyton.

HellermannTyton designs and manufactures a broad range of high-grade nylon ties, clips, channels and fixings for fastening cables and wires in a broad range of applications. We also produce products with value added identification and security features.

Our heatshrink insulation, convoluted tubing and cable covering products provide insulation and physical protection for wires and cables. We are a market leader in systems for the automated application of cable fixings and identification printing and application systems.

We also produce a range of products used in the installation of local area and wide area communications networks such as raceways, ducting, racks, patch panels and modular jacks.

Systems

Our Systems group comprises PG Drives Technology, a leading supplier of sophisticated electronic control systems for specialist electrical vehicles in the mobility and industrial markets.

PG Drives Technology develops power control systems for use in a variety of specialist electrically powered vehicles. These include medical vehicles such as powered wheelchairs and mobility scooters as well as small industrial vehicles such as floor cleaning vehicles and aerial access platforms. Our systems allow the user to control the direction and speed of the vehicle as well as controlling other aspects of the vehicle's functions, including seating or platform position, lights, turn indicators and vehicle diagnostics.

Chairman's letter

Dear Shareholder

2004 was a year of considerable progress across a broad front for Spirent. The return to growth of the Performance Analysis division of Spirent Communications is an important milestone and is a result of our long term strategy of focusing on next-generation telecoms technologies. The Service Assurance division still faces challenges as it undergoes a reinvigoration of its activities and we have taken actions to position it for future growth. Our Network Products group had another good year while the Systems group's results reflect the difficult nature of its market at present. In addition, having restructured the balance sheet and met certain financial requirements in relation to our borrowing terms, we have restored strategic flexibility to the Company.

I am delighted that Anders Gustafsson joined us as Chief Executive after the retirement of Nicholas Brookes. His exceptional skill set is ideally suited to the challenges ahead as we work to grow our communications activities. We have been fortunate in adding as a non-executive director Kurt Hellström who brings great strengths in the critical telecoms area. I believe we now have a Board that is well aligned with our strategic priorities. I am immensely grateful to My Chung, who resigned from the Board during the year, and to Richard Moley, who is retiring from the Board at the 2005 Annual General Meeting, for their dedicated service to the Company.

We are fully compliant with the requirements under the UK Combined Code on Corporate Governance and considerable efforts have been expended in respect of compliance with the applicable provisions of the US Sarbanes-Oxley Act and in keeping the Company in line with good practice in corporate governance and social responsibility issues. We continue to give a high priority to maintaining high standards in these areas.

The achievements of 2004 have made your Company stronger and well poised to make further progress.

Yours faithfully

John Weston

John Weston CBE
Chairman

Chief Executive's letter

Dear Shareholder

I am pleased to be reporting an overall improvement in the performance of your Company in 2004 as a result of our investment in and focus on growth markets.

Overall turnover increased by 9 per cent in constant currencies to £475.0 million, with strong results reported by our Performance Analysis division which achieved a substantial rise in turnover, up 31 per cent in constant currencies. Our Service Assurance division had a difficult year and we are working to reinvigorate this business. Operating profit for the Group as a whole was up materially by 28 per cent in constant currencies to £42.8 million. Earnings per share increased by 29 per cent to 2.99 pence. Strong cash generation enabled us to reduce debt to £26.4 million at the year end from £57.5 million.

Spirent is well positioned to build on its strengths, including its leading position in next-generation technologies, broad product portfolio, depth of expertise and our strong commitment to innovation and product development. Going forward, we will continue to leverage our expertise across our Communications group to deliver testing solutions for new and evolving telecoms technologies. We have sharpened our focus on our customers' needs and have established strong positions in virtually all next-generation technologies that are critical to our customers' migration to packet-based networks and services. I believe the organisational changes and improvements we have implemented have laid a solid foundation from which we can progress.

In my first year as Chief Executive I am very excited about our accomplishments and our future. I would like to acknowledge and applaud the hard work and dedication of our employees around the world who make our successes possible and who are vital to our future growth.

As we look ahead, our strategy to focus on and grow our Communications group provides us with exciting opportunities and challenges. I am confident we are on the right course to achieve our objectives.

Yours faithfully

Anders Gustafsson
Chief Executive

Operating and financial review

Overview

Our performance in 2004 showed a marked improvement as a result of our investment in and focus on growth markets. In the Communications group, our Performance Analysis division achieved a substantial improvement in its results, with turnover up 31 per cent in constant currencies and operating profit up materially from £4.4 million to £19.7 million due to increased customer spending on next-generation technologies. Actions have been taken to reinvigorate the Service Assurance division, but we are not anticipating a recovery in its performance until the latter part of 2005. Results for the division were affected by market pressures, with turnover down 10 per cent in constant currencies and operating profit at break-even. The Network Products group delivered another strong performance, with turnover up 11 per cent and operating profit up 27 per cent in constant currencies. The movement in the US dollar exchange rate reduced reported turnover by £32.8 million, operating profit by £3.2 million and profit before taxation, amortisation and exceptional items by £2.5 million. Product development spending in the Communications group was £60.4 million, 24 per cent of turnover, to secure our position at the forefront of telecoms technology. Strong cash generation reduced net debt to £26.4 million at the end of 2004 compared with £57.5 million at the end of 2003.

Operating review

Communications

£ million	2004	2003	Change % Reported	Change % Constant currency
Turnover				
Performance Analysis	176.8	148.7	19	31
Service Assurance	74.7	91.7	(19)	(10)
Communications group	251.5	240.4	5	15
Operating profit				
Performance Analysis	19.7	4.4	>100	>100
Service Assurance	0.2	9.4	(98)	(95)
Communications group	19.9	13.8	44	63
Return on sales (%)				
Performance Analysis	11.1	3.0		
Service Assurance	0.3	10.3		
Communications group	7.9	5.7		

Our Communications group, Spirent Communications, is a leading provider of test and monitoring solutions and systems for next-generation telecoms equipment and services worldwide. In 2004 we achieved an improvement in the overall results of our Communications group due to a recovery in the Performance Analysis division, which has benefited from increased spending on next-generation technologies. Results for the Service Assurance division were weak due to pressures in its market and we are working to enhance our products to address customers' evolving needs. Turnover for the group was up by 15 per cent on a constant currency basis compared with 2003. As a result of increased volumes, operating profit increased to £19.9 million representing a 63 per cent increase in constant currencies over the prior year. Return on sales improved to 7.9 per cent compared with 5.7 per cent in 2003.

In order to be able to meet our customers' needs and to secure our position at the forefront of telecoms technology we have maintained our investment in product development, spending a total of £60.4 million, or 24 per cent of the Communications group's turnover, in the period (2003 £57.8 million and 24 per cent). Total product development spending for the year was split as to £43.2 million in the Performance Analysis division and £17.2 million in the Service Assurance division (2003 £39.4 million and £18.4 million, respectively). This investment continues to be directed at next-generation technologies and at maintaining the competitiveness of our products in terms of price and functionality.

During the second half of 2004 we embarked on a number of initiatives to improve the operational efficiency of the Communications group. These initiatives include the further integration of important functions such as IT, finance, human resources and group marketing and a rationalisation of the supply chain. In addition, management reporting lines have been simplified with certain of our smaller operations being integrated into our broadband and wireless activities. These actions will enable the group to make better use of shared resources and drive synergies across our various telecoms activities. A substantial headcount reduction and certain other actions have also been undertaken in the Service Assurance division. In total these actions, some of which were taken in 2005, are expected to deliver annualised cost savings of approximately £4 million.

Our strategy for Spirent Communications continues to be to advance next-generation technologies and services, to increase our presence internationally and to extend our products into the enterprise sector. We believe we have made progress in delivering this strategy during

Operating profit, return on sales and headline earnings per share are used by the Group as key measures of operating performance and are stated before the effect of goodwill amortisation and exceptional items so that period on period comparisons are not distorted. Free cash flow (cash flow before disposals, acquisitions, equity dividends and financing) is also a key measure.

Operating profit and return on sales in the text are stated before goodwill amortisation and operating exceptional items. In constant currencies or on a constant currency basis means calculated at constant exchange rates.

Headline earnings per share as referred to in the text is based on headline earnings as set out in note 12 to the Accounts.

2004 and, while challenges still remain for us in relation to the Service Assurance division, we are confident we now have the corporate structure and management with which to drive the group along its future development path.

Performance Analysis

Our Performance Analysis division develops solutions for testing the performance, functionality and conformance of telecoms equipment. This is achieved by simulating voice, video and data traffic and large-scale networks and by creating real-world conditions in the laboratories of network equipment manufacturers, telecoms service providers, enterprises and government departments. By subjecting equipment and networks to impairments and stresses customers are able to ensure that the equipment or services they are about to launch or deploy will withstand real-world conditions thereby reducing the commercial risks inherent in developing or adopting new products.

While overall telecoms capital spending was up modestly in 2004 our Performance Analysis division benefited directly from increased spending on next-generation and 3G wireless technologies by our customers during the year. This trend, which began to emerge towards the end of 2003, has largely been driven by the migration from legacy, circuit-switched networks to Internet Protocol (IP) or packet-based networks by telecoms service providers around the world. As a result turnover in the Performance Analysis division grew by 31 per cent in constant currencies in 2004. Operating profit of £19.7 million was up materially over 2003 reflecting the operational gearing inherent in this business as volumes increase. Return on sales recovered to 11.1 per cent for the period compared with 3.0 per cent in 2003.

Our portfolio of leading-edge products, services and solutions is well aligned with our customers' needs and in 2004 we grew sales in constant currencies in all of our product groups and across all customer sectors. In particular, we saw good demand for our core broadband access, metro Ethernet, gigabit Ethernet and IPv6 test systems, driven by the move towards higher speeds of data transmission, increased scalability and the proliferation of high bandwidth applications such as voice, video and data, generally referred to as 'triple play'. The momentum in the voice-over-IP (VoIP) services sector was behind the increased sales of our market-leading IP telephony test solutions during the year. Continuing concerns in relation to the delivery of mission critical processes over enterprise networks and websites resulted in strengthened demand for our web testing products both from network equipment manufacturers and enterprise customers.

Our wireless handset test activities, which represent approximately 23 per cent of this division's turnover, grew substantially in 2004 due largely to increased demand for our industry-leading CDMA-2000 handset test systems. Demand has been driven by the deployment of high speed 3G data services and the increased number of new mobile devices in the market. There was good growth in sales of our systems for testing advanced CDMA wireless services such as 'push-to-talk' and those utilising mobile IP, reflecting an increased focus on testing the applications that run on mobile devices. We are now a market leader in test solutions for mobile devices employing 1xEV-DO technology, an advanced 3G CDMA technology that was first used in Asia and is now undergoing deployment in the US and Europe. During the year we also made initial sales of our wideband CDMA handset testing solutions into strategic customers, including systems incorporating our leading location-based testing capability using Assisted GPS.

On a geographic basis we have seen increased turnover worldwide in constant currencies with sales particularly strong in the US where a large number of our major customers are located. Strong relationships with important local customers have led to record sales in China in 2004. In addition, the move by some of the major global network equipment manufacturers to establish quality assurance and research and development facilities in India and China has contributed to sales in the Asia Pacific region. We also delivered growth in our European sales over 2003 due to the continued roll out of advanced digital subscriber line (DSL) services in the region and good demand for our VoIP, web applications and wireless handset testing systems.

The results for our Performance Analysis division demonstrate that our strategy of providing solutions that enable customers to develop and deploy next-generation equipment and services more efficiently and economically has delivered growth. During 2005 we expect to continue to benefit from further customer spending on technologies critical to the migration to packet-based networks.

Service Assurance

Our Service Assurance division provides systems that enable telecoms service providers to test and assure broadband leased line, DSL and IP services. Our products include operations support systems software, remote test probes, network access systems and consulting and technical services. We also supply portable systems for fault identification and testing of copper telephone lines in the field. Our systems help service providers reduce their operational costs by automating and

Operating and financial review continued

centralising their network testing and service assurance processes, reducing the need for expensive physical intervention and facilitating faster responses to customers' problems.

The performance of our Service Assurance division in 2004 was affected by market pressures with turnover for the division down 10 per cent in constant currencies compared with 2003. Operating profit for 2004 was down substantially at £0.2 million compared with £9.4 million in 2003, after incurring an operating loss of £2.0 million in the second half of the year.

We continued to supply and support DSL and leased line monitoring systems for major US service providers during the year. However, sales of our leased line systems declined faster than anticipated in the period as customers increasingly focused their capital spending on advanced IP services. Service providers continue to seek to reduce the cost of deploying DSL services and we have responded to this trend by re-engineering certain elements of our offering to increase the cost effectiveness of our DSL monitoring solutions. Our hardware probes remained the largest contributor to sales in 2004 with maintenance and support contracts representing just over a quarter of this division's sales in the year. We have had success in the IP space with initial orders for SmartSight™, our recently launched IP monitoring and diagnostic system, and we have been encouraged by the levels of customer interest in this range of solutions. We expect to launch further enhancements to the SmartSight product range in 2005. Our field test business saw significant growth over 2003 driven by the shipment of a major order of portable fault testers to a leading European service provider.

The future growth of our Service Assurance division will come from the delivery of cost effective DSL monitoring solutions, success in the IP services sector and the broadening of our customer base geographically. Consequently, over the last six months we have taken several steps to realign our resources and reduce operating costs including changing the senior management, reducing employee numbers by approximately 15 per cent and redirecting marketing and product development efforts. We have increased our marketing efforts outside the US and, in particular, have adopted a direct sales strategy in China which involves exiting our joint venture, Spirent DM, and creating a direct sales force based in Beijing. We are currently actively working with a number of non-US customers to help them define their future strategy for DSL and IP service assurance.

The global telecoms sector is currently undergoing a migration from legacy networks towards IP-based networks and services. These new networks and services will require sophisticated monitoring and diagnostic systems to enable network operators to deliver the high quality, reliable telecoms services their customers have come to expect. We believe the actions we have taken in our Service Assurance division will enable us to take advantage of this trend but we are not anticipating a recovery in its performance until the latter part of 2005.

Network Products

£ million	2004	2003	Change % Reported	Change % Constant currency
Turnover	187.8	174.4	8	11
Operating profit	20.4	16.7	22	27
Return on sales (%)	10.9	9.6		

Our Network Products group produces innovative products and solutions for the fastening, identification, protection and connectivity of wires and cables in electrical and communications networks in a broad range of applications. The group operates under the global brand HellermannTyton in 30 countries worldwide and has manufacturing facilities in all the major geographic regions.

Our Network Products group delivered another strong performance in 2004 with turnover of £187.8 million up 11 per cent in constant currencies over the same period last year. Operating profit of £20.4 million was ahead by 27 per cent in constant currencies over 2003. Return on sales improved to 10.9 per cent from 9.6 per cent due to increased operational efficiencies. As anticipated, results for the second half of 2004 were marginally below the first half due to the normal seasonality of this business. Capital expenditure was up over 2003 as planned due to the expansion of capacity at our major manufacturing sites and we plan to further increase capacity in 2005.

In Europe our sales benefited from increased automotive production and our ability to increase the number of products per platform on new models. Sales in the US were up due to the general economic recovery as well as our increased penetration of the automotive and telecoms markets and successful new product introductions. Sales in Japan through our associate company showed good growth and we made progress in China due to the increasing OEM and automotive production levels in the region.

We were successful in growing sales to the automotive sector, which represents the largest proportion of this group's turnover, with increased cabling in cars driving demand for our cable management and fastening products. In addition, with the increasing trend among volume car manufacturers to move production to emerging economies, our ability to supply customers directly in these regions has helped increase sales. Sales to the heavy vehicles market were good in all regions but particularly in the US where heavy truck manufacturers increased their manufacturing volumes in the year. We increased sales in our next largest market, the electrical wholesalers and catalogue houses, although their end markets continue to be difficult. We saw growth in sales of our connectivity systems but the communications market remains very price competitive and we took actions during the year to reduce the cost base. The RapidNet pre-terminated structured cabling system launched last year has received increasing acceptance and we have secured several important installations in the enterprise and public sector markets. We also secured further deployments for Autotools, our market-leading automated bundling systems, at major automotive and white goods harness makers worldwide during the year.

Our strong customer focus, technical leadership and world class operational excellence have enabled us to capitalise on our market-leading positions in Europe, South America and the Asia Pacific region during 2004 and we expect to continue to make further progress in 2005.

Systems

£ million	2004	2003	Change % Reported	Change % Constant currency
Turnover	31.3	37.9	(17)	(14)
Operating profit	1.9	6.1	(69)	(69)
Return on sales (%)	6.1	16.1		

Figures in the above table relate to PG Drives Technology only. Divested businesses contributed £4.4 million of turnover and £0.6 million of operating profit in 2004 and £13.5 million of turnover and a £0.6 million operating loss in 2003.

After the sale of our last remaining aerospace business in August 2004, the Systems group now comprises PG Drives Technology, a leading supplier of power control systems for powered medical and small industrial vehicles. The continued weakness of the US dollar has adversely affected the trading performance of PG Drives Technology with the transaction effect reducing operating profit by approximately £3 million. Turnover and operating profit were down 14 per cent and 69 per cent, respectively, in constant currencies compared with 2003. Return on sales reduced to 6.1 per cent compared with 16.1 per cent in 2003. We have had some success in reducing our exposure to the US dollar:sterling exchange rate by increasing the number of components purchased in US dollars. We have also moved some of our production to China to reduce the logistical costs of supporting our activities in the Asia Pacific region.

Continuing constraints in US government healthcare funding for powered wheelchairs dampened demand for our wheelchair systems during the year. Due to the competitiveness of our established VSI, S-Drive and TRIO+ products we were, however, successful in increasing customer penetration in both the mobility and our new industrial vehicles markets during the year. In 2005 we are planning to launch several new products that will enable us to strengthen our position in both our addressed markets.

While results for this group are currently being affected by the weak US dollar and reduced US government healthcare funding, longer term prospects for our main mobility vehicle market remain positive, as we anticipate that increasing affluence and the desire for mobility will increase the demand for powered medical vehicles.

Financial review

Results

£ million	2004	2003	Change % Reported	Change % Constant currency
Turnover	475.0	466.2	2	9
Operating profit	42.8	36.0	19	28
Return on sales (%)	9.0	7.7		

Reported turnover for 2004 of £475.0 million was up 2 per cent and operating profit of £42.8 million was up 19 per cent compared with 2003. In constant currencies turnover was up by 9 per cent and operating profit was up by 28 per cent compared with 2003. Return on sales for the Group improved to 9.0 per cent from 7.7 per cent in 2003.

Reported results have been affected by the weakness of the US dollar relative to sterling with an average US dollar:sterling exchange rate of $1.83: £1 in 2004 compared with $1.64: £1 in 2003. In 2004 currency translation reduced turnover by £32.8 million, operating profit by £3.2 million and profit before taxation, amortisation and exceptional items by £2.5 million.

Operating and financial review continued

Turnover by source grew in constant currency terms in all geographic regions during 2004. Turnover by market grew in constant currencies in all regions except the Asia Pacific region, where growth from the Network Products group and Performance Analysis division was offset by lower demand for our Systems group's products. Operating profit by source in North America grew by 64 per cent in constant currencies compared with 2003. Operating profit also grew in the Asia Pacific region but reduced by 4 per cent in constant currencies in Europe due to the effect of the weak US dollar on trading.

Product development spending for the Group in 2004 was £67.3 million, or 14 per cent of turnover (2003 £66.0 million and 14 per cent), the large majority of which was invested in the Communications group.

A £0.7 million loss from interests in joint ventures in 2004 relates to our share of the losses in our joint venture company in China, Spirent DM. Income from interests in joint ventures reported in 2003 included our share of profits from WAGO which was divested in April 2003.

Net interest payable, excluding the exceptional interest expense, reduced to £6.8 million in 2004 compared with £9.3 million in 2003 due principally to the continued reduction in net debt during 2003 and 2004.

Profit before taxation, amortisation and exceptional items was £37.4 million compared with £30.0 million in 2003. Reported profit before taxation was £24.0 million compared with £0.3 million for 2003.

The effective rate of taxation for 2004 was 24.1 per cent compared with 27.7 per cent for 2003 as a result of the utilisation of tax losses. We anticipate that the effective tax rate for 2005 will be approximately 25 per cent.

Headline earnings per share of 2.99 pence increased by 29 per cent over 2003. The weighted average number of shares outstanding at the period end was 939.2 million (2003 929.3 million). After charging goodwill amortisation and exceptional items, basic earnings per share for 2004 was 1.70 pence (2003 loss 0.05 pence).

Net debt has reduced significantly to £26.4 million at 31 December 2004 from £57.5 million at the end of 2003. The effect of translation has reduced net debt by £5.4 million due principally to the weak US dollar.

Our borrowing covenant ratios at the year end were net interest cover of 5.8 times (covenant ratio: greater than or equal to 2.5 times) and net debt to EBITDA of 0.5 times (covenant ratio: less than or equal to 2.25 times). Having met the financial covenant requirements under the terms of our borrowings, we will revert to semi-annual covenant tests, with covenants of net interest cover of not less than 3.0 times and net debt to EBITDA of not more than 3.0 times, and certain other restrictions within our borrowing terms will be relaxed.

We were granted an order of the High Court in November 2004 confirming the cancellation of the share premium account and capital redemption reserve in order to eliminate the deficit in the Company's distributable reserves.

Exceptional items

Operating exceptional items of £2.9 million have been charged in 2004 which related to restructuring costs within our businesses and the exit from our joint venture company, Spirent DM.

Total non-operating exceptional items in 2004 were a net loss of £0.9 million. In August 2004 the remaining aerospace maintenance, repair and overhaul (MRO) business was divested for a net loss of £2.5 million after charging £4.9 million of goodwill previously written off to reserves and now reinstated in accordance with Financial Reporting Standard 10. Provisions on vacant property and accrued expenses related to prior year disposals of £1.6 million have been released.

A make-whole amount of £0.5 million has been charged as an exceptional interest expense in 2004. In 2003 we reported an exceptional interest expense of £16.1 million in relation to the make-whole amount on the partial prepayment of our senior notes and related bank fees.

Financing

During 2004 we prepaid a total of $19.4 million (£10.6 million) of our senior notes. Following this $124.8 million (£65.0 million) of notes remained outstanding at 31 December 2004. Our £30 million bank facility remained nil drawn at the end of 2004 at which point we had cash at bank and in hand of £51.7 million. A new £30 million bank facility was put in place in February 2005 and this facility has a 364-day term and a 12 month term-out option.

Further details of our treasury management and financial instruments can be found in note 29 to the Accounts.

Cash flow

In 2004 we were cash generative in all our operating groups. Operating cash flow for 2004 was down by 12 per cent at £60.3 million compared with £68.2 million in 2003 due largely to the pension payments referred to below.

Cash flow before disposals, acquisitions and financing, or free cash flow, for 2004 was £23.0 million compared with £38.2 million in 2003. Net capital expenditure increased to £24.8 million as planned compared with net £15.8 million in 2003. We expect capital investment to increase to approximately £35 million in 2005 due to investments in IT within our Communications group and the expansion of capacity within the Network Products group.

Net cash payments of tax of £3.1 million were made in 2004 compared with a net inflow of £8.9 million in 2003 when we had the benefit of a carry back of tax losses, principally in the US.

In 2004 we made our first additional annual cash contribution of £3.5 million to our defined benefit UK pension plans and we will make a similar contribution to the schemes in the first half of 2005. We also settled the liability of £3.7 million due to Nicholas Brookes, the former Chief Executive of the Company, on his retirement in respect of his unfunded unapproved retirement benefit (UURB).

Excluding the make-whole amounts, net interest payments of £7.2 million in 2004 were below the £9.5 million paid in 2003. In 2004 we paid make-whole amounts of £2.3 million, including £1.8 million accrued in 2003, on the prepayment of senior notes compared with £13.7 million paid in 2003.

Disposals and acquisitions

We divested our MRO aerospace business for net cash proceeds of £2.5 million in August 2004. During the year we acquired the minority shareholdings in two of our Network Products subsidiaries for a cash consideration of £1.1 million.

Pension fund

At the end of 2004 the pension liability reduced to £27.0 million (31 December 2003 £35.2 million), net of deferred taxation of £11.1 million (2003 £13.0 million). The assets in the schemes have increased during the year as a result of the performance of the equity markets and the Company's contribution of £3.5 million to the defined benefit UK pension plans. The Company will make a further contribution of £3.5 million to the defined benefit UK pension plans in the first half of 2005. The UURB liability of £3.7 million was settled in 2004.

Adoption of International Financial Reporting Standards

Spirent is required to comply with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) with effect from 1 January 2005. For the Spirent Group the main areas on which we expect IFRS to make an impact will be the reporting and treatment of goodwill and intangible assets, share-based payments, financial instruments and profit or loss on disposal of operations. The adoption of IFRS will not affect our position under existing borrowing covenants as they are calculated under UK GAAP as it existed at 31 December 2002 nor will IFRS change the cash flow, risk profile or economics of the business going forward.

Spirent is expecting to report two years of comparative data in accordance with the requirements for US listed companies and as a consequence the IFRS transition date for Spirent will be 1 January 2003, being the start of the earliest period of the comparative information required.

We discuss below the areas that will be affected by the adoption of IFRS compared with UK GAAP, based on IFRS expected to be in force at 31 December 2005. These are subject to ongoing review and endorsement by the EU and interpretive guidance by the International Accounting Standards Board (IASB) and are therefore still subject to change. All information provided below is for illustrative purposes only and is subject to further management review and external audit.

IFRS 3 'Business Combinations' prohibits amortisation of goodwill and requires that it be carried at cost with impairment reviews undertaken annually or when indicators of impairment exist. The Spirent Group did not make any major acquisitions in either the 2003 or 2004 accounting periods and we will apply IFRS 3 prospectively from the transition date. Goodwill amortisation charged under UK GAAP for 2003 and 2004 was £9.7 million and £9.1 million, respectively, and these charges will be reversed in the restatements under IFRS.

In accordance with IFRS 2 'Share-based Payment' a charge will be recognised for the fair value of employee stock options granted. The fair value will be calculated using a binomial model and will include all options granted since 7 November 2002 which are not vested at 1 January 2005 as allowed by the standard. The charge, which does not affect cash flow, will consequently build up over time. It is expected to be minimal for 2003 and in the region of £5 million for 2004.

Operating and financial review continued

IAS 19 'Employee Benefits' permits a number of different approaches for the accounting treatment of defined benefit pension plans. Spirent expects to adopt the approach which is similar to the UK standard Financial Reporting Standard (FRS) 17 'Retirement Benefits'. Spirent adopted FRS 17 for UK GAAP reporting in 2003.

Spirent will apply IAS 32 and 39 'Financial Instruments' prospectively, that is with effect from 1 January 2005, and hence no adjustments for financial instruments will be required in the profit and loss restatements for 2003 and 2004. The principles of IAS 39 require that financial instruments be measured at fair value. Spirent uses derivative financial instruments to hedge its exposure to fluctuations in interest and foreign exchange rates. In general the number and fair value adjustments of these transactions is relatively small and we would therefore not anticipate a significant effect on our results in respect of IAS 39 unless our activity in such instruments increases.

Goodwill written off to reserves and arising prior to 1 January 1998, which is reinstated under UK GAAP, is not reinstated in the calculation of the profit or loss on disposal of subsidiaries under IFRS. Furthermore, IAS 21 'The Effects of Changes in Foreign Exchange Rates' requires the cumulative exchange differences on foreign operations to be included in the calculation of profit or loss on disposal. These combined requirements will increase the profit reported on our disposals in 2003 by £5.0 million to £8.6 million and restate the loss reported in 2004 by £4.9 million to a profit of £4.0 million.

There will be other less significant differences between IFRS and UK GAAP and some changes to the presentation of our financial results required as a result of the restatements under IFRS.

We expect the net effect of the above adjustments will be to increase the reported level of earnings in respect of the 2003 and 2004 financial years under IFRS compared with UK GAAP. This is principally because the reversal of the goodwill amortisation charge and the adjustment in respect of the profit or loss on disposals (both excluded for headline earnings calculations, in any event), will exceed the share-based compensation charge arising under IFRS 2, the latter being a non-cash item.

Restated figures for the 2004 interim and 2004 final results will be made available before the publication of the 2005 interim results.

Dividend

In November we completed the process required to eliminate the deficit in the Company's distributable reserves. Although we are now in a position to rebuild distributable reserves through retained profits, out of which dividends may be paid, no decision to resume dividend payments has been taken by the Board.

The Board and senior management

In August 2004 Anders Gustafsson was appointed Chief Executive after the retirement of Nicholas Brookes on 30 June 2004. After joining the Group, Anders Gustafsson took over direct responsibility for Spirent Communications. In September 2004 My Chung, Executive Director of Spirent and President of Spirent Communications, resigned from the Board and we would like to thank him for his contribution to Spirent and wish him well for the future. In November William Burns was appointed President of the Service Assurance division of Spirent Communications.

In December we were delighted to announce the appointment of Kurt Hellström as a non-executive director. He was formerly President and Chief Executive Officer of Ericsson and has exceptional experience of the telecoms industry, particularly in wireless communications and the Asia Pacific market. Richard Moley will retire from the Board with effect from the date of the 2005 Annual General Meeting and we would like to thank him for his valuable contribution during his tenure as a non-executive director.

Outlook

During 2005 we expect our Performance Analysis division to benefit from further customer spending on technologies critical to the migration to packet-based networks. In our Service Assurance division we have taken actions to cut costs and reinvigorate the business, but we do not anticipate seeing a recovery in its performance until the latter part of 2005. Our Network Products group is expected to continue to make further progress in 2005.

As expected, we have had a satisfactory start to 2005 and looking ahead we anticipate further progress as we pursue our strategy of growing our communications business.

Board of directors

● Audit Committee
● Remuneration Committee
○ Nomination Committee

All the directors are considered independent of the management of the Company with the exception of Anders Gustafsson, Eric Hutchinson and Göran Ennerfelt.

Further biographical details of the directors can be found on the Company's website at www.spirent.com. The executive directors are supported by a team of senior management and their biographies can also be found on the Company's website.

Executive directors

1. Anders Gustafsson, Chief Executive (44) ○

Anders Gustafsson was appointed Chief Executive in August 2004. Prior to joining the Company he was the Senior Executive Vice President – Global Business Operations of Tellabs, Inc.

2. Eric Hutchinson, Finance Director (49)

Eric Hutchinson was appointed Finance Director in 2000, having previously been responsible for all financial reporting and control within the Group. He is also a non-executive director and Chairman of the audit committee of Trifast plc.

Non-executive directors

3. John Weston CBE, Chairman (53) ● ○

John Weston CBE was appointed non-executive Chairman in 2002 and is Chairman of the Nomination Committee. He was Chief Executive of BAE SYSTEMS plc from 1998 to 2002. He is also Chairman of Acra Controls, Inbis plc and learndirect – the University for Industry.

4. James Wyness (67) ● ● ○

James Wyness was appointed to the Board in 1979 and is the senior independent non-executive director. He was previously Managing Partner then Senior Partner of Linklaters. He is a non-executive director and was previously Chairman of Saracens Limited.

5. Marcus Beresford CBE (62) ● ● ○

Marcus Beresford CBE was appointed to the Board in 1999 and is Chairman of the Remuneration Committee. He was previously Chief Executive of GKN plc. He is also non-executive Chairman of Ricardo plc and a non-executive director of Cobham plc.

6. Frederick D'Alessio (56) ● ○

Frederick D'Alessio was appointed to the Board in January 2004. He was previously President of Advanced Services at Verizon Communications Inc. He is a general partner and founder of Capitol Management Partners and sits on the boards of SS8 Networks, Inc., Aware, Inc., Hatteras Networks, Inc. and Network Equipment Technologies, Inc.

7. Göran Ennerfelt (64) ○

Göran Ennerfelt was appointed to the Board in 2000. He is President and Chief Executive Officer of Axel Johnson AB, a member of the Axel Johnson Group. He is also Chairman of the Swedish Federation of Trade and Vice Chairman of the Confederation of Swedish Enterprise, as well as a director of Svenska Handelsbanken and the Swedish National Committee of the International Chamber of Commerce.

8. Andrew Given (57) ● ● ○

Andrew Given was appointed to the Board in 2003 and is Chairman of the Audit Committee. He was formerly Deputy Chief Executive of Logica plc. He is also the senior independent non-executive director and Chairman of the audit committees of both VT Group plc and Spectris plc.

9. Kurt Hellström (61) ● ○

Kurt Hellström was appointed to the Board in December 2004. He was formerly President and Chief Executive Officer of Ericsson. He is also a member of the board of directors of Atlas Copco AB, Bharti Tele-Ventures Limited, Kineto Wireless and Gemplus International S.A.

10. Richard Moley (65) ● ○

Richard Moley was appointed to the Board in 2000. He was previously a director and Senior Vice President of Cisco Systems, Inc. He is also a non-executive director of Linear Technologies Corporation, Echelon Corporation, Calient Systems Inc. and Polaris Networks, Inc. He will retire from the Board with effect from the date of the 2005 Annual General Meeting.

Corporate social responsibility statement

We recognise that our social, environmental and ethical conduct has an impact on our reputation. We therefore take our corporate social responsibilities (CSR) seriously and are committed to advancing our policies and systems across the Group to ensure we address and monitor all aspects of CSR that are relevant to our business. These include good ethical behaviour, concern for employee health and safety, care for the environment and community involvement.

We strive to maintain a productive and open dialogue with all parties who may have an interest in our activities including shareholders, customers, suppliers and employees. We have an established investor relations programme, conduct regular customer satisfaction surveys, monitor supplier performance and actively encourage feedback from our employees. We maintain our website as one of the main routes for providing information to interested parties and for contacting us.

The Board takes ultimate responsibility for CSR and is committed to developing and implementing appropriate policies while adhering to a fundamental commitment to create and sustain long term value for shareholders. As a Group driven largely by technological innovation our main assets are the talents and skills of the people we employ. The Board does not believe that, to date, the activities of the Group present any significant environmental risks. We have established a committee to coordinate Group-wide CSR efforts that meets on a regular basis.

Ethics

Spirent expects that all of its business is conducted in compliance with high ethical standards of business practice. We apply these standards to all dealings with employees, customers, suppliers and other stakeholders.

The Group's Ethics Policy, which has been approved by the Board, is available on our website at www.spirent.com/ethics. Our Ethics Policy has been developed to ensure that the Group's business is conducted in adherence with high ethical and legal principles and sets standards of professionalism and integrity for all employees and operations worldwide. The Ethics Policy also contains provisions for 'whistleblowing' whereby employees may report, in confidence, suspected wrongdoings.

Appropriate ethical behaviour is reviewed as part of the Group's internal control process.

Employees

The Group aims to attract, retain and motivate the highest calibre of employees within the context of an operating structure that encourages their development and initiative.

Employees are provided with a continuing learning and development opportunity to fulfil their potential and this process is managed to align development with the Group's strategic and business units' goals and objectives. Formal performance management processes are now operating in the majority of the Group, linked to the vision and values of the organisation. These processes are reinforced with appropriate remuneration and incentive systems.

The development of our performance management systems, including an online system in parts of the Group, will enable the Group to deliver appropriate training programmes which, when coupled with links to the education sector at undergraduate and postgraduate levels, reinforce our commitment to learning and development.

Management development and succession planning are processes which are recognised as being critical to the future success of the business and are managed accordingly. They are constantly re-evaluated particularly as the labour markets in which Spirent operates recover.

As the importance of human resources (HR) metrics to the strategic planning process is recognised, we are implementing a global HR system within our Communications group to help facilitate organisational development, supported by the adoption of a 'shared services' model across support functions.

Intellectual property and innovation are critical to Spirent's future success and appropriate career paths have been developed for technical staff which operate in parallel with more traditional management career paths. Initiatives such as our Engineering Fellowship Programme help to facilitate this. We also believe that it is important to reward innovation and the continuous development of the organisation and a number of recognition programmes have been implemented across the Group.

The Group is committed to providing equality of opportunity to all existing and prospective employees without unlawful or unfair discrimination. Full support is given to the employment and advancement of disabled persons and this is reinforced through the Group's Ethics Policy.

Local business unit management is responsible for developing and implementing arrangements for employee information, consultation, communication and involvement which best meet their own particular needs within the context of a Group cascade process.

Similarly, the importance of two-way communication is recognised particularly as it relates to the business and its performance. A variety of tools are utilised to achieve this including senior management briefings, 'all-hands' meetings, the regular distribution of an in-house magazine, *viewpoints*, and increasing use of online communication.

Health and safety

The Chief Executive is the director appointed by the Board to have responsibility for the health and safety and environmental performance of the Group.

The Group Health and Safety Policy places responsibility for the management of health and safety on the local business unit management, who are supported by the Group internal control team and local external advisers, where necessary.

Each business unit has a senior individual designated as being responsible for ensuring the business unit conforms to local statutory health and safety regulations as well as Group policy. All business units provide employees with a written health and safety policy.

Spirent's 'Operational Excellence Programme' which is further described in the Directors' statement on corporate governance on pages 16 to 18, continues to further the corporate objective of continuous improvement in the area of health and safety. An annual internal report on our health and safety performance is collated from a questionnaire completed by all our business units. The highlights of this report in respect of 2004 are:

– we had 405 incidents that required on-site First Aid, an 11 per cent reduction compared with 2003 and 17 per cent down on 2002;

– we saw a small increase in ill health/long term sickness levels with five cases reported compared with three in 2003 and four in 2002;

– we saw a reduction in accident frequency and severity; and

– we had two accidents that required short term hospitalisation compared with one in 2003 and none in 2002.

The business units undertake annual independent external reviews of health and safety performance and also have regular designated health and safety awareness training, particularly at our manufacturing sites.

The Group's health and safety performance and significant risk exposures are reviewed regularly by management, twice a year by the Audit Committee and annually by the Board.

Environmental

Good environmental practice and the impact that our operations have on the environment are of great importance to Spirent. The main aim of Spirent's Environmental Policy is to comply with local, state and national environmental legislation in all jurisdictions in which we operate and to adopt responsible environmental practices. The full text of our Environmental Policy is available on our website at www.spirent.com/environment.

Business units are required to comply with Group policy and local statutory regulations and are encouraged to set their own environmental targets. An annual environmental questionnaire is completed by each business unit which highlights their environmental performance.

Our Network Products group's manufacturing sites worldwide operate ISO 14001 accredited environmental management systems. In addition, various sales and distribution locations worldwide have achieved ISO 14001 accreditation and a number are working towards achieving this accreditation. The Communications group's businesses are also introducing formal environmental management systems, with a number having already achieved ISO 14001 accreditation.

The majority of Spirent Group manufacturing sites have ISO 9001 accreditation, and in the case of the Service Assurance division also TL-9000 accreditation.

Business units closely monitor energy consumption and where possible have introduced energy efficient measures, such as replacing existing equipment with more energy efficient machinery, installing light sensors and fitting temperature control devices.

A large proportion of our products are designed and manufactured to take account of the recycling and disposal of the product at the end of its life cycle. Our businesses are committed to meeting the first phase of The Waste Electrical and Electronic Equipment Regulations (the WEEE Regulations) and are working towards full compliance with The Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Regulations 2004 (the RoHS Regulations).

The environmental performance of the Group continues to improve with business units meeting goals for reducing energy consumption, reducing waste and greater recycling. There are also programmes in place aimed at reducing the amount of waste sent to landfill by increasing the volume of recycling and also training and education initiatives to promote and improve environmental performance.

The vacant site where historic activity had led to minor land contamination is continuing to be remedied with full cooperation of the local statutory body.

Group performance and risk exposure reviews are undertaken in parallel with those for health and safety as described above.

Community

Spirent recognises the importance of local communities to our businesses and through our Charitable Donations Policy we strive to be a responsible partner in the communities in which we operate. We encourage all our businesses to support the particular needs of their communities by contributing to local charities and community initiatives. Support takes the form of employee time and skills, gifts in kind and cash donations. In 2004 Spirent made charitable donations of £63,000 (2003 £63,000). In response to the tsunami disaster in South Asia the Company made a charitable contribution of £50,000 in early 2005.

In 2004 we continued to support local education through a range of initiatives including 'career shadowing days', field trips for young people and internships and work experience programmes for school and university students. During the year we supported The Duke of Edinburgh's Award programme, sponsored the Best Electronic Engineering Student at the annual Science, Engineering & Technology Student of the Year Awards and were actively involved in the Young Enterprise programme in the UK. We aim to provide support in all regions in which we operate. For example, in South Africa our employees have provided technical training for disadvantaged students through an Institute of Electricians programme.

Our employees serve our communities by volunteering their time to various programmes including Habitat for Humanity and Junior Achievement in the US. We continue to donate materials and equipment to local causes throughout the world. We encourage our employees to become involved in fund raising activities for local concerns and community initiatives. Through activities such as 'food drives', collections and sponsored events our businesses help organisations which provide food, clothing and other assistance to disadvantaged children and families around the world.

Spirent continues to support and encourage all our employees and businesses to pursue new ways of contributing to their communities.

Report of the directors

The directors present their Report and the audited consolidated accounts for the year to 31 December 2004.

Principal activities, business review and results
The principal activities, review and results for the year (inclusive of financial performance, likely future developments and prospects) are set out on pages 1 to 10. Principal divisions, subsidiaries and associates are listed on page 68.

Dividends
No interim dividend was paid during the year (2003 nil) and the directors do not recommend the payment of a final dividend (2003 nil).

Research and development
Product development and innovation are considered key strategies to maintain and improve the Group's competitive position and therefore continue to receive high priority. This commitment is highlighted by the £67.3 million research and development spend during the year, equivalent to 14 per cent of turnover (2003 £66.0 million and 14 per cent). The Company will continue to commit resources as appropriate to research and development.

Major transactions
In August 2004 the Company divested its aerospace maintenance, repair and overhaul software business from within its Systems group for net cash proceeds of £2.5 million. During 2004 the Company acquired the minority shareholdings in two Network Products subsidiaries for a cash consideration of £1.1 million. Further details of these transactions are set out in notes 32 and 33 to the Accounts.

Share capital
Changes in the Company's share capital during the period are given in note 31 to the Accounts.

Substantial shareholdings
At the date of this Report, the Company had been notified of the following interests in 3 per cent or more of its issued share capital:

	% held
Lexa BV	12.40
Barclays plc	12.04
Fidelity International Limited	6.99
Legal & General Group plc	3.13

Additional shareholder information, including a profile of shareholdings, appears on page 72.

Share listings
The primary listing for the Company's Ordinary shares is on the London Stock Exchange. The Company's Ordinary shares are also traded on the New York Stock Exchange in the form of American Depositary Shares and these are evidenced by American Depositary Receipts (ADRs), each one of which represents four Ordinary shares. The Bank of New York is the authorised Depositary bank for the Company's ADR programme.

Directors
The names and brief biographical details of the current directors are shown on page 11. All held office throughout the year and up to the date of this Report with the exception of Anders Gustafsson, who was appointed as Chief Executive and as a director of the Company on 1 August 2004, and Kurt Hellström, who was appointed as a non-executive director on 9 December 2004. Nicholas Brookes retired as Chief Executive and as a director of the Company on 30 June 2004. My Chung resigned as a director on 3 September 2004. Richard Moley will retire from the Board with effect from the date of the 2005 Annual General Meeting.

Retirement and election of directors
Pursuant to the Company's Articles of Association and the revised Combined Code on Corporate Governance (see the Directors' statement on corporate governance on pages 16 to 18), Marcus Beresford and Eric Hutchinson will retire by rotation at the Annual General Meeting (AGM) on 4 May 2005 and, being eligible, offer themselves for re-election. James Wyness, having served more than nine years on the Board, also offers himself for re-election. Having been appointed since the last AGM, Anders Gustafsson and Kurt Hellström will also retire at the forthcoming AGM and, being eligible, offer themselves for election. Anders Gustafsson and Eric Hutchinson are the only two directors subject to election or re-election who have service contracts with the Company.

Directors' interests
Göran Ennerfelt has a connected notifiable interest in the Spirent Ordinary shares held by Lexa BV (see Substantial shareholdings on this page) which, for statutory purposes, is also deemed to be an interest of the director.

The directors' interests (including those of their immediate families and any connected persons) in the share capital of the Company are set out in the Report on directors' remuneration on pages 19 to 26.

Save as disclosed, no contracts or arrangements have been entered into during the year or subsisted at the year end in which any director had, directly or indirectly, a material interest which was significant in relation to the Group's business.

Employees
The Group's employment policies regarding disabled persons and further information on employee training, development and involvement is explained in the Corporate social responsibility statement on pages 12 and 13.

Employee share schemes
The Company operates a number of share incentive schemes, details of which can be found in note 31 to the Accounts. The Company operates all employee share plans in the UK, the US and Canada.

Social responsibility and donations
The Group's Corporate social responsibility statement appears on pages 12 and 13. Charitable donations of £63,000 were made in the year (2003 £63,000). This amount excludes operating units' support and participation in local community activities. No political donations were made in the year (2003 nil).

Creditor payment policy
Group operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted and it is Group policy to comply with those terms and to make suppliers aware of them.

At 31 December 2004 the Company had an average of 54 days purchases outstanding in trade creditors (2003 52 days).

Corporate governance
The Directors' statement on corporate governance is set out on pages 16 to 18. The Statement of directors' responsibilities in respect of preparing the accounts appears below.

Going concern
After making enquiries, the directors confirm that they have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the going concern basis continues to be adopted in preparing the Accounts.

Annual General Meeting
The AGM will be held at 10.30am on Wednesday 4 May 2005 at The Copthorne Hotel (London Gatwick), Copthorne Way, Copthorne, Crawley, West Sussex RH10 3PG, United Kingdom.

Auditors
A resolution to re-appoint Ernst & Young LLP as auditors and authorising the directors to determine their remuneration will be proposed at the forthcoming AGM.

By Order of the Board

Paul Eardley
Company Secretary
24 February 2005

Statement of directors' responsibilities in respect of the accounts

The Companies Act 1985 requires directors to prepare accounts for each accounting period which give a true and fair view of the state of affairs of the Company and the Group at the end of the accounting period and of the profit or loss of the Group for that period. In preparing the accounts the directors are required to:

– select suitable accounting policies and then apply them consistently;

– make judgements and estimates that are both reasonable and prudent; and

– state whether applicable accounting standards have been followed, subject to any material departures being disclosed and explained in the notes to the accounts.

The directors are responsible for:

– keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the accounts comply with the Companies Act 1985; and

– taking reasonable steps to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Company's website. Financial information published on the website is based on legislation in the UK governing the preparation and dissemination of accounts that may be different from comparable legislation in other jurisdictions.

Directors' statement on corporate governance

The Board is committed to maintaining high standards of corporate governance, the process by which the Group is directed and managed, risks are identified and controlled and effective accountability assured. The Board considers that it has complied throughout the year under review with the requirements of the revised Combined Code on Corporate Governance (the Code) which was issued in 2003. This statement describes how the principles and provisions of corporate governance set out in the Code have been applied within the Group.

The Board

The Board comprises a non-executive Chairman, seven further non-executive directors and two executive directors, details of whom are given on page 11. The roles of Chairman and Chief Executive are separate with a clear division of responsibility between them which is set out in writing and agreed by the Board.

The size, balance and composition of the Board supports the Board's role, which is to determine the long term direction and strategy of the Group, create value for shareholders, monitor the achievement of business objectives, ensure that good corporate governance is practised and to ensure that the Group meets its other responsibilities to its shareholders, customers and other stakeholders. The Board is also responsible for ensuring that appropriate processes are in place in respect of succession planning for appointments to the Board and to senior management positions.

The non-executive directors (each appointed for an initial three year term) have a wide range of skills and experience which helps to ensure that independent judgement is exercised on issues such as strategy and performance and also that a proper balance of power is maintained for full and effective control. The non-executive directors (in particular the Chairman) devote sufficient time and attention as necessary in order to perform their duties. Other professional commitments of the non-executive directors are provided in their biographies on page 11.

The Board requires that all non-executive directors are independent in character and judgement and the independence of each director is reviewed at least annually. As Göran Ennerfelt has a material notifiable interest in the share capital of the Company (see the Report of the directors on pages 14 and 15), the Board has concluded that he is not to be considered as independent of the management of the Company. In accordance with the Code, the Board has reviewed the independence of James Wyness, who has served on the Board in excess of nine years. The review concluded that James Wyness is independent in character and in the exercise of his judgement and for these reasons the Board considers him to be independent. In accordance with the Code, James Wyness will stand for annual re-election at each Annual General Meeting (AGM).

The Board has appointed James Wyness as the senior independent director. The senior independent director is available to meet shareholders upon request if they have concerns which contact through the normal channels of the Chairman or executive directors has failed to resolve, or for which such contact is inappropriate.

It is the policy of the Board to hold at least six Board meetings a year, including a meeting to review and approve long term strategy. There were 10 Board meetings during 2004. Full attendance of the Board is expected at meetings and in 2004 all directors attended except for the following absences: Nicholas Brookes (1), My Chung (3), Marcus Beresford (2), Frederick D'Alessio (2), Göran Ennerfelt (5), Richard Moley (1) and James Wyness (1). The reasons for the absences were due to either unavoidable changes in the Board meeting calendar at short notice, the director being ill or the director having to be elsewhere for other urgent business. Where the director was absent, full documentation for the meeting was issued and briefings were provided as appropriate.

A schedule of matters specifically reserved for the Board's decision has been adopted whilst certain other responsibilities have been delegated to four standing Committees with clearly defined terms of reference which, together with the composition of each Committee, are reviewed annually. Each Committee is provided with sufficient resources so that it may undertake its duties. The terms of reference for the Audit, Remuneration and Nomination Committees are available upon request to the Company Secretary and are also available on the Company's website.

The executive directors are supported by a team of senior managers who are responsible for assisting in the development and achievement of the Group's corporate strategy, business plans, budgets and for reviewing operational and financial performance. The team, together with the executive directors, are responsible for agreeing and monitoring policies and other matters not reserved for the Board. Further details of the senior management team can be found on the Company's website.

To ensure good communication between the Board and each Committee, the Company Secretary is the appointed Secretary to all standing Board Committees.

All directors receive appropriate training and induction upon appointment and subsequently as necessary. Non-executives enhance their understanding of the Group through regular business sector presentations, the receipt of monthly reports from the Chief Executive and site visits. The Chairman and the executive directors are responsible for ensuring that the Board receives accurate and clear information in a timely manner for Board meetings and on other occasions.

The Board has established a process to evaluate the performance of the Board, its Committees and individual directors. The evaluation process includes self-assessment by the Board together with the assistance of an external adviser. Key processes include assessments of the:

– relevant contribution of the Board, each Committee, each director and the overall composition of the Board;

– effectiveness of the leadership of the Company Chairman;

– effectiveness of relationships and communications with key management; and

– quality of information provided to the Board to enable it to perform its duties.

Key outputs of the process are used to further improve areas which are working well and to address any weaknesses.

In addition to the evaluation process, the Chairman holds regular meetings with the other non-executives at which executive directors are not present. The senior independent director also holds, at least annually, a meeting of the other non-executives at which the Chairman is not present to appraise the Chairman's performance.

The Company has arranged insurance cover in respect of legal action against its directors and certain other officers. The directors also have access to the advice and services of the Company Secretary (and if necessary, access to further independent advice, at the Company's expense), who advises the Board and its Committees in respect of their procedures, directors' duties and responsibilities, corporate governance and all compliance matters. The appointment and removal of the Company Secretary is a matter reserved to the Board.

Board appointments

The Company's Articles of Association require that all directors seek election by shareholders at the first AGM following their appointment. They also require that all directors seek re-election at least every three years.

Board Committees

Acquisitions and Divestments Committee

Chairman, Anders Gustafsson

The Acquisitions and Divestments Committee comprises the executives and any two non-executive directors. The Committee is primarily concerned with the evaluation and approval of any acquisitions and divestments delegated to it by the Board.

Audit Committee

Chairman, Andrew Given

The Audit Committee comprises three independent non-executive directors. The Code requires that the Audit Committee includes a member who has recent, significant and relevant financial experience and the Board believes that Andrew Given provides such experience.

During 2004, the Committee held five meetings and there was full attendance by Committee members with the exception of Marcus Beresford who was absent for one meeting. At all meetings the external auditors, the Chief Executive, the Finance Director, the Head of Internal Control and the Head of Financial Reporting are in attendance. Other directors who are not members may attend at the invitation of the Committee Chairman. The Committee also meets with the external auditors in private for part of each meeting.

The Committee reviews all published accounts and post audit findings before their presentation to the Board, focusing in particular on accounting policies, compliance, management judgement and estimates. It also monitors the Group's internal control and risk management regime (including the effectiveness of the internal audit function) and financial reporting. Any significant findings or identified weaknesses are closely examined so that appropriate action can be taken, monitored and reported to the Board.

The Audit Committee also advises the Board on the appointment of external auditors and on the scope, results and cost effectiveness of both audit and non-audit work. The Committee has adopted a policy which prohibits certain types of non-audit work that may be performed by the Company's auditors, particularly where auditor objectivity and independence would be at risk. Other non-audit work which may be provided by the auditor is put to tender where considered appropriate. Prior to any non-audit work being awarded to the auditors, consideration is also given to costs, quality of service and efficiency. The Audit Committee also assesses the overall objectivity of the auditors' services so that an independent professional relationship is maintained. Details of the auditors' remuneration for 2004 appear in note 5 to the Accounts.

Nomination Committee

Chairman, John Weston

The Nomination Committee comprises all the non-executive directors and the Chief Executive and meets at least once a year. During 2004, the Committee held two meetings at which there was full attendance by Committee members with the exception of Nicholas Brookes, Frederick D'Alessio, Göran Ennerfelt, Andrew Given, Richard Moley and James Wyness, each of whom was absent for one meeting. The Committee is responsible for reviewing the composition and structure of the Board and for identifying and recommending candidates for executive and non-executive positions, based on the required role and capabilities which have been specified for the appointment. Executive search consultants are used by the Committee to assist this process as appropriate.

Remuneration Committee

Chairman, Marcus Beresford

The Remuneration Committee consists exclusively of independent non-executive directors. During 2004, the Committee held six meetings and there was full attendance by Committee members with the exception of Marcus Beresford and Frederick D'Alessio, each of whom was absent for one meeting. Other directors who are not members may attend at the invitation of the Committee Chairman.

No director is involved in determining his own remuneration. The Remuneration Committee has delegated responsibility for setting remuneration for all executive directors and the Chairman, whilst the Board is responsible for setting the remuneration of the non-executive directors.

Further details on the Remuneration Committee are included in the Report on directors' remuneration on pages 19 to 26.

Relations with shareholders

The Board attaches considerable importance to its relationships and communication with shareholders. Communication is facilitated by full year and interim reports issued to shareholders. Further information and services available to shareholders are described on page 72.

A valuable dialogue has been established with principal institutional investors through a programme of investor relations events throughout the year. The Company also discusses major remuneration and long term incentive proposals with principal investors prior to any required shareholder approval. In addition to a dialogue with principal shareholders, the Board also commissions external advisers to undertake investor perception reviews, the results of which are reported to the Board. All contact with institutional investors, financial analysts, fund managers, brokers and the media is controlled by written guidelines to ensure the protection of price-sensitive information during such dialogue.

It is the Company's practice to issue the Notice convening the AGM at least 20 working days before the meeting and to propose separate resolutions on each substantially separate issue. All directors are expected to attend the AGM to take any relevant questions. A report showing the number of proxy votes cast for, against and withheld for each resolution is available for shareholders attending the AGM in respect of resolutions which have been voted on by a show of hands. These results are also posted on the Company's website.

Internal control

Introduction

The Board has overall responsibility for the Group's system of internal control, which comprises a process for identifying, evaluating and managing the risks faced by the Group and for regularly reviewing its effectiveness in accordance with the Guidance for Directors on Internal Control (Turnbull). The Board confirms that this process was in place throughout the year under review and up to the date of approval of these Accounts. The primary aim is to operate a system which is appropriate to the business and which can, over time, increase shareholder value whilst safeguarding the Group's assets. The system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

Directors' statement on corporate governance continued

Process

The Group's 'Operational Excellence Programme' ensures that internal control and risk management processes continue to become embedded in the organisation. Day-to-day responsibility for effective internal control and risk monitoring rests with senior management at operating group and business unit level.

Spirent operates corporate internal control and risk management functions which report into the Head of Internal Control. The functions operate on a global basis and play a key role in providing an objective view and continuing assessment of the effectiveness of the internal control systems throughout the Group to operating management, the Audit Committee and the Board. The work programme of the functions is focused on the areas perceived to be of greatest risk to the Group and is agreed annually in advance by the Audit Committee.

The Group's system of internal control and risk management comprises an integrated risk management strategy consisting of regular self-assessment encompassing all operating units and preparation of a remedial action plan, as appropriate. This system is coordinated by Spirent's corporate internal control and risk management functions. Significant risks are also regularly reviewed by the Audit Committee and by the Board.

In addition to this process, the following key elements are critical to the overall internal control environment:

- an organisational structure with clear operating procedures, defined lines of responsibility and delegated levels of authority;
- an Ethics Policy (which has been approved by the Board), which sets standards of professionalism and integrity for all employees and operations. The Ethics Policy also includes 'whistleblowing' procedures whereby employees may report, in confidence, suspected wrongdoings;
- a comprehensive strategic planning, financial control and budgeting system which is properly documented and regularly reviewed; and
- a disciplined acquisitions and divestments due diligence process and post acquisition integration programme.

Review of effectiveness

The Board, assisted by the Audit Committee, has reviewed the effectiveness of the system of internal control for the period under review, taking account of material developments since that date using the process set out above.

US corporate governance compliance

As the Company has a secondary listing on the New York Stock Exchange (NYSE), it is subject to certain US legislation. Following the introduction of the Sarbanes-Oxley Act 2002 in the US, the NYSE introduced new corporate governance standards. Companies which do not have their primary listing on the NYSE (such as Spirent) are generally permitted to follow home country practice (ie the UK Listing Rules and the Code) in lieu of NYSE's standards. Generally, NYSE's corporate governance standards do not vary significantly from those adopted in the UK, however, NYSE rules require any such significant variances to be disclosed. Following a review of the NYSE corporate governance standards, the following are considered significant variances to home country practice:

- NYSE rules provide that nomination committees should consist entirely of independent directors. Spirent's Nomination Committee (whose constitution is in accordance with the Code) includes Anders Gustafsson and Göran Ennerfelt, neither of whom are independent;
- NYSE rules provide that nomination/corporate governance committees are responsible for developing and recommending to the Board a set of corporate governance principles applicable to the Company. Spirent, however, reserves these responsibilities for the whole Board (in accordance with the Code); and
- NYSE rules require audit committees to be directly responsible for the appointment and retention of the Company's external auditor. Spirent's Audit Committee, in accordance with the Code, however, is responsible for making recommendations to the Board on the appointment and retention of the auditor.

In accordance with NYSE requirements, the above summary of significant variances in corporate governance practices can be found on the Company's website at www.spirent.com/corporategovernance

Pensions governance

The Group's principal pension and retirement schemes exist in the UK and the US. Scheme funds are held separately from those of the Group and are administered by Trustees (which include employees and independent members). The schemes do not lend money or lease any assets to the Group.

Reporting

The Statement of directors' responsibilities in respect of preparing the accounts is set out on page 15. A report by the auditors, Ernst & Young LLP, which includes details of their responsibilities in respect of the Company's compliance with the Code, is set out on page 27.

Report on directors' remuneration

1. Introduction and compliance

This Report has been prepared by the Remuneration Committee (the Committee) and approved by the Board in compliance with statutory requirements and the Combined Code on Corporate Governance (the Code) issued in 2003.

The Board considers that it has complied throughout the year under review with the requirements of the Code. The Directors' statement on corporate governance and this Report describe how the principles of corporate governance set out in the Code have been applied within the Group.

2. Role and remit of the Remuneration Committee

The composition of the Committee, made up wholly of independent non-executive directors, is given on page 11. The Committee makes recommendations to the Board on the Company's policy and framework of executive directors' remuneration and its cost. The Committee also determines the remuneration of each executive director and certain other senior executives. In addition, the Committee is responsible on behalf of the Board for monitoring and managing shareholder dilution arising from share incentive plans.

In order to assist the Committee in carrying out its duties, during the year the Committee consulted on a regular basis with its independent external remuneration advisers. During the year the Committee retained Watson Wyatt (who are also consultant actuaries to the Company on pension matters) as advisers. Other advisers during the year were as follows (additional services provided, all by appointment of the Company, are shown alongside in brackets):

– JPMorgan Cazenove Limited (who are one of the Company's brokers);

– Kepler Associates; and

– Linklaters (who are one of the Company's legal advisers).

The Committee also consulted with the Company's Head of Compensation and Benefits and the Company Secretary regarding remuneration and related corporate governance issues. In addition, with respect to the remuneration of senior executives (for whom the Company's remuneration policy also applies, see below), the Committee also consulted with the Chief Executive.

3. Remuneration policy

The Company's remuneration policy, which has not changed during the year and will apply for the following financial year, is to:

– attract, retain and motivate the high calibre professional, managerial and technological expertise necessary to realise the Group's business objectives without paying excessively;

– ensure that the remuneration framework and its constituent reward elements are competitive and where appropriate reflect the international nature of the Group's business and the markets within which it operates; and

– maintain the correct balance and linkage between individual and business performance so as to align the interests of the executive with those of shareholders, particularly that of enhancing shareholder value.

The Committee has developed remuneration packages that fit this policy on an integrated and total reward basis. This is achieved by providing base salary plus benefits, pension benefits, an annual short term incentive bonus and discretionary awards under the Company's share incentive plans, the latter two elements of which are performance-related. In normal circumstances, it is the Committee's policy that at least 50 per cent of an executive director's target total annual remuneration package is based on performance-related elements. The recent history of the Company's share price volatility and its consequent impact on the 'value' of the long term incentive component of the total remuneration package means in practice that the actual balance of performance versus non-performance elements can vary from year to year. In designing the performance-related elements of remuneration, the Committee has followed the provisions set out in Schedule A to the Code.

The Committee continues to monitor and review the level and constituent elements of remuneration packages and will consult with its major institutional shareholders as appropriate with regards to any significant proposed changes.

4. Executive directors' remuneration

a) Base salary and benefits

The level of base salary is reviewed and established annually by reference to both the performance and responsibilities of the individual and prevailing market rates for executives of similar status in comparable companies. When reviewing salaries, the Committee is mindful of and sensitive to the wider scene, especially regarding employees' pay and employment conditions elsewhere in the Group. For 2004, Eric Hutchinson and My Chung were awarded increases in annual base salary of £20,000 and $20,000, respectively, bringing their total annual base salary to £270,000 and $370,000. My Chung left the Company by mutual agreement and resigned as a director in September 2004. Nicholas Brookes retired as a director of the Company in June 2004, however, no base salary increase was awarded to him during 2004 prior to his retirement.

Pension and other benefits have regard to competitor practice in the home country of each executive. Benefits include a company car or car allowance and healthcare, disability and life insurance coverage. Pension details are given in paragraphs 4(c) and 7(b).

As noted above, the Company's remuneration policy applies to the most senior managers below Board level. In respect of 2004, the total remuneration (ie base salary, bonus and taxable benefits) for the lowest paid and highest paid senior manager was £125,500 and £437,500, respectively. Average pay for these individuals was £264,548.

b) Annual and other incentive bonus schemes

The Committee reviews annual incentive bonus scheme targets and performance conditions each year to incentivise the executive to meet the short term strategic objectives of the Company.

In respect of 2004, Eric Hutchinson participated in an annual scheme which, consistent with UK market practice and levels, was structured around a formula providing for an on-target performance bonus of 50 per cent of base salary with a maximum of 100 per cent of base salary for exceptional performance. Performance was measured against targets in the Company's headline earnings per share (EPS) and cash flow, accounting for 80 per cent and 20 per cent of any bonus, respectively. During the year, he earned an annual bonus of £270,000, equivalent to 100 per cent of base salary.

The Committee also awarded Eric Hutchinson an additional payment of £14,167 in respect of his additional duties as acting Chief Executive for the interim period between the retirement of Nicholas Brookes and the appointment of Anders Gustafsson.

Report on directors' remuneration continued

4. Executive directors' remuneration continued

Anders Gustafsson was appointed Chief Executive in August 2004 and participated in the same annual bonus arrangements as Eric Hutchinson on a pro-rata basis for the year. He was entitled to a guaranteed minimum on-target performance bonus (pro-rated for the year) in respect of 2004. He earned an annual bonus of £183,300, equivalent to 100 per cent of base salary pro-rated for the year.

As part of his joining arrangements, and in order to provide one time only compensation for the loss of certain benefits from his previous position, Anders Gustafsson received other awards. He received a conditional award over Spirent shares to a value of £100,000 upon his appointment. The shares will be held in a trust for three years, as detailed in paragraph 7(a) below. He was also awarded a signing bonus of £100,000 upon his appointment. The signing bonus is repayable to the Company if his employment terminates before the first anniversary for any reason other than death, disability or certain other events.

My Chung (who was US based) resigned as a director in September 2004 and participated in an annual bonus scheme which was apportioned pro-rata until the date of his resignation. Consistent with US market practice and levels, for 2004 he had a target bonus opportunity of 50 per cent with a maximum opportunity of 200 per cent of salary for exceptional performance. Performance was measured against profit targets and cash generation targets for the Communications group, accounting for 80 per cent and 20 per cent of any bonus, respectively. He earned an annual bonus of \$123,333 (£67,395 using an exchange rate of £1 = \$1.83), which was equivalent to 50 per cent of base salary pro-rated for the period he served as a director during the year.

Nicholas Brookes did not participate in an annual bonus plan in respect of 2004.

c) Directors' pensions

Eric Hutchinson participates in the non-contributory funded senior executive level of the Spirent Group Staff Pension and Life Assurance Plan (the Staff Plan). This defined benefit arrangement will provide him at normal retirement age of 60, and dependent on length of service, with a pension of up to two-thirds of salary, subject to Inland Revenue limits and other statutory conditions. It also provides for dependants' pensions and a cash lump sum on death. Pensionable salary is the director's base salary only.

Nicholas Brookes, who retired in June 2004, also participated in the Staff Plan up until his retirement. The Company undertook to Nicholas Brookes, whose salary for approved pension purposes under the Staff Plan was capped by the provisions of the Finance Act 1989 (£99,000 and £102,000 for the tax years 2003/2004 and 2004/2005, respectively), that his benefit entitlements shall be as if the 'cap' did not apply.

The Company had a contractual liability, as disclosed in previous annual reports, to pay Nicholas Brookes an unfunded unapproved retirement benefit (UURB) which was agreed when he joined the Company in 1995. It was agreed to commute all of his pension entitlement under the UURB in exchange for a lump sum payment of £3.7 million in cash, which was paid to him upon his retirement.

Anders Gustafsson is entitled to receive from the Company a pension contribution of 30 per cent of basic salary. Subject to statutory limits the Company makes approved contributions into the executive section of the Spirent Retirement Cash and Life Assurance Plan (the Cash Plan). The Executive section of the Cash Plan is non-contributory and provides benefits on a defined contribution basis. Contributions to the Cash Plan are held in an individual account and invested in accordance with member elections. The Cash Plan provides for a dependant's pension and a cash lump sum on death in service. In respect of those contributions which are not paid into the Cash Plan the Company has established an UURB on a defined contribution basis and the UURB balance is credited with interest.

My Chung participated in the Spirent International Inc Retirement and Profit Share Plan, a defined contribution plan approved under section 401(k) of the US Internal Revenue Code (the IR Code). The Company made matching contributions of up to 2 per cent and was permitted to make discretionary profit sharing contributions of up to 8 per cent of the maximum compensation permitted for these purposes under the IR Code. Under the IR Code, the maximum annual amount of an employee's compensation that can be taken into account in determining the employer's contribution is \$205,000 in respect of 2004. The normal retirement age under this plan is 65 and, consistent with local practice, bonuses were pensionable for all participating US employees, including My Chung.

During 2004, the Committee conducted a review of UK executive pension provisions in the light of the Government's tax simplification changes, which are expected to come into effect in April 2006. The Committee concluded, as a principle, that it would not be appropriate for the Company to provide additional compensation to executives who would be adversely affected. In respect of existing members of the Company's defined benefit arrangements, the Committee has concluded that no material changes will be made to existing arrangements. In determining arrangements for Anders Gustafsson, the implications of the tax simplification changes were taken into account as part of the Committee's deliberations on an appropriate remuneration package when he joined the Company.

Further details of pension contributions and payments are given in paragraphs 6(b) and 6(c).

d) Medium and long term incentive plans

The Committee approves the grant of all options under the Executive Share Option Scheme (ESOS) and the Spirent Stock Incentive Plan (SSIP) in which executive directors participate (see below). The SSIP was formerly known as the Spirent Stock Option Plan. All grants are subject to prior satisfactory individual performance and grant amounts vary with the individual's potential impact on longer term business results.

The executives are also eligible to participate in the Company's all employee share plans (further details of which are provided in note 31 to the Accounts).

Executive Share Option Scheme

As stated in the circular to shareholders dated 2 June 2004 regarding an Extraordinary General Meeting, authority for granting further options under the ESOS expires during 2005 and no further annual grants will be made under the ESOS prior to its expiry. A replacement to the ESOS will be proposed in due course.

All executive directors who served during the year participated in the ESOS. All ESOS grants made after 11 May 2000 to executive directors are subject to enhanced performance conditions on exercise. The performance conditions require the Company's headline EPS to increase over a period of three consecutive financial years within a range of 9 per cent (minimum performance for 25 per cent option vesting) and 15 per cent (for 100 per cent option vesting), with a sliding scale between these points. In addition, performance testing over the 10 year option term is measured from a base point fixed at the date of grant. Performance will be tested on the third anniversary of grant and, if the target conditions at that time have not yet been met in full, performance will be tested again on the fourth and fifth anniversaries of grant only, with the performance hurdle being increased in proportion to the extended period. The Committee recognises that some shareholders have expressed concern in respect of retesting on performance conditions and this will be reflected in the proposals for a replacement ESOS when the current scheme expires later in 2005.

The current scheme allows executive directors to receive annual awards of options up to three times base salary, however, in determining any award the Committee will have regards to prevailing relevant circumstances.

ESOS grants made before 11 May 2000 to executive directors are subject to a performance condition which was in line with prevailing market practice at that time. The performance condition on exercise is that, over a period of three consecutive financial years, there has been an increase in the Company's headline EPS which is at least 6 per cent more than the increase in the Retail Price Index over the same period. The same performance condition is tested on the third anniversary of grant and, if the performance condition has not been met at that time, at each subsequent anniversary of grant until the expiry of the option (on the tenth anniversary of grant).

Spirent Stock Incentive Plan

The SSIP was approved by shareholders in June 2004 for Communications group employees. My Chung, who was Group President of Spirent Communications and a director of the Company until September 2004, participated in the SSIP.

SSIP awards prior to June 2004 normally vest over four years, with 25 per cent exercisable on the first anniversary of the date of grant, and thereafter in equal proportions on a monthly basis. In line with prevailing market practice and as previously approved by shareholders, no pre-exercise performance conditions attach to SSIP awards granted prior to June 2004.

From June 2004, SSIP awards granted to senior Communications group executives, including My Chung, were exercisable only on the achievement of performance conditions. The present four year vesting has been retained but awards vest (ie become exercisable) at 25 per cent per annum provided targets in EPS growth are met. The targets are broadly the annual equivalent to those which currently exist for executive directors under the ESOS.

Further information on the ESOS and SSIP is provided in note 31 to the Accounts.

The Committee believes that the grant structure, performance conditions and grant levels under the ESOS and SSIP have represented the most appropriate medium to long term incentive arrangements enabling Spirent to compete for, motivate and retain the highest calibre executives which it needs to drive the business forward and increase shareholder value.

In order to assist further in aligning the interests of executives and shareholders, shareholding guidelines are in place which encourage executive directors and certain senior managers to build up a meaningful level of shareholding of up to two times salary through the retention of shares following exercise. Attainment of these guidelines will be taken into account by the Committee in determining future awards for executive directors and senior managers.

As a result of the transition to International Financial Reporting Standards, the Committee has resolved that it will adjust as necessary EPS performance condition measurements in respect of outstanding options to ensure that performance is measured on a consistent basis.

e) Service contracts

The Committee's policy is to offer service contracts which provide for no more than 12 months' notice from the Company in normal circumstances.

Nicholas Brookes retired from the Board in June 2004 and had entered into a service contract on 5 May 1995 (which was amended on 1 January 2003) which was terminable at any time by either party on 12 months' notice. Eric Hutchinson entered into a service contract on 13 December 1999 which currently has an unexpired term of 122 months and is terminable at any time by either party on 12 months' notice. My Chung resigned from the Board in September 2004 and had entered into a service contract on 9 May 2001 which was terminable at any time by the Company on 12 months' notice and by him on six months' notice. Anders Gustafsson entered into a service contract on 1 August 2004 which currently has an unexpired term of 186 months and is terminable by the Company on 12 months' notice and by him on six months' notice.

All contracts contain provisions for the Company to make payment in lieu of notice and for removal of the director for poor performance or misconduct without compensation. The Company will seek to apply practical mitigation measures to any payment of compensation on termination, taking into account all relevant circumstances. All service contracts contain appropriate provisions to protect the legitimate interests of the Company with respect to preventing any terminated director from working in a business which competes against the Company. Service contracts do not contain any compensation rights which could be increased on a change of control in the Company.

f) External appointments

Spirent recognises the mutual benefit for executive directors to serve as non-executives of companies in other industries outside the Group. Such appointments are subject to prior Board approval and any related fee entitlements are for the account of the executive concerned. In June 2004 Eric Hutchinson joined the board of Trifast plc as a non-executive director and received fees of £14,596 arising from this appointment.

5. Non-executive directors' remuneration

The remuneration of the Chairman is determined by the Committee and the remuneration of the other non-executive directors is determined by the Board. The remuneration of all non-executive directors is reviewed following a recommendation by the Chief Executive and after consultation with independent external advisers concerning competitive market practice. The Company's remuneration policy (which has not changed during the year and will apply for the following financial year) with regards to non-executive directors is to pay fees which are in line with market practice. No remuneration increase was awarded in respect of 2004.

Non-executive directors are not eligible to participate in bonus or share incentive arrangements and their service does not qualify for pension purposes or other benefits. No element of their fees is performance-related. Non-executive directors do not have service contracts and are normally appointed, subject to the Company's Articles of Association, for an initial three year term. Any subsequent extension to the term by the Board is not automatic and is subject to prior recommendation of the Nomination Committee.

Further information on non-executive directors' fees is provided in paragraph 6(a) below.

Report on directors' remuneration continued

6. Directors' remuneration[1]

a) Individual and total remuneration of the directors holding office during 2004

	Salary £000	Fees[2] £000	Taxable benefits[3] £000	Bonus[4] £000	Total[5] 2004 £000	Total[5] 2003 £000
Executive directors						
N Brookes	250.0	0.1	22.1	23.3	295.5	744.7
M Chung[6]	337.0	–	16.9	90.0	443.9	275.3
A Gustafsson	183.3	–	117.0	283.3	583.6	–
E Hutchinson[7]	270.0	0.5	20.3	294.9	585.7	398.7
Non-executive directors						
M Beresford	–	37.0	–	–	37.0	37.0
F D'Alessio	–	32.6	–	–	32.6	–
G Ennerfelt	–	30.0	–	–	30.0	30.0
A Given	–	37.0	–	–	37.0	8.5
K Hellström	–	1.9	–	–	1.9	–
R Moley	–	35.0	–	–	35.0	35.0
J Weston	–	150.0	–	–	150.0	150.0
J Wyness	–	37.0	–	–	37.0	37.0
P Cheng	–	–	–	–	–	35.0
Total 2004	1,040.3	361.1	176.3	691.5	2,269.2	1,751.2
Total 2003	963.4	334.0	86.1	367.7	1,751.2	

Notes

1 Information relating to directors' remuneration has been audited by the Company's auditors.

2 Nicholas Brookes and Eric Hutchinson earned these fees in respect of their services to the Board and its Committees. The non-executive directors receive a basic annual fee of £30,000 in respect of their services. John Weston receives an annual fee of £150,000 which covers both his basic annual fee and his additional duties as Chairman. Andrew Given and Marcus Beresford each received an additional £7,000 per annum in recognition of their extra responsibilities as Chairmen of the Audit Committee and Remuneration Committee, respectively. An additional annual fee, equivalent to that paid to the Chairman of the Audit or Remuneration Committee, is paid to the senior independent director (currently James Wyness). Richard Moley and Frederick D'Alessio each received an additional £5,000 per annum in recognition of the extensive international travelling commitment required to perform their duties.

3 Taxable benefits include a company car or car allowance and life, disability and healthcare insurance coverage, personal tax advice and premiums for life assurance.

In accordance with the Company's normal policy it was agreed to meet the costs, subject to a cap, of Anders Gustafsson relocating from the US to the UK in order to commence his appointment and these costs are included in his taxable benefits.

4 In 2001, Nicholas Brookes, My Chung and Eric Hutchinson each received deferred cash bonus awards which were held as Ordinary shares on a non-beneficial basis (see paragraph 7(a) below for further details). The shares were released to the respective directors during 2004 and the market value of those shares at the time of release is included in the bonus figures above.

Further details of the annual bonuses earned by the executive directors who served during the year are provided in paragraph 4(b) above. In 2003, Nicholas Brookes, My Chung and Eric Hutchinson earned annual bonuses of £200,000, £42,700 and £125,000, respectively.

5 The figures relate to the period of each director's Board membership. Andrew Given, Frederick D'Alessio, Anders Gustafsson and Kurt Hellström were appointed to the Board in October 2003, January 2004, August 2004 and December 2004, respectively. Paul Cheng, Nicholas Brookes and My Chung either retired or resigned as directors in December 2003, June 2004 and September 2004, respectively.

6 My Chung resigned as a director of the Company in September 2004 and received his annual base salary in US dollars (2004 $370,000 per annum; 2003 $350,000 per annum). An average exchange rate of £1 = $1.83 was used in respect of 2004 remuneration (2003 £1 = $1.64). 2004 salary relates to base salary of £134,800 for the period until his resignation from the Board plus £202,200, being the equivalent of 12 months' salary in accordance with the termination provisions of his service contract.

7 Remuneration as shown above excludes fees received as a result of external appointments (see paragraph 4(f) above).

b) Directors' pensions

The pensions earned from the non-contributory defined benefit arrangements in place for the participating executive directors during 2004 were as follows:

	Age at 31 December 2004	Years of pensionable service	Increase in accrued pension during the year £000	Increase, before inflation, in accrued pension during the year £000	Accumulated total accrued pension At 31 December 2004[1] £000	At 31 December 2003 £000
N Brookes[2]	57	17	8.3	3.3	286.1	277.8
E Hutchinson	49	20	12.3	6.5	180.0	166.7

	Transfer value of the increase in accrued pension[3] £000	Transfer value, before inflation, of the increase in accrued pension[3] £000	Total transfer value of pension[3] At 31 December 2004 £000	At 1 January 2004 £000	Increase in total transfer value of pension during the year £000	Increase, before inflation, in total transfer value of pension during the year £000
N Brookes[2]	144.0	55.3	5,078	4,876	201.6	113.9
E Hutchinson	151.6	79.7	2,213	1,811	401.5	338.3

Notes

1 The pension entitlements shown are those which would be paid annually from normal retirement age of 60 based on service to 31 December 2004. Eric Hutchinson's total accrued pension is restricted to 20 years' service.

2 Nicholas Brookes retired as a director and Chief Executive in June 2004 and the above figures relate to the period up to the date of his retirement. See paragraph 4(c) above for further information in respect of the unfunded pension provision relating to his pension undertaking in excess of the statutory earnings cap.

3 The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and represents a liability of the Company (in respect of unfunded arrangements) and of the Staff Plan (in respect of funded arrangements), not a sum paid or due to the individual. The transfer value cannot therefore be meaningfully added to annual remuneration.

4 No additional voluntary contributions have been included in the above table.

c) Directors' remuneration and payments to former directors – summary

	2004[1] £000	2003[1] £000
Total emoluments of all directors	2,269	1,751
Gains made on exercise of share options[2]	8	1
Company contribution to 401(k) Retirement and Profit Share Plan[2]	11	12
Company contribution to the Cash Plan in respect of pensions[3]	11	–
Ex gratia pension to former director[4]	5	5
	2,304	1,769

Notes

1 Figures relate to the period of each director's Board membership.

2 Prevailing average conversion rates of £1 = $1.64 and £1 = $1.83 were used for 2003 and 2004, respectively. These relate to My Chung.

3 These payments relate to Anders Gustafsson.

4 This relates to an annual ex gratia pension to Geoff Bastians, who retired from the Board in 1984.

Report on directors' remuneration continued

7. Directors' interests[1]

a) Summary of interests in Ordinary share capital

The beneficial and non-beneficial interests of the directors (and their immediate families and any connected persons) in the Ordinary share capital of the Company at the beginning and end of the year are set out below. The Company's statutory register of directors' interests contains full details of directors' shareholdings and options over shares and is available for inspection at the registered office during normal business hours on any business day.

	At 31 December 2004[2]			At 1 January 2004[2]		
	Ordinary shares beneficial[3]	Ordinary shares non-beneficial	Options and rights to acquire Ordinary shares	Ordinary shares beneficial[3]	Ordinary shares non-beneficial	Options and rights to acquire Ordinary shares
Executive directors[4]						
N Brookes	2,973,398	–	3,583,990	2,947,083	26,315[5]	3,602,135
M Chung	75,721	–	2,341,327	31,377	39,620[6]	3,174,349
A Gustafsson	–	180,180[6]	1,800,000	–	–	–
E Hutchinson	738,381	–	3,282,447	726,210	12,171[5]	2,154,447
Non-executive directors						
M Beresford	65,225	–	–	65,225	–	–
F D'Alessio	28,000	–	–	–	–	–
G Ennerfelt[7]	119,000,000	–	–	119,000,000	–	–
A Given	–	–	–	–	–	–
K Hellström	–	–	–	–	–	–
R Moley	1,010,000	–	–	1,010,000	–	–
J Weston	1,600,000	–	–	1,600,000	–	–
J Wyness	346,037	–	–	346,037	–	–

Notes

1 Information relating to directors' interests has been audited by the Company's auditors.

2 The figures relate to the period of each director's Board membership. Frederick D'Alessio, Anders Gustafsson and Kurt Hellström were appointed to the Board in January 2004, August 2004 and December 2004, respectively. Nicholas Brookes retired and My Chung resigned as directors in June 2004 and September 2004, respectively.

3 Directors' beneficial holdings do not form part of the remuneration provided by the Company.

4 The Company's executive directors, with other employees of the Group, are potential beneficiaries of certain Ordinary shares held in the Employee Share Ownership Trust (ESOT). The UK executive directors, with other employees of the Group, are also potential beneficiaries of the Spirent Sharesave Trust (SST), which was formerly known as the Spirent Qualifying Employee Share Ownership Trust. As potential beneficiaries of the ESOT and the SST, the respective directors are deemed by the Companies Act 1985 to be interested in some of the Ordinary shares held by those Trusts. At 31 December 2004, the deemed beneficial interests in the ESOT and the SST were 259,066 Ordinary shares and 3,508,136 Ordinary shares, respectively (31 December 2003 281,626 and 3,508,136, respectively). Further details on the Company's share plans are provided in note 31 to the Accounts. The deemed interests of the executive directors in respect of the shares held in the ESOT and the SST are not included in the table above.

5 The non-beneficial interests of Nicholas Brookes and Eric Hutchinson represented their respective £100,000 and £46,250 deferred cash bonus awards made under the terms of the annual incentive bonus plan for 2000. The bonuses were used to purchase shares in the market in 2001 and the shares were held in the ESOT for a period of three years from that date. The directors obtained a beneficial interest in the shares when they were released from the ESOT in 2004 following completion of the three year deferment period.

6 The non-beneficial interests of My Chung and Anders Gustafsson over 39,620 shares and 180,180 shares, respectively, exist in a similar manner to that described in note 5 above except that My Chung's interest arises from a deferred cash bonus of $175,000 and Anders Gustafsson's interest arises from a conditional award over shares to a value of £100,000. The awards were made to My Chung and Anders Gustafsson in 2001 and 2004, respectively, both in recognition of their appointments to the Board. My Chung obtained a beneficial interest in the shares when they were released from the ESOT in 2004 (on the third anniversary of his appointment to the Board). Anders Gustafsson's shares will be released beneficially to him from the ESOT on the third anniversary of his appointment, subject to him still being in the Company's employment at that time.

7 Göran Ennerfelt has a connected notifiable interest in the Spirent Ordinary shares held by Lexa BV (see the Report of the directors on pages 14 and 15) which, for statutory purposes, is also deemed to be an interest of the director.

b) Options and rights to acquire Ordinary shares

	Plan type[1]	At 31 December 2004[2]	Exercised/lapsed during the year	Granted during the year	At 1 January 2004[2]	Date of grant	Exercise price per share pence	Date first exercisable	Expiry date
N Brookes	ESOS	221,068	–	–	221,068	30.09.96	136	30.09.99	29.06.05
	ESOS	30,410	–	–	30,410	23.04.97	118	23.04.00	29.06.05
	ESOS	43,922	–	–	43,922	27.04.98	152	27.04.01	29.06.05
	ESOS	149,590	–	–	149,590	11.05.00	334	11.05.03	29.06.05
	ESOS	205,000	–	–	205,000	09.04.01	305	09.04.04	29.06.05
	SRSOS[3]	–	18,145	–	18,145	05.10.01	93	–	30.06.04
	ESOS	468,000	–	–	468,000	02.04.02	134	30.06.04	01.10.05
	ESOS	774,000	–	–	774,000	02.05.02	113	30.06.04	01.11.05
	ESOS	1,692,000	–	–	1,692,000	25.03.03	16	30.06.04	24.09.06
M Chung	ESOS	93,482	–	–	93,482	16.07.98	163	16.07.01	31.12.05
	ESOS	112,734	–	–	112,734	01.04.99	133	01.04.02	31.12.05
	ESOS	65,819	–	–	65,819	11.05.00	334	11.05.03	31.12.05
	SSIP	341,921	–	–	341,921	11.05.00	334	11.05.01	01.03.05
	SARP	42,740	–	–	42,740	12.05.00	335	12.05.01	01.03.05
	SSIP	250,000	–	–	250,000	08.12.00	613	08.12.01	01.03.05
	ESOS	80,000	–	–	80,000	09.04.01	305	09.04.04	31.12.05
	SSIP	178,747	16,253	–	195,000	09.04.01	305	09.04.02	01.03.05
	SSIP	499,995	250,005	–	750,000	02.04.02	134	02.04.03	01.03.05
	ESPP[4]	–	17,328	–	17,653	01.01.03	14	01.01.04	01.01.04
	ESOS	225,000	–	–	225,000	25.03.03	16	31.12.04	31.12.05
	SSIP	437,497	562,503	–	1,000,000	25.03.03	16	25.03.04	01.03.05
	ESPP	13,392	–	13,392	–	01.01.04	50	05.01.05	05.01.05
	SSIP[3]	–	600,000	600,000	–	05.08.04	56	–	31.12.04
A Gustafsson	ESOS	1,800,000	–	1,800,000	–	05.08.04	56	05.08.07	04.08.14
E Hutchinson	ESOS	17,652	–	–	17,652	27.04.95	108	27.04.98	26.04.05
	ESOS	42,928	–	–	42,928	29.04.96	140	29.04.99	28.04.06
	ESOS	33,786	–	–	33,786	23.04.97	118	23.04.00	22.04.07
	ESOS	29,586	–	–	29,586	27.04.98	152	27.04.01	26.04.08
	SRSOS	12,363	–	–	12,363	22.10.98	83	01.01.06	30.06.06
	ESOS	75,156	–	–	75,156	01.04.99	133	01.04.02	31.03.09
	ESOS	55,562	–	–	55,562	11.05.00	334	11.05.03	10.05.10
	ESOS	105,000	–	–	105,000	09.04.01	305	09.04.04	08.04.11
	SRSOS	8,693	–	–	8,693	05.10.01	93	01.12.08	31.05.09
	ESOS	234,000	–	–	234,000	02.04.02	134	02.04.05	01.04.12
	ESOS	387,000	–	–	387,000	02.05.02	113	02.05.05	01.05.12
	ESOS	1,128,000	–	–	1,128,000	25.03.03	16	25.03.06	24.03.13
	SRSOS	24,721	–	–	24,721	26.09.03	38	01.12.10	31.05.11
	ESOS	1,128,000	–	1,128,000	–	05.08.04	56	05.08.07	04.08.14

Notes

1 Key to plan type:
ESOS – Executive Share Option Scheme; ESPP – US Employee Stock Purchase Plan; SARP – Stock Appreciation Rights Plan; SRSOS – UK Savings Related Share Option Scheme; SSIP – Spirent Stock Incentive Plan (formerly known as the Spirent Stock Option Plan).

An explanation of each plan and its operation is given in note 31 to the Accounts.

2 Figures relate to the period of each director's Board membership.

3 The options expired prior to the date first exercisable.

4 The final exercise price and number of purchase rights under the ESPP, an all employee share plan, cannot be determined until maturity (ie 12 months following the date of grant). The purchase rights granted calculation was based on the market price of an Ordinary share (less a 15 per cent discount) at the date of grant and the rate of exchange between the US dollar and sterling on the date of grant. In accordance with the rules of the ESPP, My Chung's purchase rights were exercised automatically as part of a maturity on 1 January 2004 over 17,328 Ordinary shares in respect to his 2003 ESPP account. The small difference between the rights outstanding at the year end and the amount purchased was caused by exchange rate fluctuations between the US dollar and sterling.

Report on directors' remuneration continued

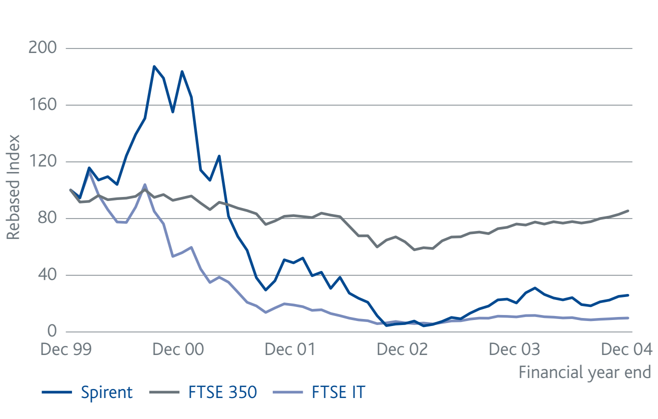
7. Directors' interests continued

The middle market price of an Ordinary share on 2 January 2004 (the London Stock Exchange having been closed for trading on 1 January 2004) and 31 December 2004 was 58.25 pence and 73.75 pence, respectively, and during that period ranged between a high of 89.5 pence and a low of 47.75 pence.

Save as disclosed, there have been no changes between the year end and 24 February 2005 (the date on which the Accounts have been signed) in the directors' beneficial or non-beneficial interests in the Ordinary share or loan capital of the Company or any subsidiary.

8. Total Shareholder Return (TSR) performance

The graph below shows TSR performance (ie growth in the value of a share or index, assuming dividends and other distributions are reinvested) for the last five financial years of Spirent plc as shown against the FTSE 350 Index and the FTSE Information Technology Index (FTSE IT). The Committee believes that both the FTSE 350 and the FTSE IT provide broad equity market indices against which the performance of Spirent can be fairly compared, and that the FTSE IT index provides a particularly representative collection of comparator companies.



9. Shareholder advisory resolution in respect of the report on directors' remuneration

In accordance with statutory requirements, an ordinary resolution to approve this Remuneration Report will be proposed at the forthcoming 2005 Annual General Meeting.

Signed on behalf of the Board

Marcus Beresford CBE
Chairman of the Remuneration Committee
24 February 2005

Independent auditors' report to the members of Spirent plc

We have audited the Group's accounts for the year ended 31 December 2004 which comprise the Consolidated profit and loss account, Consolidated statement of total recognised gains and losses, Reconciliation of movements in shareholders' funds, Consolidated balance sheet, Consolidated cash flow statement, Reconciliation of net cash flow to movement in net debt, Company balance sheet, the related notes 1 to 34 and the schedule of Principal divisions, subsidiaries and associates. These accounts have been prepared on the basis of the accounting policies set out therein. We have also audited the information in the Report on directors' remuneration 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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Report on directors' remuneration and the accounts in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of directors' responsibilities in respect of the accounts.

Our responsibility is to audit the accounts and the part of the Report on directors' remuneration to be audited in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards and the Listing Rules of the Financial Services Authority (the Listing Rules).

We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts and the part of the Report on directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Report of the directors is not consistent with the accounts, 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 or the Listing Rules regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the Directors' statement on corporate governance reflects the Company's compliance with the nine provisions of the 2003 FRC Code on Corporate Governance 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 and consider whether it is consistent with the accounts. This other information comprises the Highlights, Our business at a glance, Chairman's letter, Chief Executive's letter, Operating and financial review, Board of directors, Corporate social responsibility statement, Report of the directors, Directors' statement on corporate governance, the unaudited part of the Report on directors' remuneration, Financial history, Shareholder information and Contact details. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts and the part of the Report on directors' remuneration to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, 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 accounts and the part of the Report on directors' remuneration 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 accounts and the part of the Report on directors' remuneration to be audited.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2004 and of the profit of the Group for the year then ended, and the accounts and the part of the Report on directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered Auditor
London
24 February 2005

Consolidated profit and loss account

Year to 31 December	Notes	2004 £ million Before exceptional items	2004 £ million Exceptional items	2004 £ million Total	2003 £ million Total
Turnover – Group and share of joint venture		475.0	–	475.0	488.6
Less share of joint venture's turnover		–	–	–	(22.4)
Turnover	2, 3	475.0	–	475.0	466.2
Cost of sales		(274.9)	–	(274.9)	(279.8)
Manufacturing margin		200.1	–	200.1	186.4
Operating expenses	4	(166.4)	(2.9)	(169.3)	(167.6)
Operating profit	2, 3, 5	33.7	(2.9)	30.8	18.8
Operating exceptional items	6	–	2.9	2.9	7.5
Goodwill amortisation		9.1	–	9.1	9.7
Operating profit before goodwill amortisation and exceptional items		42.8	–	42.8	36.0
(Loss)/income from interests in joint ventures		(0.7)	–	(0.7)	2.7
Income from interests in associates		2.8	–	2.8	2.1
Operating profit of the Group, joint ventures and associates		35.8	(2.9)	32.9	23.6
Non-operating exceptional items					
(Loss)/profit on the disposal of operations	33	–	(0.9)	(0.9)	3.6
Profit before interest		35.8	(3.8)	32.0	27.2
Net interest payable	8	(6.8)	–	(6.8)	(9.3)
Exceptional interest payable	8	–	(0.5)	(0.5)	(16.1)
Other finance expense	10	(0.7)	–	(0.7)	(1.5)
Profit before taxation	2	28.3	(4.3)	24.0	0.3
Taxation	11	(7.7)	–	(7.7)	(0.6)
Profit/(loss) after taxation		20.6	(4.3)	16.3	(0.3)
Minority shareholders' interest – equity				(0.3)	(0.2)
Profit/(loss) attributable to shareholders				16.0	(0.5)
Basic earnings/(loss) per share	12			1.70p	(0.05)p
Headline earnings per share	12			2.99p	2.31p
Diluted earnings/(loss) per share	12			1.67p	(0.05)p

The notes on pages 33 to 68 form part of these Accounts.

Consolidated statement of total recognised gains and losses

Year to 31 December	Notes	2004 £ million	2003 £ million
Profit/(loss) attributable to shareholders		16.0	(0.5)
Gain on lapsed options	31	1.2	1.2
Exchange adjustment on subsidiaries, joint ventures and associates	31	(0.7)	6.1
Overseas taxation on exchange adjustment		–	(0.2)
Reinstatement of deferred tax asset on pension liability	11	–	12.6
Actuarial gain recognised on the pension schemes	10, 31	3.0	0.3
Taxation on actuarial gain	11, 31	(0.9)	(0.1)
Total recognised gains and losses for the year		18.6	19.4

Reconciliation of movements in shareholders' funds

Year to 31 December	Notes	2004 £ million	2003 £ million
Shareholders' funds at 1 January		119.9	95.1
Total recognised gains and losses		18.6	19.4
Other movements			
New shares issued	31	2.1	0.7
Reversal of employee share scheme cost	31	0.2	–
Other	31	(2.0)	2.1
Goodwill on disposal of subsidiaries acquired before 1998	31	4.9	2.6
Shareholders' funds at 31 December		143.7	119.9

The notes on pages 33 to 68 form part of these Accounts.

Consolidated balance sheet

At 31 December	Notes		2004 £ million		2003 £ million
Fixed assets					
Intangible assets	13		88.8		101.6
Tangible assets	14		86.3		90.2
Investments	18				
Investment in joint venture		–		0.3	
Investment in associates		15.8		14.6	
			15.8		14.9
Total fixed assets			190.9		206.7
Current assets					
Stocks	19	54.0		55.0	
Debtors	20	89.9		86.9	
Cash at bank and in hand	22	51.7		37.6	
		195.6		179.5	
Current liabilities					
Creditors due within one year	23	(116.8)		(111.3)	
Loans and overdrafts	24	(1.8)		(1.8)	
		(118.6)		(113.1)	
Net current assets			77.0		66.4
Assets less current liabilities			267.9		273.1
Long term liabilities					
Creditors due after more than one year	25		(80.2)		(95.6)
Provisions for liabilities and charges	26				
Deferred taxation		(1.9)		(2.3)	
Other provisions		(13.8)		(17.9)	
			(15.7)		(20.2)
Assets less liabilities (excluding pension liability)			172.0		157.3
Pension liability	10		(27.0)		(35.2)
Assets less liabilities (including pension liability)			145.0		122.1
Capital and reserves	31				
Called up share capital		31.9		31.5	
Share premium account		1.3		697.5	
Capital reserve		10.9		17.7	
Capital redemption reserve		–		0.7	
Investment in own shares		–		(2.6)	
Profit and loss account		99.6		(624.9)	
Shareholders' funds – equity			143.7		119.9
Minority interests – equity			1.3		2.2
Total equity			145.0		122.1

The notes on pages 33 to 68 form part of these Accounts.

Signed on behalf of the Board

Anders Gustafsson
Director
24 February 2005

Consolidated cash flow statement

Year to 31 December	Notes	2004 £ million	2003 £ million
Net cash inflow from operating activities	7	60.3	68.2
Dividends received from associates		0.1	0.1
Returns on investments and servicing of finance	21	(9.5)	(23.2)
Taxation	21	(3.1)	8.9
Capital expenditure and financial investment	21	(24.8)	(15.8)
Acquisitions and disposals	21	1.2	60.4
Management of liquid resources	21	–	0.1
Financing	21	(9.5)	(143.6)
Net cash inflow/(outflow)		14.7	(44.9)

Reconciliation of net cash flow to movement in net debt

Year to 31 December	Notes	2004 £ million	2003 £ million
Net cash inflow/(outflow)		14.7	(44.9)
Cash outflow arising from the change in debt and lease financing		11.0	144.3
Cash inflow arising from the change in liquid resources		–	(0.1)
Movement arising from cash flows	22	25.7	99.3
Debt issue costs	22	0.3	(0.8)
New finance leases	22	(0.3)	(0.3)
Exchange adjustment	22	5.4	6.1
Movement in net debt		31.1	104.3
Net debt at 1 January	22	(57.5)	(161.8)
Net debt at 31 December	22	(26.4)	(57.5)

The notes on pages 33 to 68 form part of these Accounts.

Company balance sheet

At 31 December	Notes		2004 £ million		2003 £ million
Fixed assets					
Tangible assets	14		15.8		15.2
Shares in subsidiaries	16		263.3		542.2
Loans to subsidiaries	17		175.3		218.2
Investments	18				
Investment in associate			0.1		0.1
Total fixed assets			454.5		775.7
Current assets					
Stocks	19	8.6		3.5	
Debtors	20	25.3		18.8	
Cash at bank and in hand		28.9		13.8	
		62.8		36.1	
Current liabilities					
Creditors due within one year	23	(19.7)		(18.1)	
Net current assets			43.1		18.0
Assets less current liabilities			497.6		793.7
Long term liabilities					
Creditors due after more than one year	25		(309.3)		(595.5)
Provisions for liabilities and charges					
Other provisions	26		(2.0)		(0.5)
Assets less liabilities (excluding pension liability)			186.3		197.7
Pension liability	10		(27.0)		(35.2)
Assets less liabilities (including pension liability)			159.3		162.5
Capital and reserves	31				
Called up share capital		31.9		31.5	
Share premium account		1.3		697.5	
Capital reserve		10.9		17.7	
Capital redemption reserve		–		0.7	
Merger reserve		1.2		1.2	
Investment in own shares		–		(2.6)	
Profit and loss account		114.0		(583.5)	
Total equity			159.3		162.5

The notes on pages 33 to 68 form part of these Accounts.

Signed on behalf of the Board

Anders Gustafsson
Director
24 February 2005

Notes to the accounts

1. Accounting policies

Basis of accounting

The Accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 December each year. The Company is not required to present a separate profit and loss account as provided by Section 230 of the Companies Act 1985.

Results of subsidiaries acquired in the year are consolidated from the date of acquisition. The consolidated accounts include the Group's share of profits of its joint ventures and associates.

Associates are entities in which the Group has a continuing participating interest, other than subsidiaries, and exercises significant influence over their operating and financial policies. Results are based on management accounts to 31 December. The investment in associates is accounted for using the equity method.

Entities in which the Group holds an interest on a long term basis and which are jointly controlled by the Group and other parties are treated as joint ventures. Joint ventures are accounted for using the gross equity method. Results are based on management accounts to 31 December.

All intra group transactions, balances, income and expenses are eliminated on consolidation.

Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of transaction. The results of overseas subsidiaries, joint ventures and associates are translated into sterling using average rates.

Monetary assets and liabilities denominated in foreign currencies are translated at the rates ruling at the balance sheet date. Profits and losses arising from the re-translation of opening net assets of overseas subsidiaries, treating long term intra group loans as part of the equity investment, and exchange adjustments arising from the translation of the results of overseas subsidiaries, joint ventures and associates, are dealt with through reserves.

All other exchange profits and losses are taken to the profit and loss account, with the exception of differences on foreign currency borrowings used to finance or provide a hedge against Group equity investments in overseas subsidiaries, which are taken directly to reserves together with the exchange differences on the carrying amount of the related investments.

Financial instruments

The Group uses derivative financial instruments to hedge its exposures to fluctuations in interest and foreign exchange rates. The Group's policy is not to undertake any trading activity in financial instruments. Financial instruments will be accounted for as hedges when designated as hedges at the inception of the contract.

Forward exchange contracts are used to hedge foreign exchange exposures arising on forecast receipts and payments in foreign currencies. The rates under these contracts are used to record the hedged item, and as such gains and losses on foreign currency contracts are offset against the foreign exchange gains and losses on the related financial assets and liabilities. Where the contract is a hedge against future transactions, gains and losses are deferred until the transaction occurs.

Interest rate swaps are occasionally used to hedge the Group's exposure to movements in interest rates. Receipts and payments on interest rate instruments are recognised on an accruals basis over the life of the underlying financial instrument. Interest rate swaps are not revalued to fair value or shown in the Group balance sheet at the year end but are disclosed in the fair value table in note 29.

Gains or losses arising on hedging instruments, which are cancelled due to the termination of the underlying exposure, are taken to the profit and loss account immediately.

Finance costs associated with debt issuances are charged to the profit and loss account over the life of the instruments.

The aggregate fair values at the balance sheet date of the hedging instruments described above are disclosed in note 29.

Liquid resources include short term deposits, government securities and similar securities, which are readily convertible into known amounts of cash.

Short term debtors and creditors that meet the definition of a financial asset or liability, respectively, have been excluded from all analyses prepared under Financial Reporting Standard (FRS) 13 'Derivatives and Other Financial Instruments: Disclosures', including numerical disclosures except for the analysis of net currency exposure, as permitted by the Standard.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group, the revenue can be reliably measured and when the Group has transferred to the buyer the significant risks and rewards of ownership. In addition, revenue is only recognised when collectibility is probable.

For the sale of services, revenue is recognised in accounting periods in which the service is rendered. Revenue from maintenance contracts is recognised over the period of performance.

Revenue from product sales of hardware and software is recognised at the time of delivery and acceptance and when there are no significant vendor obligations remaining. It is not until acceptance has occurred that the risks and rewards of ownership are transferred to the buyer. Terms of acceptance are dependent upon the specific contractual arrangement agreed with the customer.

Notes to the accounts continued

1. Accounting policies continued

Contractual arrangements are accounted for as two or more separate transactions only where the commercial substance is that the individual components operate independently of each other because they are capable of being provided separately from one another and it is possible to attribute reliable fair values to every component. To the extent that a separate component comprises a product sale of hardware or software, revenue is recognised as described above. Revenue is recognised on other components as the Group fulfils its contractual obligations and to the extent that it has obtained the right to consideration.

The Group does not enter into a significant number of long term contracts. Revenue and estimated profits on long term contracts are recognised under the percentage-of-completion method of accounting. When estimates of total contract revenues and costs indicate a loss, a provision for the entire amount of the contract loss is recognised in the period in which the loss becomes evident.

The Group does not enter into bill and hold transactions.

Product development

Expenditure is charged to the profit and loss account in the year in which it is incurred.

Employee benefits

When an employee has rendered services to the Group during an accounting period, short term benefits expected to be paid in exchange for those services are recognised in the same accounting period.

Share based compensation

The Group operates a stock appreciation rights plan which gives rise to a profit and loss charge in respect of the intrinsic value of the award. This expense is charged over the vesting period.

Other share based awards do not currently attract a profit and loss charge, as, other than the SAYE schemes discussed below, shares are not granted at a discount to the market price at the date of the invitation.

The Group operates Inland Revenue approved SAYE schemes together with equivalent schemes for overseas employees that allow the grant of options at a discount to the market price at the date of the invitation. The Group and the Company have made use of the exemption under Urgent Issues Task Force (UITF) Abstract 17 'Employee Share Schemes' not to recognise any compensation charge in respect of these schemes.

These schemes are discussed in more detail in note 31.

Pension contributions

In the UK the Group operates two pension schemes for the benefit of employees. These schemes require contributions to be made to separately administered funds, based on triennial actuarial valuations. Other schemes are defined contribution in nature.

The assets of the defined benefit schemes are measured at their market value at the balance sheet date and the liabilities of the schemes are measured using the projected unit method. The discount rate used to measure the schemes' liabilities is the current rate of return on an AA corporate bond of equivalent term and currency to the liabilities. The extent to which the schemes' assets exceed or fall short of the schemes' liabilities is shown as a surplus or deficit in the balance sheet net of deferred tax.

The regular service cost of providing retirement benefits to employees in defined benefit schemes is charged to operating profit in the year together with the cost of providing benefit improvements in respect of past service and gains or losses arising on settlements and curtailments.

A credit for the expected return on the schemes' assets and a charge for the increase during the period in the present value of the schemes' liabilities because the benefits are one year closer to settlement, are included in other finance expense in the profit and loss account. Differences arising between the actual and expected returns on the schemes' assets together with changes in the actuarial assumptions are included in the statement of total recognised gains and losses.

Contributions payable to the other overseas defined contribution plans are charged to the profit and loss account in the year for which they are due.

Government grants

Government grants towards research and development costs are recognised as income over periods which match them with the related costs and are deducted in reporting the related expense.

Capital grants are treated as deferred income and are released to the profit and loss account over the estimated useful lives of the assets to which they relate.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable represents the amount expected to be paid or recovered in respect of taxable profit for the year and is calculated using tax rates that have been enacted or substantially enacted at the balance sheet date.

Deferred taxation is provided on an undiscounted basis on all timing differences that have originated but not reversed at the balance sheet date except as referred to below. Amounts provided are calculated with reference to tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Provision is made for tax that would arise on the remittance of the retained earnings of overseas subsidiaries, associates and joint ventures, only to the extent that, at the balance sheet date, the dividends have been accrued as receivable.

Deferred tax assets are recognised only to the extent that it is considered more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not provided on gains on fair value adjustments to fixed assets arising at acquisition, or gains on the disposal of fixed assets that have been rolled over into replacement assets, unless there is a binding agreement to dispose of the assets concerned. Provision will not be made where it is considered more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only when the replacement assets are sold.

Goodwill

Goodwill arising on the acquisition of subsidiaries and representing the excess of cost over the fair value of the attributable assets and liabilities acquired is capitalised as an intangible asset and amortised over its estimated useful economic life up to a maximum of 20 years. Goodwill is reviewed for impairment at the end of the first full financial year following acquisition and in other periods if events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill arising prior to 1998 and previously written off against reserves, has not been reinstated but, in accordance with FRS 10 'Goodwill and Intangible Assets', would be charged to the profit and loss account on the subsequent disposal of the business to which it related. Where impairment has been identified in accordance with FRS 11 'Impairment of Fixed Assets and Goodwill', goodwill arising prior to 1998 has also been reviewed for impairment.

Other intangible assets

Other separately identifiable intangible assets such as patent fees, licence fees and trademarks, are capitalised on the balance sheet only when the value can be measured reliably or the intangible asset is purchased as part of the acquisition of a business. Such intangible assets are amortised over their useful economic lives on a straight line basis. The carrying value of intangible assets is reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

Tangible assets

Depreciation is not provided on freehold land. Depreciation is provided to write off all other assets over their estimated useful lives at rates which take into account commercial conditions at their location. Usual asset lives are as follows:

Freehold buildings	50 years
Leasehold properties	50 years or lease period if less
Plant and machinery	3 to 8 years
Fixtures, fittings and equipment	
Building installations	20 years or lease period if less
Fittings and equipment	3 to 8 years
Motor vehicles	3 to 5 years
Business systems software	4 years

The carrying values of tangible fixed assets are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Leases

Finance leases, which transfer substantially all the risks and rewards of ownership of the assets concerned, are capitalised in the balance sheet at net present value. The corresponding liabilities are recorded as long term or current liabilities depending on the period when they are due. The interest elements of the rental obligations are charged to the profit and loss account over the periods of the leases as a finance cost. Capitalised leased assets are depreciated over their estimated useful life.

Operating lease rentals are charged to the profit and loss account over the period of the lease.

Stocks

Stocks are valued at the lower of cost and estimated net realisable value. Cost includes all costs in bringing each product to its present location and condition, being the full manufacturing cost on a first-in-first-out basis, including attributable overheads based on a normal level of activity. Net realisable value represents the selling price less further costs to be incurred to completion and on sale.

Provisions

Provisions are recorded when the Group has a present, legal or constructive obligation as a result of a past event which it is probable that the Group will be required to settle by an outflow of resources and for which a reliable estimate of the amount of the obligation can be made. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

Where the effect of the time value of money is material, the amount of the provision shall be the present value of the expenditures expected to be required to settle the obligation.

Notes to the accounts continued

2. Segmental analysis

	2004 £ million	2003 £ million
Turnover		
Performance Analysis	176.8	148.7
Service Assurance	74.7	91.7
Communications	251.5	240.4
Network Products	187.8	174.4
Systems	35.7	51.4
	475.0	466.2
Profit before taxation		
Operating profit before goodwill amortisation and exceptional items		
Performance Analysis	19.7	4.4
Service Assurance	0.2	9.4
Communications	19.9	13.8
Network Products	20.4	16.7
Systems	2.5	5.5
	42.8	36.0
Operating exceptional items		
Performance Analysis	1.3	(5.1)
Service Assurance	(1.9)	(0.1)
Communications	(0.6)	(5.2)
Non-segmental	(2.3)	(2.3)
	(2.9)	(7.5)
Goodwill amortisation		
Performance Analysis	(3.7)	(3.9)
Service Assurance	(5.1)	(5.5)
Communications	(8.8)	(9.4)
Network Products	(0.3)	(0.3)
	(9.1)	(9.7)
Operating profit	30.8	18.8
(Loss)/income from interests in joint ventures	(0.7)	2.7
Income from interests in associates	2.8	2.1
(Loss)/profit on the disposal of operations	(0.9)	3.6
Total net interest payable *note 8*	(7.3)	(25.4)
Other finance expense	(0.7)	(1.5)
Profit before taxation	24.0	0.3

	2004 £ million	2003 £ million
Operating assets		
Performance Analysis	68.6	85.6
Service Assurance	51.4	60.5
Communications	120.0	146.1
Network Products	97.9	93.7
Systems	6.6	5.0
Segmental operating assets *note 3*	224.5	244.8
Investment in joint venture *note 18*	–	0.3
Investment in associates *note 18*	15.8	14.6
Tax payable *note 23*	(26.2)	(24.7)
Operating assets	214.1	235.0
Net debt *note 22*	(26.4)	(57.5)
Provisions for liabilities and charges *note 26*	(15.7)	(20.2)
Assets less liabilities (excluding pension liability)	172.0	157.3
Pension liability *note 10*	(27.0)	(35.2)
Assets less liabilities (including pension liability)	145.0	122.1

3. Geographical analysis

	2004 £ million	2003 £ million
Turnover by market		
Europe	167.4	149.6
North America	223.4	229.3
Asia Pacific, Rest of Americas, Africa	84.2	87.3
	475.0	466.2
Turnover by source		
Europe	184.9	168.2
North America	243.4	262.1
Asia Pacific, Rest of Americas, Africa	46.7	35.9
	475.0	466.2

Notes to the accounts continued

3. Geographical analysis continued

	2004 £ million	2003 £ million
Operating profit		
Operating profit before goodwill amortisation and exceptional items		
Europe	20.6	21.7
North America	20.1	13.0
Asia Pacific, Rest of Americas, Africa	2.1	1.3
	42.8	36.0
Operating exceptional items		
Europe	(2.1)	(2.3)
North America	(0.8)	(5.2)
	(2.9)	(7.5)
Goodwill amortisation		
Europe	(1.5)	(1.5)
North America	(7.6)	(8.2)
	(9.1)	(9.7)
Operating profit	30.8	18.8
Operating assets		
Europe	54.0	74.0
North America	159.3	158.8
Asia Pacific, Rest of Americas, Africa	11.2	12.0
Segmental operating assets *note 2*	224.5	244.8

4. Net operating expenses

	Before exceptional items	Exceptional items	Total	Total
Selling and distribution	116.7	–	116.7	110.0
Administration	49.9	2.9	52.8	58.3
Other operating income	(0.2)	–	(0.2)	(0.7)
Net operating expenses including goodwill amortisation and exceptional items	166.4	2.9	169.3	167.6
Included within administration costs above				
Operating exceptional items	–	2.9	2.9	7.5
Goodwill amortisation	9.1	–	9.1	9.7
Net operating expenses before goodwill amortisation and exceptional items	157.3	–	157.3	150.4

5. Operating profit

Operating profit is arrived at after charging:

	2004 £ million	2003 £ million
Operating exceptional items *note 6*	2.9	7.5
Goodwill amortisation	9.1	9.7
Depreciation		
Owned assets	25.2	29.0
Finance leased assets	0.2	0.3
Operating lease costs		
Plant and equipment	0.5	0.4
Land and buildings	11.1	11.3
Product development costs	67.3	66.0

Disclosure of fees paid to auditors

	2004 £ million	2003 £ million
Audit services		
Audit fees – Ernst & Young LLP	1.4	1.2
Other fees paid to Ernst & Young		
Further assurance services	0.2	0.1
Tax services	0.4	0.6
	0.6	0.7
These fees were paid to:		
Ernst & Young LLP	0.5	0.5
Ernst & Young overseas	0.1	0.2
	0.6	0.7

Notes to the accounts continued

6. Operating exceptional items

	2004 £ million	2003 £ million
Finance renegotiation costs	–	2.3
Restructuring costs (including asset write-downs and lease provisions)	1.6	5.2
Exit from joint venture	1.3	–
	2.9	7.5

7. Reconciliation of operating profit to net cash inflow from operating activities

	2004 £ million	2003 £ million
Operating profit	30.8	18.8
Depreciation	25.4	29.3
Loss/(profit) on disposal of tangible fixed assets	0.4	(0.1)
Tangible fixed asset write-downs	0.6	2.2
Goodwill amortisation	9.1	9.7
Stock compensation expense	0.6	0.6
Deferred income received	4.9	0.2
(Increase)/decrease in debtors	(9.1)	3.8
(Increase)/decrease in stocks	(1.0)	3.1
Increase in creditors	9.3	5.7
Decrease in provisions	(2.9)	(5.9)
Pension fund liability	(7.8)	0.8
Net cash inflow from operating activities	60.3	68.2

8. Net interest payable

	2004 £ million	2003 £ million
Interest receivable and similar income	1.6	3.1
Interest payable		
Senior unsecured loan notes	(6.7)	(8.8)
Bank loans and overdrafts	(0.9)	(2.6)
Other loans	(0.2)	(0.3)
Discount on unwind of lease provision	(0.2)	–
Interest on finance leases	(0.4)	(0.5)
	(6.8)	(9.1)
Share of joint venture's interest	–	(0.2)
Net interest payable	(6.8)	(9.3)
Exceptional interest expense	(0.5)	(16.1)
Total net interest payable	(7.3)	(25.4)

On prepayment of the senior unsecured loan notes a make-whole amount becomes due. These amounts are included above in the exceptional interest expense of £0.5 million (2003 £16.1 million).

9. Employees

The average number of people employed by the Group during the year was:

	2004 Number	2003 Number
Manufacturing	2,705	2,768
Selling and distribution	1,394	1,310
Administration	422	420
	4,521	4,498

Their payroll costs were:

	£ million	£ million
Remuneration	160.7	154.5
Social security costs	17.4	17.3
Other pension costs	5.1	6.4
	183.2	178.2

Please refer to the Report on directors' remuneration on pages 19 to 26 for disclosures relating to the remuneration, share options and long term incentives and pensions of the directors.

10. Pensions

Defined benefit schemes

The only significant defined benefit plans are in the UK and comprise the Staff Pension Plan and Retirement Cash Plan. These plans have been combined for the purposes of the following disclosures.

The most recent actuarial valuation at 1 April 2003 has been used and updated by our independent actuaries.

i) The financial assumptions used to calculate the schemes' liabilities were:

	2004 %	2003 %	2002 %
Valuation method – projected unit			
Inflation	2.9	2.8	2.3
Rate of increase in salaries	3.6	3.5	3.0
Rate of increase for pensions in payment pre 2001 service	3.0	3.0	3.0
Rate of increase for pensions in payment post 2001 service	2.7	2.7	2.3
Rate of increase in deferred pensions	2.9	2.8	2.3
Rate used to discount schemes' liabilities	5.3	5.4	5.5

Notes to the accounts continued

10. Pensions continued

ii) The assets and the liabilities in the schemes for the Group and Company were as follows:

	Long term rate of return expected %	2004 £ million	Long term rate of return expected %	2003 £ million	Long term rate of return expected %	2002 £ million
Equities	7.5	62.2	7.8	61.3	7.5	52.5
Gilts	5.0	11.9	4.8	15.3	4.5	15.7
Bonds	4.5	18.8	5.1	9.6	5.0	7.4
Cash	5.0	2.6	4.3	4.5	4.0	2.3
Property	6.5	4.6	6.8	1.8	6.5	4.3
Other	5.6	6.8	5.6	6.3	5.5	6.8
Total market value of assets		106.9		98.8		89.0
Actuarial value of liability		(144.2)		(142.2)		(130.9)
Net deficit in the schemes		(37.3)		(43.4)		(41.9)
Related deferred tax asset		11.1		13.0		–
Deficit in schemes, net of tax		(26.2)		(30.4)		(41.9)
Actuarial value of unfunded pension liability		(0.8)		(4.8)		(4.3)
Net pension liability		(27.0)		(35.2)		(46.2)

iii) Analysis of the amounts charged to the profit and loss account

	2004 £ million	2003 £ million
Analysis of amount charged to operating costs		
Current service cost	1.8	2.2
Analysis of amount credited to other finance expense		
Expected return on pension schemes' assets	6.6	5.7
Interest on pension schemes' liabilities	(7.3)	(7.2)
Other finance expense	(0.7)	(1.5)
Net profit and loss charge	2.5	3.7
Analysis of amount recognised in statement of total recognised gains and losses		
Actual return less expected return on pension schemes' assets	3.6	5.5
Experience gains and losses arising on the schemes' liabilities	2.4	6.8
Changes in assumptions underlying the present value of the schemes' liabilities	(3.0)	(12.0)
Actuarial gain recognised in the statement of total recognised gains and losses	3.0	0.3
Movement in deficit in the year		
Deficit in the schemes at 1 January	(43.4)	(41.9)
Current service cost	(1.8)	(2.2)
Employer contributions paid	5.6	1.9
Other finance expense	(0.7)	(1.5)
Actuarial gain	3.0	0.3
Net deficit in the schemes at 31 December	(37.3)	(43.4)

iv) History of experience gains and losses

	2004	2003	2002
Difference between the expected and actual return on the schemes' assets			
Amount (£ million)	3.6	5.5	(20.3)
Percentage of the schemes' assets (per cent)	3.4	5.6	(22.8)
Experience gains and losses on the schemes' liabilities			
Amount (£ million)	2.4	6.8	(0.9)
Percentage of the present value of the schemes' liabilities (per cent)	1.7	4.8	(0.7)
Total amount recognised in the statement of total recognised gains and losses			
Amount (£ million)	3.0	0.3	(23.6)
Percentage of the present value of the schemes' liabilities (per cent)	2.1	0.2	(18.0)

The Group will continue to make additional contributions of £3.5 million per annum on 1 July in order to comply with the Minimum Funding Requirements for the UK defined benefit plans.

The above plans are funded and have full UK Inland Revenue tax-exempt approval by which benefits are limited due to the statutory earnings cap (an Inland Revenue limit on the amount of earnings that can be made pensionable under the plans for members who joined after May 1989). Certain members, whose salaries are in excess of this cap, have had their benefits increased through unapproved unfunded arrangements to the level that would otherwise have applied in respect of the basic salary only. The Company has contractually agreed to pay the additional retirement benefits itself and a provision at 31 December 2004 of £0.8 million (2003 £4.8 million) is included in the net pension liability above. This represents the actuarial value, as confirmed by the Company's pension advisers, of the unapproved benefit entitlements accrued at that date. The value is assessed and reviewed on a Market Value basis in line with the Main Plan Valuation and adjusted each year by the charge for the year (equivalent to a contribution to a funded plan) of £0.1 million (2003 £0.2 million) and interest on the unfunded liability of nil (2003 £0.3 million). The additional death-in-service benefits over the statutory cap are separately insured by the Company under an unapproved scheme.

Defined contribution schemes

United Kingdom

The Group maintains defined contribution pension schemes for employees in the UK. These plans are known as 'Cash Builder' or 'Pension Builder' and employer contributions into these schemes for 2004 were £0.1 million (2003 £0.1 million).

United States

The Group maintains defined contribution pension benefit plans for employees of its US subsidiaries. These plans, known as 401(k) plans, allow employees to defer a percentage of their salary for retirement. There are four different 401(k) plans within the US businesses and each of these plans has different features regarding Company contributions, maximum deferral percentages and investment choices.

The investment choices offered are among a selection of diversified mutual funds offering a broad mix of investment return potential with varying levels of risk. In aggregate the Company contributions to the various US plans totalled $4.6 million for 2004 (2003 $4.4 million). Total assets in the defined contribution plans at the end of 2004 were $116.8 million (2003 $103.1 million). There were no defined benefit plans in the US at 31 December 2004.

Other jurisdictions

Outside the UK and the US employees are provided with pension arrangements determined in accordance with approved local practice and regulations and these arrangements are defined contribution schemes. Total contributions for 2004 in respect of these schemes amounted to £0.3 million (2003 £0.2 million).

Total contributions to defined contribution schemes were £2.9 million (2003 £3.0 million).

Notes to the accounts continued

11. Taxation

Analysis of charge for the period

	2004 £ million	2003 £ million
Current tax		
Overseas taxation	7.4	4.9
Under/(over) provision in prior years		
UK tax	–	1.1
Overseas taxation	(1.3)	(7.1)
	6.1	(1.1)
Share of joint venture's taxation	–	1.1
Share of associates' taxation	1.0	0.9
Total current tax charge	7.1	0.9
Deferred tax		
Origination and reversal of timing differences	1.7	(0.3)
Origination of deferred tax assets	(1.1)	–
Total deferred tax charge/(credit)	0.6	(0.3)
Total tax charge for the year	7.7	0.6

There was no tax effect in respect of operating exceptional items (2003 £1.7 million credit) nor was there any effect in respect of the non-operating exceptional items (2003 nil).

In 2003 a credit of £12.6 million arose in the statement of total recognised gains and losses as a deferred tax asset was recognised on the pension fund liability.

A charge of £0.9 million (2003 £0.1 million) arises on the actuarial gain and this has been included in the statement of total recognised gains and losses.

Factors affecting tax charge for the period

The current tax charge for the year is lower than the standard rate of corporation tax in the UK (30 per cent).

The differences are explained as follows:

	2004 £ million	2003 £ million
Profit before tax	24.0	0.3
Profit before tax multiplied by the standard rate of corporation tax in the UK of 30 per cent (2003 30 per cent)	7.2	0.1
Expenses not deductible for tax (primarily goodwill amortisation)	3.8	7.3
Movement in timing differences	(0.6)	0.3
Different tax rates on overseas earnings and other adjustments	(2.0)	(0.8)
Tax overprovided in previous years	(1.3)	(6.0)
Total current tax charge	7.1	0.9

Factors that may affect future tax charges

Deferred tax assets of £13.3 million (2003 £18.3 million) arising principally on timing differences in the US and UK have not been recognised. These assets can only be realised when they reverse against suitable taxable profits. Although the directors ultimately expect to realise these assets, there is currently insufficient evidence under FRS 19 'Deferred Tax' to recognise a deferred tax asset in respect of these timing differences.

In addition, the Group has tax losses arising in the US of £70.6 million (2003 £70.1 million) and in the UK of £39.6 million (2003 £24.8 million) that are available for offset against future taxable profits. A deferred tax asset has not been recognised in respect of these losses as their future recovery is uncertain.

In total, deferred tax assets amounting to £52.6 million (2003 £50.3 million) have not been recognised on unutilised losses and timing differences.

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries, associates and the joint venture. No deferred tax asset has been recognised in respect of the tax deduction which may be available on the future exercise of stock options.

12. Earnings/(loss) per share

Earnings/(loss) per share is calculated by reference to the profit/(loss) for the year and the number of Ordinary shares in issue during the year as follows:

	2004 £ million	2003 £ million
Basic earnings/(loss) attributable to shareholders	16.0	(0.5)
Operating exceptional items	2.9	7.5
Goodwill amortisation	9.1	9.7
Loss/(profit) on the disposal of operations	0.9	(3.6)
Exceptional interest charge	0.5	16.1
Prior year tax credit	(1.3)	(6.0)
Attributable taxation on exceptional items	–	(1.7)
Headline earnings attributable to shareholders	28.1	21.5

	Number million	Number million
Weighted average number of shares in issue – basic and headline	939.2	929.3
Dilutive potential of employee share options	18.1	–
Weighted average number of shares in issue – diluted	957.3	929.3

The shares in issue used to calculate basic and headline earnings/(loss) per share exclude the shares held by the Spirent Sharesave Trust (SST) (formerly Spirent Qualifying Employee Share Ownership Trust) and the Spirent Employee Share Ownership Trust (ESOT) in accordance with FRS 14 'Earnings per Share'.

Notes to the accounts continued

13. Intangible assets

Goodwill

	2004 £ million
	Group
Cost	
At 1 January	1,785.5
Exchange adjustment	(40.2)
At 31 December	1,745.3
Amortisation	
At 1 January	1,683.9
Provided during the year	9.1
Exchange adjustment	(36.5)
At 31 December	1,656.5
Net book value at 31 December 2004	88.8
Net book value at 31 December 2003	101.6

14. Tangible assets

2004 £ million

	Land and buildings Freehold	Land and buildings Long lease	Land and buildings Short lease	Plant and machinery	Fixtures, fittings and equipment	Total
						Group
Cost						
At 1 January	16.4	11.0	22.4	120.7	66.6	237.1
Exchange adjustment	(0.8)	0.1	(0.8)	(4.4)	(3.5)	(9.4)
Additions						
Owned assets	0.1	0.1	0.6	16.5	8.0	25.3
Leased assets	–	–	–	–	0.3	0.3
Inter-class transfers	–	–	–	(0.7)	0.7	–
Disposals	–	–	(0.2)	(2.8)	(4.5)	(7.5)
Disposal of operations *note 33*	–	–	(0.1)	–	(1.7)	(1.8)
At 31 December	15.7	11.2	21.9	129.3	65.9	244.0
Depreciation						
At 1 January	2.9	1.8	8.5	88.5	45.2	146.9
Exchange adjustment	(0.2)	–	(0.5)	(3.3)	(2.9)	(6.9)
Provided during the year	0.4	0.4	1.5	14.0	9.1	25.4
Inter-class transfers	–	–	–	(0.4)	0.4	–
Fixed asset write-down	–	0.5	–	–	0.1	0.6
Disposals	–	–	(0.2)	(2.2)	(4.2)	(6.6)
Disposal of operations *note 33*	–	–	(0.1)	–	(1.6)	(1.7)
At 31 December	3.1	2.7	9.2	96.6	46.1	157.7
Net book value at 31 December	12.6	8.5	12.7	32.7	19.8	86.3

	Land and buildings					2004 £ million
	Freehold	Long lease	Short lease	Plant and machinery	Fixtures, fittings and equipment	Total
						Company
Cost						
At 1 January	1.0	9.0	0.4	28.4	6.6	45.4
Additions	–	0.1	–	2.8	0.7	3.6
Disposals	–	–	–	(0.6)	(0.3)	(0.9)
Transfers in	–	–	–	1.7	1.9	3.6
At 31 December	1.0	9.1	0.4	32.3	8.9	51.7
Depreciation						
At 1 January	0.4	1.4	0.2	22.9	5.3	30.2
Provided during the year	0.1	0.2	–	2.2	0.8	3.3
Fixed asset write-down	–	0.5	–	–	0.1	0.6
Disposals	–	–	–	(0.6)	(0.3)	(0.9)
Transfers in	–	–	–	1.3	1.4	2.7
At 31 December	0.5	2.1	0.2	25.8	7.3	35.9
Net book value at 31 December	0.5	7.0	0.2	6.5	1.6	15.8

Tangible assets include the following finance leased assets:

			Group
Net book value at 1 January	0.4	0.6	1.0
Depreciation provided during the year	–	0.2	0.2
Net book value at 31 December	0.3	0.5	0.8

15. Capital commitments and contingent liabilities

		2004 £ million		2003 £ million
	Group	Company	Group	Company
Capital expenditure commitments				
Contracted but not provided	1.0	0.1	1.5	0.8
Contingent liabilities				
Bank guarantees	–	1.6	–	1.8

Spirent plc, the parent company, has provided indemnities of £0.5 million (2003 £1.0 million) for certain ongoing business obligations under letters of credit for subsidiary companies.

Notes to the accounts continued

16. Shares in subsidiaries

	2004 £ million
	Company
Cost	
At 1 January	1,996.3
Additions	155.5
Transfers to subsidiaries	(433.9)
Disposals	(0.5)
At 31 December	1,717.4
Provisions	
At 1 January and 31 December	1,454.1
Net book value at 31 December	263.3

17. Loans to subsidiaries

	Company
At 1 January	218.2
Exchange adjustment	(3.2)
Advances	13.7
Repayments	(53.4)
At 31 December	175.3

18. Fixed asset investments

Joint ventures

	Group
At 1 January	0.3
Share of retained loss	(0.7)
Additions	0.2
Accrued contribution to the joint venture	0.2
At 31 December	–

The joint venture company at 31 December 2004 and 31 December 2003 was:

	% holding	Nature of business
Spirent DM Ltd	40	Communications

It was agreed in 2004 that the Group would exit from the Spirent DM joint venture.

In 2003 the joint venture result included the Group's share of the profit of WAGO. Spirent divested of its interests in WAGO in April 2003.

	2004 £ million	2003 £ million
Profit and loss account		
Share of turnover	–	22.4
(Loss)/profit before taxation	(0.7)	2.5
Taxation	–	1.1
Share of (loss)/profit after taxation	(0.7)	1.4

The share of the gross and net assets of the joint venture included in the consolidated financial statements at 31 December 2004 is nil (2003 £0.3 million).

Associates

	2004 £ million	
	Group	Company
Cost		
At 1 January and 31 December		0.1
Share of retained profits and reserves		
At 1 January	14.6	–
Exchange adjustment	(0.5)	–
Share of retained profits for the year	1.7	–
At 31 December	15.8	–
Net book value at 31 December	15.8	0.1

The associated companies at 31 December 2004 and 31 December 2003 were as follows:

	% holding	Nature of business
Tyton Company of Japan	49	Cable management products
3M/ECC	20	Cable management products

19. Stocks

	2004 £ million		2003 £ million	
	Group	Company	Group	Company
Raw materials	12.1	2.6	12.6	0.5
Work in progress	6.2	0.7	5.0	0.1
Finished goods	35.7	5.3	37.4	2.9
	54.0	8.6	55.0	3.5

Notes to the accounts continued

20. Debtors

	2004 £ million		2003 £ million	
	Group	Company	Group	Company
Due within one year				
Trade debtors	74.6	9.0	69.5	6.3
Owed by subsidiaries	–	9.2	–	8.2
Owed by associates	0.3	0.1	0.2	–
Other debtors	6.3	2.0	8.2	0.4
Tax recoverable	–	3.6	–	2.6
Prepayments and accrued income	7.2	1.4	7.3	1.3
	88.4	25.3	85.2	18.8
Due after one year				
Other debtors	0.2	–	0.2	–
Prepayments	1.3	–	1.5	–
	1.5	–	1.7	–
Total debtors	89.9	25.3	86.9	18.8

21. Notes to the cash flow statement

	2004 £ million	2003 £ million
Returns on investments and servicing of finance		
Interest received	1.6	3.6
Interest paid	(8.4)	(12.6)
Interest element of finance lease rental payments	(0.4)	(0.5)
Exceptional interest paid	(2.3)	(13.7)
Net cash outflow for returns on investments and servicing of finance	(9.5)	(23.2)
Taxation		
Corporation tax paid	–	(3.3)
Overseas tax (paid)/received	(3.1)	12.2
Tax (paid)/received	(3.1)	8.9
Capital expenditure and financial investment		
Capital expenditure	(25.3)	(16.7)
Receipts from sales of tangible assets	0.5	0.9
Net cash outflow for capital expenditure and financial investment	(24.8)	(15.8)
Acquisitions and disposals		
Acquisition of subsidiaries *note 32*	(1.1)	(1.1)
Contribution to joint venture	(0.2)	(0.5)
Disposal of operations *note 33*	2.5	62.0
Net cash inflow for acquisitions and disposals	1.2	60.4
Management of liquid resources		
Sale of investments	–	0.1
Financing		
Issue of share capital	1.5	0.7
New loans	–	9.4
Repayment of loans	(10.2)	(152.9)
Repayment of capital element of finance lease rentals	(0.8)	(0.8)
Net cash outflow from financing	(9.5)	(143.6)

22. Analysis of changes in net debt

£ million

	1 January 2004	Cash flow	Non-cash changes	Exchange adjustment	31 December 2004
Cash at bank and in hand	37.6	14.7	–	(0.6)	51.7
Overdrafts	(0.7)	–	–	–	(0.7)
Net cash	36.9	14.7	–	(0.6)	51.0
Bank loans due within one year	(0.4)	(0.1)	0.3	–	(0.2)
Other loans and finance lease obligations due within one year	(0.7)	(0.1)	–	(0.1)	(0.9)
Net liquid funds	35.8	14.5	0.3	(0.7)	49.9
Senior unsecured loan notes due after one year	(80.8)	10.3	–	5.7	(64.8)
Bank loans due after one year	(3.3)	0.9	–	0.2	(2.2)
Other loans and finance lease obligations due after one year	(9.2)	–	(0.3)	0.2	(9.3)
Net debt	(57.5)	25.7	–	5.4	(26.4)

23. Creditors due within one year

	2004 £ million		2003 £ million	
	Group	Company	Group	Company
Trade creditors	28.0	8.9	27.6	5.3
Payments received on account	0.1	–	–	–
Owed to subsidiaries	–	2.0	–	2.0
Owed to associates	0.8	–	0.8	–
Other creditors	7.1	1.3	10.0	1.2
Accruals and deferred income	49.5	6.4	42.9	8.8
Corporation tax – UK and overseas	26.2	–	24.7	–
Other taxes and social security costs	5.1	1.1	5.3	0.8
	116.8	19.7	111.3	18.1

24. Loans and overdrafts

Secured bank overdrafts	0.7	–	0.7	–
Bank loans due within one year *note 27*	0.2	–	0.4	–
Other loans and finance lease obligations due within one year *note 27*	0.9	–	0.7	–
	1.8	–	1.8	–

Where applicable overdrafts are secured either by mortgages on the freehold properties or by floating charges on the assets of the borrowing subsidiaries.

25. Creditors due after more than one year

Senior unsecured loan notes *note 28*	64.8	64.8	80.8	80.8
Bank loans *note 27*	2.2	–	3.3	–
Other loans and finance lease obligations *note 27*	9.3	–	9.2	–
Owed to subsidiaries	–	244.1	–	514.4
Other creditors	1.1	–	1.3	–
Deferred income	2.5	0.3	0.4	0.3
Pension	0.3	0.1	0.6	–
	80.2	309.3	95.6	595.5

Notes to the accounts continued

26. Provisions for liabilities and charges

Deferred taxation

	2004 £ million		2003 £ million	
	Group	Company	Group	Company
At 1 January	2.3	–		
Movement in respect of pension liability	(1.0)	–		
Charge for the year *note 11*	0.6	–		
At 31 December	1.9	–		
Deferred taxation provided				
Capital allowances in advance of the corresponding charges for depreciation	1.4	–	1.4	–
Other short term timing differences	0.5	–	0.9	–
	1.9	–	2.3	–

In accordance with FRS 19 'Deferred Tax', deferred tax assets have not been recognised in respect of total tax losses of £110.2 million (2003 £94.9 million). In addition, deferred tax assets of £13.3 million (2003 £18.3 million) arising principally in respect of timing differences have not been recognised (see note 11).

Other provisions

	2004 £ million	
	Group	Company
Lease provisions		
At 1 January	17.9	0.5
Charged during the year	1.7	1.7
Released during the year	(1.8)	–
Released during the year in respect of prior year disposals	(1.2)	–
Discount on unwind of lease provision	0.2	–
Utilised during the year	(4.1)	(0.2)
Exchange adjustment	(0.2)	–
At 31 December	12.5	2.0
Restructuring costs		
Charged during the year	1.3	–
At 31 December	1.3	–
Total other provisions	13.8	2.0
Current	4.2	0.3
Non-current	9.6	1.7
Total other provisions	13.8	2.0

The lease provisions are for the continuing obligations under leases in respect of properties which have been vacated by the Group. Where material, lease obligations are discounted. The Company expects these provisions to be utilised over the next 12 years.

The restructuring costs relate to our exit from the Spirent DM joint venture and will be paid in 2005.

27. Loans and finance lease obligations

	2004 £ million		2003 £ million	
	Group	Company	Group	Company
Secured				
Bank loans wholly repayable within five years	2.4	–	3.7	–
Other loans not wholly repayable within five years	0.6	–	0.7	–
Finance lease obligations	9.6	–	9.2	–
	12.6	–	13.6	–

Repayment schedules for amounts due at 31 December are as follows:

	2004 Group	2004 Company	2003 Group	2003 Company
Bank loans				
Between two and five years	2.0	–	2.8	–
Between one and two years	0.2	–	0.5	–
Due after more than one year *note 25*	2.2	–	3.3	–
Due within one year *note 24*	0.2	–	0.4	–
Total bank loans	2.4	–	3.7	–
Other loans and finance leases				
After five years	6.8	–	7.0	–
Between two and five years	1.7	–	1.5	–
Between one and two years	0.8	–	0.7	–
Due after more than one year *note 25*	9.3	–	9.2	–
Due within one year *note 24*	0.9	–	0.7	–
Total other loans and finance leases	10.2	–	9.9	–
Total loans	12.6	–	13.6	–

Where applicable loans are secured either by mortgages on the freehold properties or by floating charges on the assets of the borrowing subsidiaries. The long term secured loans are repayable in the year 2017 and bear interest at an average rate of 4 per cent.

Notes to the accounts continued

28. Senior unsecured loan notes

	2004 £ million		2003 £ million	
	Group	Company	Group	Company
Senior unsecured loan notes 2006	2.8	2.8	3.6	3.6
Senior unsecured loan notes 2009	62.2	62.2	77.4	77.4
	65.0	65.0	81.0	81.0
Less debt issuance costs	(0.2)	(0.2)	(0.2)	(0.2)
Due after more than one year *note 25*	64.8	64.8	80.8	80.8

At 31 December 2004 the following loan notes were in issue:
i) $5.5 million bearing interest at 9.19 per cent repayable on 23 November 2006;
ii) $36.2 million bearing interest at 9.31 per cent repayable on 23 November 2009;
iii) $65.9 million bearing interest at 9.41 per cent repayable on 23 November 2009;
iv) $17.2 million bearing interest at 10.00 per cent repayable on 23 November 2009. An interest rate derivative was entered into in 1999 to reduce the effective interest rate to 9.53 per cent.

Loan notes are repayable:
i) at maturity; or
ii) at any time at the Company's option in an amount of not less than 5 per cent of the aggregate principal amount then outstanding plus a make-whole amount.

If Spirent plc repaid at its option the total principal amount of the loan notes at 31 December 2004 then a make-whole amount of $22.1 million (£11.5 million) would become payable.

29. Financial risk management

The key objective of the Group Treasury department is to manage the financial risks of the business and to ensure that sufficient liquidity is available to the Group. All treasury activity operates within a formal control framework. The Board has approved treasury policies and guidelines and periodically reviews treasury activities. Additionally, it is the Group's policy that speculative treasury transactions are expressly forbidden.

The major risks managed by Treasury, under the approved policies, are liquidity and refinancing risk, interest rate and currency risk and counterparty credit risk. Financial instruments including derivatives are used to manage these exposures when deemed appropriate.

Financing

The Group's objective is to ensure that there are sufficient sources of funding to meet projected requirements. Its operations are financed through a combination of retained earnings and external financing. Financing is raised principally by the parent company and lent to subsidiaries on commercial terms. Debt is largely sourced from the syndicated bank market and the US private placement market.

At 31 December 2004, the amount of senior unsecured loan notes was $124.8 million, equivalent to £65.0 million at 31 December 2004 exchange rates. These notes have maturity dates of 2006 and 2009.

Committed bank facilities amounted to £30 million at 31 December 2004 on which there were no amounts drawn. These facilities matured on 2 February 2005 but were replaced with a new 364-day bank facility of £30 million. This new facility has a 12 month term-out option.

Interest rate management

The objective of our interest rate management policy is to reduce the volatility of the interest charge. Interest rate exposure is managed through an optimum mix of fixed and floating rate debt and the use of interest rate swaps.

At 31 December 2004 the Group's borrowings were composed of 51 per cent of fixed rate debt. This excludes $72.1 million of senior unsecured loan notes which have been swapped into floating rates through the use of interest rate swaps which terminate on 23 November 2009. These swaps are callable at the counterparties' option at six monthly intervals.

Our interest charge excluding exceptional interest expense was £6.8 million (2003 £9.3 million). A one percentage point movement in short term US dollar interest rates based on the year end position would impact profit before taxation by approximately £0.3 million.

Currency management

Currency exposures arise from trading transactions undertaken by subsidiaries in foreign currencies and on the translation of the operating results and net assets of our overseas subsidiaries.

Group Treasury, by means of forward foreign exchange contracts, carries out the majority of the transaction hedging activity.

We do not enter into instruments to hedge the translation exposures of the operating results or net assets of our overseas subsidiaries since these are accounting and not cash exposures. However, to provide a partial hedge we match, as far as possible, the currency of our borrowings with the currency profile of our operating results and net assets.

At 31 December 2004 the balance sheet translation exposure was 61 per cent hedged (2003 61 per cent).

During the year sterling strengthened against the US dollar the main currency to which we are exposed.

Interest rate risk

The interest rate profile of the Group's financial assets and liabilities at 31 December after taking into account interest rate swaps was as follows:

2004 £ million	At floating interest rates	Non-interest bearing	Total
Financial assets			
Sterling	29.1	0.2	29.3
US dollar	9.1	1.8	10.9
Euro	5.8	0.4	6.2
Others	4.3	1.2	5.5
	48.3	3.6	51.9

2003 £ million	At floating interest rates	Non-interest bearing	Total
Financial assets			
Sterling	8.5	0.4	8.9
US dollar	17.2	1.1	18.3
Euro	4.0	0.6	4.6
Others	4.3	1.7	6.0
	34.0	3.8	37.8

The financial assets of the Group comprise:

	2004 £ million	2003 £ million
Debtors due after more than one year (excluding prepayments) *note 20*	0.2	0.2
Cash at bank and in hand *note 22*	51.7	37.6
	51.9	37.8

Floating rate financial assets comprised cash deposits at call, seven day and monthly rates. The weighted average period to maturity for financial assets on which no interest is paid is less than one year.

Notes to the accounts continued

29. Financial risk management continued

	At fixed interest rates	At floating interest rates	Non-interest bearing	Total
				2004 £ million
Financial liabilities				
Sterling	–	–	3.0	3.0
US dollar	30.2	37.5	11.1	78.8
Euro	9.7	0.5	0.8	11.0
Other	–	0.2	–	0.2
	39.9	38.2	14.9	93.0

	At fixed interest rates	At floating interest rates	Non-interest bearing	Total
				2003 £ million
Financial liabilities				
Sterling	–	–	1.3	1.3
US dollar	43.7	40.4	16.1	100.2
Euro	10.0	0.4	1.8	12.2
Other	0.2	0.4	–	0.6
	53.9	41.2	19.2	114.3

	2004 Average interest rates of fixed rate liabilities %	2004 Weighted average period to maturity of fixed rate liabilities years	2004 Weighted average period to maturity of non-interest bearing liabilities years	2003 Average interest rates of fixed rate liabilities %	2003 Weighted average period to maturity of fixed rate liabilities years	2003 Weighted average period to maturity of non-interest bearing liabilities years
Financial liabilities						
Sterling	–	–	5.0	11.5	2.3	4.7
US dollar	9.2	4.6	2.9	9.2	5.6	3.1
Euro	4.9	12.1	8.4	5.7	12.8	6.5
Other	–	–	–	11.2	2.1	–
Group	8.1	6.4	3.6	8.6	6.9	3.5

The financial liabilities of the Group comprise:

	2004 £ million	2003 £ million
Bank overdrafts, current instalment of loans and finance lease obligations *note 24*	1.8	1.8
Senior unsecured loan notes due after more than one year *note 25*	64.8	80.8
Bank loans due after more than one year *note 25*	2.2	3.3
Other loans and finance lease obligations due after more than one year *note 25*	9.3	9.2
Other creditors falling due after more than one year *note 25*	1.1	1.3
Provisions *note 26*	13.8	17.9
	93.0	114.3

2003 comparatives have been restated to include provisions.

The floating rate liabilities at 31 December 2004 comprise primarily $72.1 million (2003 $72.1 million) of the senior unsecured loan notes for which interest rate swaps are in place. Other floating rate liabilities bear interest at various rates set with reference to the prevailing LIBOR or equivalent for the time period and country.

Maturity of financial liabilities

The maturity profile of the Group's financial liabilities at 31 December was as follows:

	2004 £ million	2003 £ million
In one year or less, or on demand	6.0	6.4
In more than one year but not more than two years	6.0	4.7
In more than two years but not more than five years	70.0	14.5
In more than five years	11.0	88.7
	93.0	114.3

The undrawn committed borrowing facilities at 31 December were as follows:

	2004	2003
Expiring in one year or less	31.6	61.5

The committed borrowing facilities comprise primarily of a £30 million multi-currency revolving credit facility.

The Group put in place a new £30 million 364-day working capital facility effective from 17 February 2005 with a 12 month term-out option to replace the existing £30 million facility.

Currency exposure of financial assets and liabilities

The table shows the net unhedged monetary assets and liabilities of Group companies at 31 December. These monetary assets and liabilities are not denominated in their functional currency and therefore give rise to exchange gains and losses in the profit and loss account.

	Net foreign currency monetary assets/(liabilities)				2004 £ million
	Sterling	US dollar	Euro	Other	Total
Functional currency of Group operation					
Sterling	–	0.1	1.6	0.3	2.0
US dollar	(0.7)	–	(0.3)	(1.8)	(2.8)
Euro	(0.6)	(0.9)	–	–	(1.5)
Other	(0.5)	2.0	–	0.7	2.2
	(1.8)	1.2	1.3	(0.8)	(0.1)

	Net foreign currency monetary assets/(liabilities)				2003 £ million
	Sterling	US dollar	Euro	Other	Total
Functional currency of Group operation					
Sterling	–	(1.0)	0.6	–	(0.4)
US dollar	(0.3)	–	(0.1)	–	(0.4)
Euro	(0.8)	(1.5)	–	0.2	(2.1)
Other	(1.9)	1.7	(0.9)	0.6	(0.5)
	(3.0)	(0.8)	(0.4)	0.8	(3.4)

Notes to the accounts continued

29. Financial risk management continued

Fair value of financial instruments

	2004 £ million		2003 £ million	
	Book value	Fair value	Book value	Fair value
Primary financial instruments held or issued to finance the Group's operations				
Short term borrowings and current portion of long term borrowings	(1.8)	(1.8)	(1.8)	(1.8)
Long term senior unsecured loan notes	(64.8)	(75.3)	(80.8)	(97.0)
Other long term borrowings	(11.5)	(11.7)	(12.5)	(11.8)
Cash and other liquid funds	51.7	51.7	37.6	37.6
Other financial assets	0.2	0.2	0.2	0.2
Other financial liabilities	(14.9)	(14.9)	(19.2)	(19.2)
	(41.1)	(51.8)	(76.5)	(92.0)
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	–	(1.0)	–	(1.3)
Forward foreign exchange contracts	–	0.5	–	0.4
	(41.1)	(52.3)	(76.5)	(92.9)

The derivative financial instruments are as follows:

i) Interest rate swaps for $72.1 million (£37.6 million). The swaps terminate on 23 November 2009 and can be cancelled at the bank's option at six monthly intervals, with no mark to market settlement. The swaps have been transacted with two banks and are split $48.0 million and $24.1 million between them. The terms of the $48.0 million swap allow for either party to exercise a break on 23 November 2005 or 23 November 2008. The swap for $24.1 million allows either party to exercise a break at 23 November 2005. If a break is exercised a mark to market settlement is made at the fair value. At 31 December 2004 the fair value was £1.0 million which would have been payable by Spirent to the banks.

ii) Forward foreign exchange contracts to hedge material transactional exposures.

Hedges

It is the Group's policy to hedge a proportion of its transactional currency exchange exposures using forward foreign currency contracts and its interest rate exposures by using interest rate swaps. Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged itself is recognised.

Unrecognised gains and losses on instruments used for hedging are as follows:

			2004 £ million	2003 £ million
	Gains	Losses	Total net gains/(losses)	Total net gains/(losses)
Unrecognised gains/(losses) at 1 January	0.4	(1.3)	(0.9)	0.9
(Gains)/losses arising in previous years recognised in the year	(0.4)	–	(0.4)	(0.9)
Gains/(losses) arising before 1 January that were not recognised in the year	–	(1.3)	(1.3)	–
Gains/(losses) arising in the year that were not recognised	0.5	0.3	0.8	(0.9)
Unrecognised gains/(losses) on hedges at 31 December	0.5	(1.0)	(0.5)	(0.9)
Expected to be recognised				
In one year or less	0.5	–	0.5	0.4
In later years	–	(1.0)	(1.0)	(1.3)
	0.5	(1.0)	(0.5)	(0.9)

30. Operating lease commitments

Annual commitments which expire:

	2004 £ million		2003 £ million	
	Group	Company	Group	Company
In respect of land and buildings (subject to periodic rent reviews)				
Within one year	0.5	–	0.3	–
In the second to fifth years	5.0	0.1	5.2	0.1
Over five years	4.0	1.1	4.4	0.6
	9.5	1.2	9.9	0.7
In respect of plant and equipment				
Within one year	0.2	–	0.4	–
In the second to fifth years	0.4	0.1	0.1	–
	0.6	0.1	0.5	–

31. Capital and reserves

2004 £ million

	Called up share capital	Share premium account	Capital reserve	Capital redemption reserve	Merger reserve	Investment in own shares[5]	Profit and loss account[2]
							Group
At 1 January	31.5	697.5	17.7	0.7	–	(2.6)	(624.9)
Exchange adjustment on subsidiaries, joint venture and associates	–	–	–	–	–	–	(0.7)
New shares issued	0.3	3.3	(2.1)	–	–	–	–
Issue of new shares – Caw Networks, Inc.	0.1	3.2	(2.7)	–	–	–	–
Reversal of employee share scheme cost	–	–	–	–	–	–	0.2
Cancellation of share premium and capital redemption reserve[4]	–	(702.7)	–	(0.7)	–	–	703.4
Profit for the year	–	–	–	–	–	–	16.0
Goodwill on disposal of subsidiaries acquired before 1998	–	–	–	–	–	–	4.9
Transfer of investment in own shares[5]	–	–	–	–	–	2.6	(2.6)
Gain on lapsed options	–	–	(1.2)	–	–	–	1.2
Actuarial gain recognised on the pension schemes	–	–	–	–	–	–	3.0
Taxation on actuarial gain	–	–	–	–	–	–	(0.9)
Other movements	–	–	(0.8)	–	–	–	–
At 31 December	31.9	1.3	10.9	–	–	–	99.6

Notes to the accounts continued

31. Capital and reserves continued

2004
£ million

	Called up share capital	Share premium account	Capital reserve	Capital redemption reserve	Merger reserve	Investment in own shares[5]	Profit and loss account[1]
							Company
At 1 January	31.5	697.5	17.7	0.7	1.2	(2.6)	(583.5)
New shares issued	0.3	3.3	(2.1)	–	–	–	–
Issue of new shares – Caw Networks, Inc.	0.1	3.2	(2.7)	–	–	–	–
Reversal of employee share scheme cost	–	–	–	–	–	–	0.2
Cancellation of share premium and capital redemption reserve[4]	–	(702.7)	–	(0.7)	–	–	703.4
Loss for the year[3]	–	–	–	–	–	–	(6.8)
Transfer of investment in own shares[5]	–	–	–	–	–	2.6	(2.6)
Gain on lapsed options	–	–	(1.2)	–	–	–	1.2
Actuarial gain recognised on the pension schemes	–	–	–	–	–	–	3.0
Taxation on actuarial gain	–	–	–	–	–	–	(0.9)
Other movements	–	–	(0.8)	–	–	–	–
At 31 December	31.9	1.3	10.9	–	1.2	–	114.0

Notes

1 The Company's profit and loss account of £114.0 million (2003 £583.5 million deficit) includes non-distributable reserves of £51.1 million (2003 £51.1 million), and a special non-distributable reserve of £61.6 million (2003 nil).

2 At 31 December 2004 the cumulative amount of goodwill charged to reserves since 1977, net of goodwill relating to subsidiaries disposed of or impaired, is £36.4 million (2003 £41.3 million).

3 The loss after taxation for the year dealt with in the accounts of the Company was £6.8 million (2003 loss £32.4 million).

4 On 24 November 2004 Spirent plc was granted an order of the High Court for the approval of the cancellation of the share premium account and capital redemption reserve (the Cancellation) which stood at that date at £702.7 million and £0.7 million, respectively. The Cancellation created a reserve in the accounts of the Company which was applied to eliminate the deficit in distributable reserves. The balance of this reserve created after the deficit in distributable reserves had been eliminated was transferred to a special non-distributable reserve. The special non-distributable reserve, which at 31 December 2004 stood at £61.6 million, will be increased in future years to the extent that the Company subsequently realises any value from its assets in excess of the value at which those assets were recorded in the Company's accounts at the time of the Cancellation.

The special non-distributable reserve will have a maximum value equal to the aggregate of the share premium account and capital redemption reserve at the time of the Cancellation, being £703.4 million. The special non-distributable reserve will be used to eliminate deficits arising in future years and is only capable of being distributed to the shareholders of the Company once all the creditors of the Company which existed at the date of the Cancellation have consented to the cancellation or been satisfied in full.

5 The investment in own shares relates to 3.5 million Ordinary shares (2003 3.5 million) held by the Spirent Sharesave Trust Limited (SST) and 9.5 million Ordinary shares (2003 9.5 million) held by the Spirent Employee Share Ownership Trust (ESOT). Shares held by the SST will be used to satisfy options under the Company's Savings Related Share Option Schemes. Shares in the ESOT are primarily held to hedge awards under various discretionary employee share schemes.

The cost of investment in own shares has been deducted from the profit and loss reserve at 31 December 2004.

The market value of own shares held in trust at 31 December 2004 was £9.6 million (2003 £7.6 million).

Defined benefit pension schemes

Amounts included within reserves in respect of the defined benefit pension schemes are as follows:

	2004 £ million		2003 £ million	
	Group	Company	Group	Company
Profit and loss account excluding pension fund deficit	125.8	140.2	(594.5)	(553.1)
Pension fund deficit *note 10*	(26.2)	(26.2)	(30.4)	(30.4)
Profit and loss account including pension fund deficit	99.6	114.0	(624.9)	(583.5)

Share capital

	Authorised		Issued and fully paid	
	2004 £ million	2003 £ million	2004 £ million	2003 £ million
Called up share capital – Ordinary shares of 3⅓ pence each	41.7	41.7	31.9	31.5

Changes during the year in the Ordinary share capital were as follows:

	Number of Ordinary shares million
Issued and fully paid at 1 January 2004	944.0
Allotted as deferred consideration for the acquisition of Caw Networks, Inc.	4.3
Allotted pursuant to share options and purchase rights exercised	7.9
Issued and fully paid at 31 December 2004	956.2

At the Annual General Meeting (AGM) held on 11 May 2004, shareholders gave authority for the Company to purchase up to 47.4 million of its own Ordinary shares in the market subject to certain specified conditions. At 24 February 2005, no purchases have been made or are contracted to be made under such authority.

In accordance with the rules of the following share schemes, options and purchase rights were exercised during the year which resulted in new Ordinary shares being allotted by the Company as follows:

	Number of Ordinary shares million	Consideration received £000
Executive Schemes	0.1	18.9
Spirent Stock Incentive Plan	2.6	605.3
Netcom Amended and Restated Stock Option Plan	1.5	339.5
Caw Amended and Restated Stock Plan[1]	0.3	27.4
All Employee Share Schemes	3.4	521.9
Total	7.9	1,513.0

Note
1 The exercise consideration for options under this plan is paid in US dollars and has been converted into sterling in the above table at an exchange rate of £1 = $1.83, being the average exchange rate for 2004.

Notes to the accounts continued

31. Capital and reserves continued

During the year, no shares were transferred from Spirent Sharesave Trust Limited.

On 4 January 2005, 2.7 million Ordinary shares were allotted following the automatic exercise of purchase rights under the Company's US Employee Stock Purchase Plan and the Global All Employee Share Purchase Plan. Between 1 January 2005 and 24 February 2005 approximately 1.2 million Ordinary shares were allotted following exercises under other employee share schemes. With the exception of the foregoing, there has been no material increase in the issued share capital, whether by exercise of options, purchase rights or otherwise, between the year end and 24 February 2005, the date on which these Accounts have been signed.

Employee share schemes

At 31 December 2004 the following options and purchase rights over Ordinary shares have been granted and remained outstanding under the Company's various employee share schemes. Figures for the options or purchase rights outstanding and the exercise price per Ordinary share have each been adjusted, where relevant, for the 3:1 subdivision of share capital in 2000 and for the rights issue effected in 2000.

		Option/purchase right exercise dates	Exercise price per share pence	Number of outstanding options/purchase rights million
Discretionary schemes				
1985 Executive Share Option Scheme	a	29.04.98-26.04.05	108	0.1
1995 Executive Share Option Scheme	a	29.04.99-04.08.14	16-598	27.0
International Executive Share Option Scheme	b	11.04.98-10.04.05	104	0.1
Spirent Stock Incentive Plan[1]	c	11.05.01-08.12.11	6-617	76.7
Acquisition related schemes				
Netcom Amended and Restated Stock Option Plan	d	23.07.99-19.07.09	15-151	8.7
Zarak Amended and Restated Stock Option Plan	e	14.11.00-12.11.10	127-572	0.6
Caw Amended and Restated Stock Plan	f	15.08.02-25.06.12	15-20[2]	0.3
All employee share save schemes[3]				
UK Savings Related Share Option Scheme	g	01.06.04-31.05.11	38-518	5.9
US Employee Stock Purchase Plan[4]	h	04.01.05-04.01.05	50	2.5
Global All Employee Share Purchase Plan[4]	i	04.01.05-04.01.05	50	0.2
Total[5]				122.1

Notes

1 A grant of options awarded in December 2003 under the Spirent Stock Incentive Plan (SSIP) is partially covered by 6.1 million Ordinary shares currently held in the ESOT. These shares were originally purchased in the market to cover awards made under the Company's now closed Long Term Share Purchase Plan and the Stock Appreciation Rights Plan but the awards relating to the shares lapsed before exercise. Although 6.1 million Ordinary shares are included above in the number of options outstanding, market-purchased shares held for the purpose of satisfying SSIP awards do not count towards the Company's overall dilution calculations.

2 Exercise prices per share for options under the Caw Amended and Restated Stock Plan are denominated in US dollars and are expressed as US cents in the above table.

3 The Company has taken advantage of the exemption within UITF Abstract 17 'Employee Share Schemes' in accounting for all employee share schemes.

4 The exercise price and number of shares subject to the purchase rights outstanding cannot ultimately be determined until the maturity of each respective offering period (ie normally 12 months following the date of grant). The exercise price and number of purchase rights outstanding as shown above are based on the market price of an Ordinary share (less the applicable 15 per cent discount) at the date of grant.

5 At 31 December 2003 there were 108.5 million options/purchase rights outstanding.

a) 1985 and 1995 Executive Share Option Schemes (ESOS)
The Inland Revenue approved 1995 ESOS incorporates the guidelines issued by the Association of British Insurers (ABI) at that time. It was subsequently amended by the Board to facilitate the award of unapproved share options both in the UK and overseas. There are currently 328 participating executives in the ESOS.

Awards under the 1995 ESOS, normally determined annually, are at the sole discretion of the Remuneration Committee after considering recommendations made to it by the Chief Executive. No price is payable on the grant of an option and no options have been, or can be, granted at a discount to the market price.

The normal exercise period for options granted under the ESOS is between the third and tenth anniversary of the date of grant. Options awarded under the 1995 ESOS are subject to the achievement of an earnings per share (EPS) performance condition before they can be exercised. The condition is that over a period of three consecutive financial years, there has been an increase in the Company's headline EPS which is at least 6 per cent more than the increase in the Retail Price Index over the same period.

All ESOS grants made after 11 May 2000 to the executive directors and certain senior managers are subject to enhanced performance conditions on exercise. These are more fully explained in the Report on directors' remuneration on pages 19 to 26.

The Remuneration Committee may in future impose different performance targets which they consider to be no less demanding. Options granted under the 1985 ESOS are exercisable unconditionally.

b) International Executive Share Option Scheme (IESOS)
Certain US executives have previously been granted unapproved options under the IESOS with participation and awards being at the discretion of the Remuneration Committee. Options are exercisable unconditionally and normally between the third and tenth anniversary of the date of grant. Again, no options have been granted at a discount to the market price. The IESOS is closed and has been replaced by the unapproved arrangements to the 1995 ESOS referred to in (a) above.

c) Spirent Stock Incentive Plan (SSIP)
The SSIP (formerly the Spirent Stock Option Plan) was introduced in 2000. This discretionary plan is primarily targeted at selected employees in the Communications group with grants normally determined annually by reference to the seniority and contribution of the individual, together with the performance of the relevant business and prevailing local market practice. Under the SSIP, grants are also permitted to selected newly hired and promoted employees on a monthly basis.

Following an Extraordinary General Meeting held in June 2004, shareholders approved the renewal of the SSIP until the Company's 2007 AGM along with several amendments including the ability to award stock appreciation rights (SARs) as well as stock options. SARs will deliver the appreciation value (ie the aggregated increase in the market value of an Ordinary share over the SAR price) in the form of new issue Ordinary shares. The SARs approach will help the Company manage its dilution headroom more efficiently as only the SAR gain and not the entire share value will need to be funded. Using a SARs-based approach, it is not possible to determine the precise level of dilution until the SARs are exercised. 20.1 million SARs, with exercise prices of between 56 pence and 71 pence were outstanding at 31 December 2004, however, no SARs were exercised in 2004.

Awards made pursuant to the SSIP normally vest over four years, provided that the employee remains in employment. Awards normally become 25 per cent exercisable on the first anniversary of the date of grant, and thereafter in equal proportions on a monthly basis over a further 36 months. Any award not exercised by the seventh anniversary of grant will lapse.

SSIP awards granted from June 2004 to certain senior managers will only become exercisable subject to the achievement of certain performance conditions which are broadly the annual equivalent of the enhanced conditions for the ESOS, described above.

No price is payable on the grant of options or SARs and no options or SARs have been, or can be, granted at a discount to the market price.

d) Netcom Amended and Restated Stock Option Plan (NARSOP)
Spirent completed the acquisition of Netcom Systems, Inc. (Netcom) in 1999. $44.5 million of the total consideration was satisfied through the roll-over of outstanding options over Netcom shares, primarily held by Netcom employees, into options over approximately 23.8 million Ordinary shares (as adjusted) on substantially similar terms as previously existed under the NARSOP. All remaining outstanding options are fully vested and exercisable until they expire.

Notes to the accounts continued

31. Capital and reserves continued

e) Zarak Amended and Restated Stock Option Plan (ZARSOP)

Out of a total consideration of approximately 44.9 million Ordinary shares issued for the acquisition of Zarak Systems Corporation (Zarak) in 2000, approximately 3.8 million shares arose in connection with the roll-over of outstanding options over Zarak shares into options over Spirent Ordinary shares on substantially similar terms as previously existed under the ZARSOP. These options are primarily held by Zarak employees and have either a five or 10 year life from the original date of grant.

Unvested rolled-over options were capable of immediate exercise (ie prior to their respective vesting date) and any shares arising from such an event were held in the ESOT until the relevant vesting date. The option holder was entitled to the beneficial (but not legal) interest in the shares whilst they were held in trust but they remained subject to forfeiture (with the original option exercise prices being refunded to the participant) if the participant's employment was terminated prior to the vesting date. All ZARSOP options and resulting shares held in the ESOT have now fully vested.

f) Caw Amended and Restated Stock Plan (CARSP)

Out of a total initial consideration for the acquisition of Caw Networks, Inc. (Caw) in 2002 of $49 million, approximately $4 million was in respect of Spirent Ordinary shares and options which arose on the roll-over of outstanding options and shares under the previous Caw employee stock plan. The options and shares will vest over a period expiring in 2006 on substantially similar terms as previously existed under the CARSP. The options are held by Caw employees and have a 10 year life from the original date of grant. Pursuant to the terms of the Merger Agreement for Caw, an additional cash payment of 78.8 US cents was payable as each share vested or upon the exercise of a vested option.

Any Ordinary shares issued under the CARSP are restricted until they have vested or are not at risk from forfeiture under the plan rules. Unvested rolled-over options are capable of immediate exercise (ie prior to their respective vesting date) and any shares arising from such an event are held in the ESOT until the relevant vesting date. The option holder is entitled to the beneficial (but not legal) interest in the shares whilst they are held in the ESOT but they remain subject to forfeiture (with the original option exercise prices being refunded to the participant) if the participant's employment is terminated prior to the vesting date.

In accordance with the original terms for acquiring Caw, in March 2004, Spirent allotted 4.3 million Ordinary shares and issued 75,000 options following the achievement by Caw of certain technical and financial earn out targets. Participation in the CARSP entitled the participants to a share in the earn out. Any earn out payment for an outstanding CARSP option was made by increasing the number of shares subject to the option and decreasing the per share exercise price so as to preserve the existing aggregate total exercise price. Of the 4.3 million shares, 54,000 shares were issued to the ESOT in respect of unvested restricted shares, which remained subject to forfeiture prior to vesting. As a result of the earn out, the additional cash payment referred to above was adjusted to 66.9 US cents as each share vests or upon the exercise of a vested option.

In accordance with the rules of the ESOS noted in (a) above, the Ordinary shares subject to rolled-over options from the acquisition of Netcom, Zarak, and Caw, or granted under the SSIP, do not count toward ABI scheme limits. The plans mentioned in (d) to (f) above are closed to new entrants and no further awards of options can be made under them.

g) UK Savings Related Share Option Scheme (SRSOS)

The SRSOS is an Inland Revenue approved scheme and is open to all UK employees, subject to a qualifying service period. The employee enters into a Save-As-You-Earn contract with the Company's savings carrier to save a regular sum of between £5 and £250 per month for a fixed period of either three or five years.

No price is payable on the grant of an option. The option exercise price is calculated by reference to the middle market price of an Ordinary share on the business day prior to the beginning of the invitation period, discounted by up to 20 per cent at the Board's discretion. Options are normally exercisable within six months of the third, fifth or seventh anniversary of the contract commencement date, as elected by the option holder at the start of the contract.

The Company has established an employee share ownership trust to honour the contractual commitment to deliver Ordinary shares against the valid exercise of outstanding options under the SRSOS and the SST, a wholly-owned subsidiary of Spirent plc, acts as sole trustee. During the year no shares were transferred to participants. SST has waived all rights to receive dividends payable on its registered shareholding except for 0.01 pence per annum in aggregate and accordingly such shareholding is not included in the Company's EPS calculation as referred to in note 12.

h) US Employee Stock Purchase Plan (ESPP)
The ESPP operates on a broadly similar basis to the SRSOS. It enables the Company to grant eligible US employees the right to acquire Spirent American Depositary Shares using proceeds of a savings contract. When joining the ESPP, participants enter into a contract to save up to 15 per cent of basic salary (gross), subject to an individual maximum of $1,000 (net) per month, over a contract period of 12 months by way of regular payroll deductions.

No price is payable on the grant of a purchase right. The purchase price will be based on the market value of an Ordinary share either on the first day of the offering period or on the last day of the offering period, whichever price is lower, less a 15 per cent discount or, where shares are to be subscribed, their nominal value (if greater).

i) Global All Employee Share Purchase Plan (GAESPP)
The GAESPP was approved by shareholders in 2001 and offers employees in countries other than the UK or US an opportunity to share in the Company's performance through share ownership. The GAESPP was implemented in Canada in January 2002 and operates on similar terms to the ESPP above, with participants entering into a 12 month contract to save up to 15 per cent of basic salary (gross), subject to an individual maximum of Cdn $1,000 (net) per month.

j) Stock Appreciation Rights Plan (SARP)
The SARP was introduced in September 1999 as an interim incentive arrangement for the employees of Netcom following the closure of the NARSOP described in (d) above and subsequently for certain other employees in the Communications group. Under the SARP, recruitment, promotion and recognition awards over Ordinary shares have been made in line with historic and local competitive market practice on a quarterly basis at the discretion of a committee of senior executives. The operation of the SARP reflects as far as practicable the now closed NARSOP. Accordingly, rights under the SARP vest over four years, 25 per cent vesting one year after the date of grant and the remainder vesting on a monthly basis over a further 36 months. Rights granted are not subject to the fulfilment of any pre-exercise performance conditions.

The SARP will deliver the appreciation value (ie the aggregated increase in the market value of an Ordinary share over the rights price) in the form of existing Ordinary shares which have been purchased in the market by the Company's ESOT. The maximum number of shares over which SARP awards can be made is 5.25 million.

At 31 December 2004, the following rights were outstanding under the SARP:

Rights exercise dates	Rights price pence	Number of rights outstanding million
10.09.00-29.06.10	182-416	2.6

Spirent Employee Share Ownership Trust (ESOT)
At 31 December 2004 the ESOT held 10.3 million Ordinary shares (2003 11.2 million Ordinary shares) to satisfy awards under various share based incentive schemes as described above. Of this number, 0.6 million Ordinary shares were unconditionally vested at 31 December 2004 (2003 1.3 million Ordinary shares).

Notes to the accounts continued

32. Acquisition of subsidiaries

	2004 £ million Total	2003 £ million Total
Minority interest	1.1	–
Net assets	1.1	–
Goodwill	–	2.7
	1.1	2.7
Consideration		
Issue of Ordinary shares – Caw Networks, Inc.	0.6	2.7
Cash (including expenses)	1.1	–
Adjustment to consideration – prior year acquisitions	(0.6)	–
	1.1	2.7
The cash flows in respect of the purchase of subsidiaries are as follows		
Cash (including expenses)	(1.1)	–
Cash (accrued in prior years)	–	(1.1)
Net cash outflow on acquisitions	(1.1)	(1.1)

The issue of Ordinary shares related to deferred consideration pursuant to the acquisition agreement of Caw Networks, Inc. 4.3 million Ordinary shares were issued on 31 March 2004 when the Spirent Ordinary share price was 75.5 pence. The consideration had been estimated in 2003 and provided at £2.7 million.

During the year we acquired the minority shareholdings in two of our Network Products subsidiaries for a cash consideration of £1.1 million.

33. Disposal of operations

	2004 £ million Total	2003 £ million Total
Net assets disposed of		
Fixed assets		
Intangible assets	–	0.6
Tangible assets	0.1	0.7
Stocks	0.2	2.3
Debtors	1.8	2.4
Creditors	(2.4)	(4.5)
Provisions	(1.2)	–
Investment in joint venture	–	54.3
Net (liabilities)/assets	(1.5)	55.8
Goodwill reinstated	4.9	2.6
	3.4	58.4
(Loss)/profit on disposal of operations	(0.9)	3.6
	2.5	62.0
Satisfied by		
Cash (less expenses)	2.5	62.0
The cash flows in respect of the disposal of operations are as follows		
Cash (less expenses) – net cash inflow from disposals	2.5	62.0

During the year the Group disposed of its aerospace maintenance, repair and overhaul software business from within its Systems group.

The business sold during the year contributed £1.2 million to the Group's operating cash flows, contributed nil in respect of net returns on investments and servicing of finance, paid £0.2 million of taxation and utilised £0.1 million for capital expenditure.

34. Related party transactions

During the year Group companies entered into the following transactions with related parties who are not members of the Group:

2004	Sales to related parties £ million	Purchases from related parties £ million	Amounts owed by related parties £ million	Amounts owed to related parties £ million
Associates				
Tyton Company of Japan	1.3	0.8	0.3	0.6
3M/ECC	–	1.5	–	0.2

2003	Sales to related parties £ million	Purchases from related parties £ million	Amounts owed by related parties £ million	Amounts owed to related parties £ million
Associates				
Tyton Company of Japan	1.0	0.9	0.2	0.6
3M/ECC	–	1.2	–	0.2

Sales to and purchases from related parties are made at normal market prices. Outstanding balances at year end are unsecured and settlement occurs in cash.

Principal divisions, subsidiaries and associates

	% held at 31 December 2004
Communications	
Communications performance analysis and service assurance systems	
Performance Analysis	
Spirent Communications Inc	100
Calabasas, California, USA	
Eatontown, New Jersey, USA	
Honolulu, Hawaii, USA	
Sunnyvale, California, USA	
Spirent Communications of Ottawa Ltd	100
Nepean, Ontario, Canada	
Spirent Communications (SW) Ltd*	100
Paignton, Devon, UK	
Service Assurance	
Spirent Communications of Rockville, Inc.	100
Rockville, Maryland, USA	
Spirent Communications (Scotland) Ltd*	100
Hamilton, Glasgow, UK	
Spirent Communications Ltd*	100
Crawley, West Sussex, UK	
Network Products	
Electrical and data network cable management and connectivity products and systems	
Trading divisions of Spirent plc	
HellermannTyton	
Aldridge, West Midlands, UK	
Plymouth, Devon, UK	
Wythenshawe, Manchester, UK	
HellermannTyton (Pty) Ltd	100
Johannesburg, South Africa	
HellermannTyton SA	100
Trappes, France	
HellermannTyton AB	100
Järfälla, Sweden	
HellermannTyton GmbH	100
Vienna, Austria	
HellermannTyton GmbH	100
Tornesch, Germany	
HellermannTyton Ltda	100
Jundaí, Brazil	
HellermannTyton Pte Ltd	75
Yishun, Singapore	
HellermannTyton Data Ltd*	100
Northampton, UK	
HellermannTyton Corporation	100
Milwaukee, Wisconsin, USA	
Tyton Company of Japan Ltd*‡	49
Tokyo, Japan	

	% held at 31 December 2004
Systems	
Control systems for the mobility and industrial markets	
PG Drives Technology Ltd	100
Christchurch, Dorset, UK	
PG Drives Technology Inc	100
Anaheim, California, USA	

The above companies operate and are incorporated in the countries listed. All shareholdings in the companies are held indirectly by Spirent plc, except where indicated by an asterisk (*) where the shareholding is held directly by Spirent plc. The activity mentioned is indicative and not comprehensive.

The percentage held reflects the proportion of shares controlled and not the beneficial interest.

‡ Associate

Financial history

£ million

	2004	2003	2002[1]	2001[1]	2000[1]
Consolidated profit and loss account					
Turnover – Group and share of joint venture	475.0	488.6	634.5	880.1	772.7
Less share of joint venture's turnover	–	(22.4)	(75.6)	(78.3)	(76.0)
Turnover	475.0	466.2	558.9	801.8	696.7
Operating profit/(loss)	30.8	18.8	(970.6)	(734.3)	110.0
Operating exceptional items					
Goodwill impairment	–	–	923.3	724.6	–
Other	2.9	7.5	41.6	34.9	2.2
Goodwill amortisation	9.1	9.7	56.1	86.6	25.7
Operating profit before goodwill amortisation and exceptional items	42.8	36.0	50.4	111.8	137.9
Joint ventures' (loss)/profit	(0.7)	2.7	7.4	9.6	13.3
Associates' profit net of goodwill amortisation	2.8	2.1	0.8	1.2	2.7
Non-operating exceptional items					
(Loss)/profit on disposal and closure of operations	(0.9)	3.6	(48.4)	14.5	(18.1)
Profit on disposal of tangible fixed assets	–	–	–	–	3.2
Profit/(loss) before interest	32.0	27.2	(1,010.8)	(709.0)	111.1
Net interest payable	(6.8)	(9.3)	(12.3)	(22.8)	(29.3)
Exceptional interest payable	(0.5)	(16.1)	–	–	–
Other finance (expense)/credit	(0.7)	(1.5)	(0.3)	0.4	–
Profit/(loss) before taxation	24.0	0.3	(1,023.4)	(731.4)	81.8
Taxation	(7.7)	(0.6)	(26.9)	(32.4)	(30.6)
Minority interest	(0.3)	(0.2)	(0.4)	(0.2)	(0.5)
Profit/(loss) attributable to shareholders	16.0	(0.5)	(1,050.7)	(764.0)	50.7
Dividends	–	–	(12.5)	(40.0)	(36.1)
Profit/(loss) for the year	16.0	(0.5)	(1,063.2)	(804.0)	14.6
Consolidated balance sheet					
Intangible assets	88.8	101.6	113.6	987.7	1,816.8
Tangible assets	86.3	90.2	110.0	137.6	136.2
Investments	15.8	14.9	63.4	62.6	53.6
Working capital (excluding cash, overdrafts and deferred tax)	23.2	28.3	46.6	32.7	111.1
Operating assets	214.1	235.0	333.6	1,220.6	2,117.7
Net borrowings	(26.4)	(57.5)	(161.8)	(179.1)	(326.4)
Provisions for liabilities and charges	(15.7)	(20.2)	(28.4)	(1.5)	(2.1)
Deferred tax asset	–	–	–	25.8	15.8
Net assets (excluding pension liability)	172.0	157.3	143.4	1,065.8	1,805.0
Pension liability	(27.0)	(35.2)	(46.2)	(15.6)	–
Net assets (including pension liability)	145.0	122.1	97.2	1,050.2	1,805.0
Shareholders' funds – equity	143.7	119.9	95.1	1,047.8	1,801.3
Minority interest – equity	1.3	2.2	2.1	2.4	3.7
	145.0	122.1	97.2	1,050.2	1,805.0
Investment					
Capital expenditure					
Owned assets	25.3	16.7	27.6	59.4	44.8
Leased assets	0.3	0.3	0.2	0.8	2.5
Depreciation	25.4	29.3	33.6	37.2	25.1
Product development	67.3	66.0	77.7	95.9	60.3

Financial history continued

	2004	2003	2002[1]	2001[1]	2000[1]
Share information					
Basic earnings/(loss) per share[4] (pence)	1.70	(0.05)	(113.90)	(83.49)	7.40
Headline earnings per share[4] (pence)	2.99	2.31	3.36	7.70	12.61
Diluted earnings/(loss) per share (pence)	1.67	(0.05)	(113.90)	(83.49)	7.18
Dividend per share (pence)	–	–	1.35	4.35	4.35
Fully paid Ordinary shares in issue at year end (million)	956.2	944.0	939.4	933.2	926.5

£ million

	2004	2003	2002[1]	2001[1]	2000[1]
Segmental analysis					
Turnover					
Performance Analysis	176.8	148.7	184.0	241.4	280.0
Service Assurance	74.7	91.7	131.4	189.2	9.2
Communications	251.5	240.4	315.4	430.6	289.2
Network Products	187.8	174.4	164.7	170.4	181.4
Systems	31.3	37.9	34.3	29.1	26.5
	470.6	452.7	514.4	630.1	497.1
Disposals[2]	4.4	13.5	44.5	171.7	199.6
	475.0	466.2	558.9	801.8	696.7
Operating profit[3]					
Performance Analysis	19.7	4.4	10.0	38.6	97.0
Service Assurance	0.2	9.4	20.8	44.8	1.6
Communications	19.9	13.8	30.8	83.4	98.6
Network Products	20.4	16.7	15.0	14.9	25.3
Systems	1.9	6.1	3.8	4.2	5.1
	42.2	36.6	49.6	102.5	129.0
Disposals[2]	0.6	(0.6)	0.8	9.3	8.9
	42.8	36.0	50.4	111.8	137.9

£ million

	2004	2003	2002[1]	2001[1]	2000[1]
Operating profit/(loss) by source					
Europe	20.4	21.5	18.9	16.9	17.8
North America	19.7	13.8	29.8	84.0	108.5
Asia Pacific, Rest of Americas, Africa	2.1	1.3	0.9	1.6	2.7
	42.2	36.6	49.6	102.5	129.0
Disposals[2]	0.6	(0.6)	0.8	9.3	8.9
	42.8	36.0	50.4	111.8	137.9
Operating exceptional items					
Goodwill impairment	–	–	(923.3)	(724.6)	–
Other	(2.9)	(7.5)	(41.6)	(34.9)	(2.2)
Goodwill amortisation	(9.1)	(9.7)	(56.1)	(86.6)	(25.7)
	30.8	18.8	(970.6)	(734.3)	110.0
Earnings before interest, taxation, depreciation, amortisation and exceptional items	68.2	65.3	84.0	149.0	163.0
Impact of exchange rate movement on profit before taxation[3]					
(Cost)/benefit	(2.5)	0.7	(1.1)	1.9	6.1

Rates against sterling

	2004	2003	2002[1]	2001[1]	2000[1]
Average exchange rates for major currencies					
US dollar	1.83	1.64	1.51	1.44	1.51
Euro	1.47	1.45	1.59	1.61	1.64

Number

	2004	2003	2002[1]	2001[1]	2000[1]
Average employment by geographical area					
Europe	1,742	1,722	1,909	2,730	2,826
North America	1,988	2,071	2,622	3,608	2,894
Asia Pacific, Rest of Americas, Africa	791	705	648	1,474	1,230
	4,521	4,498	5,179	7,812	6,950

Notes

1 Restated in 2002 and 2001 for the adoption of FRS 17 'Retirement Benefits' and in 2002, 2001 and 2000 for the adoption of UITF 38 'Accounting for ESOP Trusts'.

2 Disposals include discontinued operations and other less significant disposals and closures.

3 Before goodwill amortisation and exceptional items.

4 The weighted average number of shares in issue used to calculate earnings/(loss) per share excludes the shares held by the SST, the ESOT and Greenwood Nominees.

Shareholder information

Shareholder analysis

At 24 February 2005, the number of registered shareholders was 7,207 and the number of Ordinary shares in issue was 959.6 million.

	Number of holdings	Percentage of total shareholders	Number of shares million	Percentage of share capital
Range of holdings:				
1-5,000	4,963	68.87	7.9	0.83
5,001-10,000	880	12.21	6.6	0.69
10,001-50,000	883	12.25	18.8	1.96
50,001-100,000	125	1.73	8.8	0.90
100,001-250,000	111	1.54	18.3	1.91
250,001-500,000	66	0.92	23.6	2.46
500,001-1,000,000	60	0.83	43.5	4.53
1,000,001-Highest	119	1.65	832.1	86.72
Total	7,207	100.00	959.6	100.00
Held by:				
Individuals	5,532	76.76	33.2	3.46
Institutions	1,675	23.24	926.4	96.54
Total	7,207	100.00	959.6	100.00

Lloyds TSB Registrars*

Enquiries concerning shareholdings, change of address or other particulars should be directed in the first instance to the Company's Registrar, Lloyds TSB Registrars on 0870 600 3964. They also provide a range of online shareholder information services at www.shareview.co.uk, where shareholders can check their holdings and find practical help on transferring shares or updating their details.

Spirent Single Company ISA

Lloyds TSB Registrars (a division of Lloyds TSB Bank plc, which is regulated by the Financial Services Authority) operate a Single Company Individual Savings Account (ISA) in which Spirent Ordinary shares can be held in a tax efficient manner. Full details and an application form can be obtained from Lloyds TSB Registrars on 0870 242 4244.

Internet, telephone and postal share dealing services – Lloyds TSB Registrars

Lloyds TSB Registrars Shareview Dealing is a telephone and Internet service that provides a simple and convenient way of buying and selling Spirent Ordinary shares. For telephone services call 0870 850 0852 between 8.30am and 4.30pm, Monday to Friday, and for Internet services visit www.shareview.co.uk/dealing

A postal dealing service for buying and selling Ordinary shares is also available and a dealing form can be obtained by calling 0870 242 4244.

Share price information

The Spirent share price is available via the Company's website (www.spirent.com) and also in various newspapers published in the UK.

UK capital gains tax

For the purposes of capital gains tax, the market value of an Ordinary share on 31 March 1982, as adjusted for subsequent capitalisation issues, was 97.233 pence per share.

American Depositary Receipts (ADRs) – The Bank of New York*

The Company's shares are traded on the New York Stock Exchange (ticker: SPM) in the form of American Depositary Shares (ADS) and these are evidenced by ADRs, each one of which represents four Ordinary shares. The Bank of New York is the authorised Depositary bank for the Company's ADR programme. The Company's ADS price is quoted daily in the Wall Street Journal and can be obtained from either the Spirent website or via the New York Stock Exchange website at www.nyse.com

Spirent website at www.spirent.com

The Spirent website provides further information about Spirent and its operating groups and also provides access to annual reports, press releases, share price information and links to Spirent operating group websites. Additional corporate governance information may also be found on this website.

Unsolicited mail

The Company is obliged by law to make its share register available upon request to the public and to other organisations, which may use it as a mailing list, resulting in shareholders receiving unsolicited mail. Shareholders wishing to limit the receipt of such mail should write to the Mailing Preference Service, DMA House, 70 Margaret Street, London W1W 8SS or call +44 (0)20 7291 3310 for an application form or visit www.mps-online.org.uk

ShareGIFT

Shareholders who hold only a small number of shares, where dealing costs may make it uneconomical to sell them, may wish to consider donating them to charity through ShareGIFT, a registered charity administered by The Orr Mackintosh Foundation. The relevant share transfer form can be obtained from Lloyds TSB Registrars. Further information is available at www.sharegift.org or telephone +44 (0)20 7337 0501.

Annual General Meeting

The Company's Annual General Meeting will be held at 10.30am on Wednesday 4 May 2005 at the Copthorne Hotel (London Gatwick), Copthorne Way, Copthorne, Crawley, West Sussex RH10 3PG United Kingdom.

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