

ST Engineering's US acquisitions in recent years, namely Miltope, VT Halter Marine and San Antonio Aerospace have all shown improved performance. Significantly, the latter turned profitable and VT Halter Marine made substantial progress towards breakeven in 2004. Despite increased competitive pressures, the Group achieved improved performance in 2004 with turnover and profits at their highest levels since its formation in 1997.

## GROUP OVERVIEW

### GROUP'S VISION, MISSION & STRATEGIES

ST Engineering was formed in December 1997 through the merger of four public listed companies, Singapore Technologies Aerospace (ST Aerospace), Singapore Technologies Electronics (ST Electronics), Singapore Technologies Automotive (ST Automotive) and Singapore Technologies Marine (ST Marine), within the then Singapore Technologies Group. The merger created an integrated defence and engineering group with a comprehensive suite of capabilities and products to meet the needs of global customers.

In early 2000, the Group acquired the Chartered Industries of Singapore group of companies, which was then largely in the production of munitions and defence ordnance, and merged it with ST Automotive to form Singapore Technologies Kinetics (ST Kinetics).

Headquartered in Singapore, ST Engineering today has a staff strength of about 12,000, most of whom are located in Singapore and the US. It has also established a strong presence in various parts of the world, offering a comprehensive range of services and products through its four sectors, namely Aerospace, Electronics, Land Systems and Marine.

### Vision and Mission

ST Engineering's vision is to be a global defence and engineering group. Its mission is to bring value to its customers and partners by delivering total integrated quality solutions and support.

### Strategies

To achieve its vision and mission, the Group focusses on four areas: develop its strategic capabilities, build global networks, strengthen business partnerships and attain business excellence. These in turn provide the impetus for its customer centric business processes, strong design capabilities, quality workmanship and competitive edge through innovation, pricing and continual improvements.

### Performance measures

To measure its progress and achievements towards realising its vision and mission, the Group has both short and long term performance targets for its four focus areas. These include the number of new products/services and capabilities introduced, the number of new investments, R&D expenditure, sales and profits growth, return on equity and EVA.

## SECTOR OVERVIEW

### AEROSPACE SECTOR

The Group's aerospace arm is ST Aerospace. Since its beginnings in 1975 as a maintenance depot to the Republic of Singapore Air Force (RSAF), ST Aerospace has become a leading global third party provider of Maintenance, Repair and Overhaul (MRO) services for a wide range of military and commercial aircraft. It was ranked the world's largest third party commercial airframe MRO service provider (based on manhours for heavy airframe maintenance alone) in the latest biennial survey in March 2003 by the magazine, *Overhaul and Maintenance*.

Headquartered in Singapore, ST Aerospace has global operations and a worldwide customer base. These customers include seven of the world's 11 largest airlines, three major freight forwarders and many of the world's leading air forces. ST Aerospace has also enhanced its standing in the Low Cost Carrier (LCC) market. Its LCC clients include Valuair, AirAsia and Jetstar Asia.

Quality and safety are essential values in the aviation industry, and all ST Aerospace's operations conform to the exacting standards of its quality system. The ST Aerospace quality system is audited and approved by major airworthiness authorities such as the Civil Aviation Authority of Singapore, the US Federal Aviation Administration, the European Joint Aviation Authority, the Japan Civil Aviation Bureau and the UK Civil Aviation Authority.

ST Aerospace's major facilities are located at Changi, Paya Lebar and Seletar airports, Singapore; Mobile and San Antonio, USA; and Bournemouth and Stansted, UK. A new capability for commercial airframe MRO was added in an exciting growth market in 2004 through the start up of Shanghai Technologies Aerospace Company (STARCO) in Shanghai, China. STARCO is a Joint Venture (JV) with China Eastern Airlines (CEA).

ST Aerospace has three business groups: Aircraft Maintenance & Modification (AMM), Component/Engine Repair & Overhaul (CERO), and Engineering & Materials Services (EMS). With the capabilities of these business groups, ST Aerospace offers Total Aviation Support (TAS) covering airframe, engines and components, and material and engineering services to customers worldwide.

#### Aircraft Maintenance & Modification

The AMM business group has, since 2003, strengthened its repair capabilities for the complete spectrum of narrow and wide-body Airbus, Boeing and McDonnell Douglas aircraft types including the latest additions on the A330, A340 and B777 capabilities. For military aircraft, apart from its strong and broad based capability for many helicopters and military aircraft, ST Aerospace extended its capabilities to the F-16 fighter aircraft and the Chinook helicopter. These included airframe as well as engines and components repair and overhaul capabilities.

In 2004, in response to customer demands, the sector added three new hangars, costing about US\$20m (\$33m), at ST Mobile Aerospace Engineering (MAE) in the US and ST Aviation Services Co (SASCO) in Singapore. It also undertook to build two more narrow-body slots at its Seletar facility for ST Aerospace Engineering (STA Engineering). These are expected to be ready in early 2005. At the same time, a two wide-body aircraft hangar in STARCO at Pudong Airport is being planned to complement the current two-hangar Hongqiao facility.

#### Component/Engine Repair & Overhaul

Investments in engines and components assets (for the support of the B737CG and B737NG as well as the A319/320/321 aircraft) and MRO continued unabated. On engine support, ST Aerospace further developed capabilities for the B737CG, B737NG and the F-16. Service centre agreements were renewed with Rolls Royce for the repair and overhaul of the T56/501D



engines while new service centre status was granted by Honeywell for the repair and overhaul of its T55 engines.

On non engine components, the CERO group enhanced its range of capabilities for the B777, B767, B757, B737CG, B737NG, A320, A300/310 and the MD-11 commercial aviation components, as well as added new capabilities for the F-16 and Chinook military components. ST Aerospace received additional authorisation from Original Equipment Manufacturers (OEMs), including Howell Instruments for the repair and overhaul of all its products in South East Asia, and Sargent Controls & Aerospace for its hydraulic valves in Asia. Notable service centre renewals included an agreement with Eurocopter for the SA-330, AS-332 and AS-550 helicopters in Asia.

#### Engineering & Materials Services

ST Aerospace continued to build upon its engineering expertise. In the engineering and development arena, the sector's engineering capabilities added value to customers through Maintainability and Reliability Engineering (MRE) studies to improve the performance of their fleet cost efficiency. These MRE initiatives did not remain as studies but were translated into enhancement programmes for customers.

ST Aerospace has also extensively applied its Aircraft Maintenance and Engineering System (AMOS) to support the maintenance planning needs of its customers on TAS programmes. The software performs maintenance planning and reliability calculations while tracking components/rotables and aircraft scheduling. Armed with updated information, AMOS is able to keep customers informed, from anywhere and at any time, about the progress of their maintenance programmes in an accurate and effective manner.

#### ELECTRONICS SECTOR

ST Electronics, the electronics arm of ST Engineering, is a leading electronics and Information & Communications Technology (ICT) system house in the region. It is headquartered in Singapore with offices in Australia, China, Hong Kong, Malaysia, Mexico, Taiwan and the US. It markets to over 60 countries.

ST Electronics specialises in the design, development and integration of purpose-built electronics and ICT systems, such as broadband RF and microwave communications, intelligent rail and traffic management including fleet management and telematics solutions, real time command and control, training and simulation, intelligent building management, information security and m-commerce solutions.

ST Electronics prides itself in delivering innovative system solutions to defence, commercial and industrial customers worldwide. Its commercial customers include rail operators such as the Singapore Mass Rapid Transit, the Taiwan Department of Rapid Transit System, the Manila Light Rail Transit Authority and the Guang Zhou Metro Corporation; transportation authorities such as the Land Transport Authority (LTA) and Suzhou City (China) Public Security Bureau; and public safety agencies and network operators/system integrators worldwide.

ST Electronics' main offices are located at Ang Mo Kio and Jurong East in Singapore; Perth in Australia; Beijing, Chengdu, Shanghai, Guangzhou and Shenzhen in China; Hong Kong; Kuala Lumpur in Malaysia; Monterrey in Mexico; Taipei in Taiwan and Bangkok in Thailand.

ST Electronics has three business groups, namely Large-Scale Systems Group (LSG), Communication & Sensor Systems Group (CSG) and Software Systems Group (SSG).

### Large-Scale Systems Group

LSG is recognised as a leading regional rail electronics systems provider. Besides Singapore, it has provided rail system solutions in China, the Philippines and Taiwan. LSG's rail solutions include automatic fare collection and communications systems and electronics systems. These include supervisory control and data acquisition, security and access control, platform screen doors, passenger information, maintenance management, signalling and management information systems.

As LSG's projects are infrastructural in nature, a range of capabilities, strong local partnerships and ability to secure project financing are critical success factors to winning projects. LSG's strong track record and network of partners built over the years put it in an advantageous position as the industry moves towards private public partnerships.

### Communication & Sensor Systems Group

CSG is made up of two main business units, Agilis Communication Technologies (Agilis) and CET Technologies (CET).

Agilis, a leading supplier of Very Small Aperture Terminals (VSAT) and other satellite communications and network solutions, currently sells to customers in nearly 60 countries. New countries added in 2004 were Austria, Bangladesh, Columbia, Fiji, Hungary, Lithuania, New Zealand and Romania. Agilis continues to expand its capabilities and range of wireless communication products and solutions by launching new products including a Coastal and Mobile Surveillance System and an enhanced Network Management System.

Expanding and converging its expertise in wireless communications and fleet management capabilities, CET has added to its suite of solutions a Telematics System. By integrating General Packet Radio Service

(GPRS), Bluetooth and Global Positioning System (GPS), telematics equip vehicles with wireless communications and computing capabilities. Users can obtain information and services on the go including access to the Internet and various emergency services. Having equipped more than 20,000 vehicles for fleet owners worldwide with its advanced Fleet Management Systems, CET has strengthened its position as a leading communications solution house.

### Software Systems Group

SSG comprises two main business units, SES Systems (SES) and ST Training & Simulation (STTS). SES successfully penetrated new markets after securing an Air Traffic Control Aerodrome Visual Simulator project in India and contracts to provide e-Government solutions to government agencies in Botswana. It also acquired a stake in ECS Holdings (ECS), a public listed company in Singapore. This enables SES to leverage on ECS' extensive channel coverage and business networks in the region, particularly China and extend the reach of its IT Infrastructure product and solution offerings.

SES is the lead business unit within ST Electronics for public safety. It spearheads the sector's integrated electronics and software systems offering for homeland security and public safety purposes. The range of homeland security solutions includes border security, maritime security, key installation protection systems and track and trace solutions.

STTS continued to build on its expertise in crucial training methodologies, subject matter expertise and underlying computer and visual graphic technologies to create innovative and value added training and simulation systems. New products launched included the Unmanned Aerial Vehicle Trainer and the Advanced Combat Emulator.

ST Education and Training, a subsidiary of STTS, is gaining a reputation as a qualified maritime security consultant. It is approved by Panama as a Recognised Security Organisation to help ports and carriers meet the International Ship and Port Facility Security Code.

## LAND SYSTEMS SECTOR

ST Kinetics, the Group's land systems arm, was formed in 2000 when Chartered Industries of Singapore was acquired and merged with ST Automotive. The acquisition created a larger and more comprehensive land systems group. ST Kinetics' headquarters and major facilities are in Singapore.

ST Kinetics' defence business capabilities include integrated platform and weapon systems design and engineering, manufacturing, system integration, upgrading, MRO and other lifecycle management services. In the commercial arena, ST Kinetics provides automotive and laboratory services and is currently developing and expanding its capabilities into smart vehicle subsystems and commercial specialty vehicles.

The company had its roots in the conventional defence business. However, in the last few years, ST Kinetics has repositioned itself to focus on technologies of the future, with emphasis on smarter, network-centric solutions to meet the needs of modern armed forces. Concurrently, it has also been actively growing its commercial vehicle business, leveraging on its core automotive and vehicular competencies. While operations are mainly based in Singapore, it also has automotive businesses in China, Ireland and North America via subsidiaries and associated companies.

ST Kinetics has two business divisions: Defence Business and Commercial Business.

### Defence Business

The Defence Business division continues to support the Singapore Armed Forces (SAF) in their quest for new technologies and operating concepts for a leaner and

more potent Third Generation (3G) Army. Leveraging on its experience and technical know how on explosives and survivability solutions against armaments, the division has also embarked on homeland security initiatives in 2004.

In exports, the Defence Business division continues to secure recurring sales in existing markets as well as open new markets. It is establishing its presence in the global market through major international defence exhibitions and is actively participating in major vehicle programmes for potential customers worldwide. The contract by Finland, awarded in July to conduct a feasibility study for a Future All Terrain Vehicle programme, is an endorsement of ST Kinetics' technical competence in the global defence market.

### Commercial Business

The Commercial Business division has been growing its local automotive services and venturing into the commercial vehicles market overseas. STAR Automotive Centre (STAR) has successfully established a franchise scheme in Singapore and has signed JV agreements to set up one stop premier automotive centres with Chinese partners in Hangzhou and Guangzhou, subject to regulatory approvals. Beijing Zhonghuan Kinetics Heavy Vehicles Co (BZK), the 50-50 JV company in China, started operations in March and has been producing a range of vehicles for the construction industry. The Commercial Business division is constantly looking for opportunities to venture further overseas and to be a significant contributor to the sector's total revenue in the longer term.

## MARINE SECTOR

ST Marine is the marine arm of the Group and is headquartered in Singapore. It specialises in the design, construction, maintenance, repair, upgrading and life extension of naval and commercial vessels. Together with its US operations, VT Halter Marine, ST Marine has a global clientele that spans Asia, Europe, Middle East and the US.

### Shipbuilding

ST Marine's local facilities provide turnkey shipbuilding solutions for a wide range of naval and commercial vessels from concept definition, detailed design, construction, onboard system installation and integration, to testing and commissioning.

With its strong design capabilities, supported by the latest in 3D Computer Aided Design systems and technologies, ST Marine takes pride in delivering innovative, customised shipbuilding solutions to its international clientele.

ST Marine is currently building five frigates for the Republic of Singapore Navy (RSN). These state of the art warships are the largest and most sophisticated naval vessels ST Marine has built.

ST Marine has designed and constructed commercial vessels such as Feeder Container Vessels, RoRo/LoLo vessels and High Speed Passenger Catamaran. Its most recent commercial project was the construction of three sophisticated Platform Supply Vessels.

ST Marine's US operations, VT Halter Marine, based in Pascagoula, Mississippi, is a leader in the design and construction of medium sized ships in the US. It is currently constructing two technologically advanced Fisheries Survey Vessels (FSV) for the National Oceanic and Atmospheric Administration (NOAA) as well as two Logistic Support Vessels (LSVs) for the US Army.

In the commercial sector, VT Halter Marine's track record includes the construction of an Offshore Supply Vessel. Current commercial newbuilding projects at VT Halter Marine include the construction of a Stevedoring Crane Barge, Passenger Ferry, Harbour Tugs, Articulated Tug Barge units and a Pure Car Truck Carrier (PCTC) – the first such carrier to be built in the US.

With its strong design capabilities, backed by its sterling track record, the Marine sector is well placed to offer innovative, customised solutions to meet the demands of its customers' operations.

### Shiprepair

ST Marine is reputed for providing quality shiprepair services at competitive rates and fast turnaround time. Its proven track record extends from jumboisation and ship conversion to upgrading and retrofitting of commercial vessels. These vessels include bulk carriers and tankers, RoRo vessels, dredgers, seismic vessels, offshore supply vessels and cruise liners.

ST Marine also provides shiprepair services to naval vessels. These services include damage repairs, docking and specialised services for high speed diesel engines and midlife refits. ST Marine also refits submarines for the RSN.

Supported by comprehensive facilities which cover a total of 18.8 hectares, ST Marine has the capability to service vessels up to 70,000dwt panamax sized vessels as well as warships up to frigate size.

OPERATING REVIEW

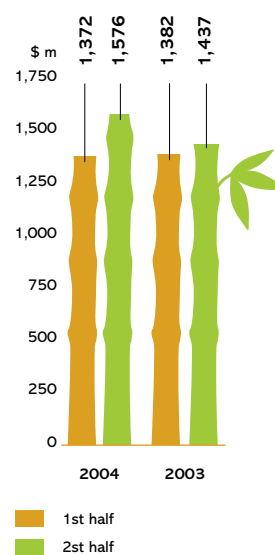
PERFORMANCE OF THE PERIOD

(a) Half Yearly Performance

In \$ m Except Per Share Amounts	2004			2003		
	1H	2H	Full Year	1H	2H	Full Year
Turnover	1,372	1,576	2,948	1,382	1,437	2,819
EBITDA	190.6	228.9	419.5	217.0	191.0	408.0
EBIT	148.5	192.5	341.0	172.8	145.6	318.4
Profit before tax	202.0	248.4	450.4	215.2	197.5	412.7
Profit after tax after minority interest	155.7	202.7	358.4	164.2	161.4	325.6
Basic earnings per share (cents) before extraordinary items	5.4	7.0	12.4	5.7	5.6	11.3
Net assets value per share (cents)	40.2	47.0	47.0	40.4	45.9	45.9

The Group's turnover for the second half of 2004 increased by 15% or \$204m compared to the first half. All sectors reported higher turnover in the second half vis-à-vis the first half. For the Aerospace sector, the higher turnover came from higher sales in SASCO and San Antonio Aerospace (SAA), as well as higher engines sales and higher project milestone completions. For the Electronics sector, the higher turnover was mainly contributed by milestone completions of the LTA Circle Line project and a command and control systems project. For the Land Systems sector, the higher turnover was mainly due to the delivery of Primus and higher munitions sales, but these were partially offset by lower delivery of other weapon programmes. For the Marine sector, the higher turnover was attributable to local shipbuilding operation.

Half Yearly Turnover



Half Yearly Profit Before Tax



The Group's net Profit Before Tax (PBT) for the second half of 2004 increased by 23% or \$46.5m over the first half due mainly to the higher turnover in the Aerospace, Electronics and Marine sectors, as well as lower operating expenses, mainly in the Aerospace and Electronics sectors.

(b) Full Year Performance

Turnover

Compared to the previous year, FY2004 turnover of the Group increased by 5% or \$129m to \$2,948m. All sectors except the Land Systems sector recorded higher turnover in FY2004 over FY2003. The increase under "Others" was due to the inclusion of turnover from Miltope of \$112m. Miltope, located in US, was acquired by the Group in December 2003.

### Aerospace sector

Compared to FY2003, the Aerospace sector's FY2004 turnover increased by 2% or \$26m to \$1,118m. The increase in turnover largely came from the AMM business group, due to higher redeliveries in SASCO and SAA, but these were partially offset by lower sales in MAE.

### Electronics sector

FY2004 turnover of \$626m for the Electronics sector increased by 2% or \$12m over that of FY2003. Both LSG and SSG registered higher turnover, but these were partially offset by lower turnover from CSG. The increase in SSG's turnover was mainly attributable to milestone completions of a command and control systems project, a ship console project and simulator projects, while the milestone completions of the LTA's Circle Line project and the supply of Multi-channel Multipoint Distribution System (MMDS) product to Mexico accounted for the higher turnover in LSG. For CSG, the lower turnover was the result of lower delivery of communications equipment.

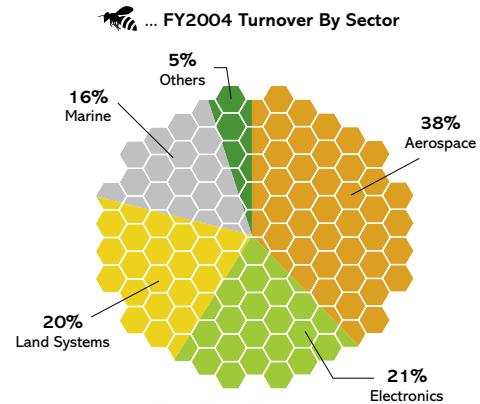
### Land Systems sector

Land Systems sector's FY2004 turnover of \$591m was lower than FY2003 by 18% or \$126m. All three business groups recorded lower turnover in the current year compared to the previous year. The lower turnover of the Automotive (Auto) business group was mainly due to the completion of an engineering development project and an armoured vehicle upgrading programme in 2003, while the lower delivery of Primus and other weapon programmes, partially offset by higher munitions sales, accounted for the lower turnover of the Munitions & Weapon (M&W) business group. For the Services, Trading and Others (S&T) business group, lower engine sales led to the lower turnover.

### Marine sector

FY2004 turnover of \$484m for the Marine sector increased by 25% or \$97m compared to FY2003. All three business groups contributed to the higher

turnover for FY2004. The increase in Shipbuilding turnover was largely due to higher activities, while the increase in Shiprepair turnover was attributable to a more active shiprepair market.



### Profit

Group PBT for FY2004 of \$450.4m was higher than that achieved in FY2003 by 9% or \$37.7m. All sectors except the Land Systems sector recorded higher PBT.

### Aerospace sector

Compared to FY2003, FY2004 PBT of the Aerospace sector of \$236.6m was higher by 5% or \$11.4m. The higher PBT was largely contributed by the EMS business group, but this was partially offset by lower PBT of the AMM and CERO business groups. The higher PBT of the EMS business group came from higher investment income and contribution from the biennial Asian Aerospace 2004 exhibition. Unfavourable sales mix accounted for the lower PBT in the CERO business group. Although turnover in the AMM business group increased, the margin dropped due to the lower utilisation of the facilities at MAE in FY2004 arising from the deferral of aircraft maintenance schedules by a major customer.

### Electronics sector

PBT of the Electronics sector in FY2004 of \$65.7m was higher than that of FY2003 by 7% or \$4.3m. The higher PBT was contributed by LSG and SSG.

SSG recorded higher PBT due to higher turnover, while higher turnover and better operational efficiency accounted for the higher PBT of LSG.

**Land Systems sector**

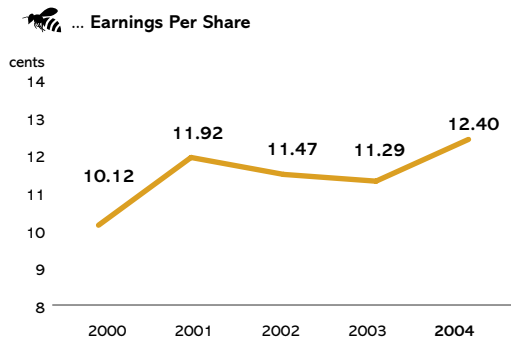
Land Systems sector's FY2004 PBT of \$72.6m was 25% or \$23.8m lower than that achieved in FY2003. Lower PBT was largely contributed by the Auto and M&W business groups. The lower PBT of the Auto business group was attributable mainly to lower contribution from lower turnover and weaker product mix as well as provision for impairment in value of a long term investment, but these were partially offset by lower operating expenses and the absence of amortisation of goodwill. The lower PBT of the M&W business group was impacted by lower turnover and weaker product mix as well as the absence of writeback of provision for liquidated damages, which aided profits for FY2003, but these were partially offset by lower operating expenses.

**Marine sector**

PBT of the Marine sector in FY2004 of \$70.1m increased significantly by 99% or \$34.9m compared to FY2003. The increase largely came from Shipbuilding and Shiprepair, but this was partially offset by lower investment income. The higher PBT recorded by Shipbuilding was in line with the higher turnover achieved, while the higher Shiprepair PBT was due to higher turnover and better margins.

**(c) Earnings Per Share (EPS)**

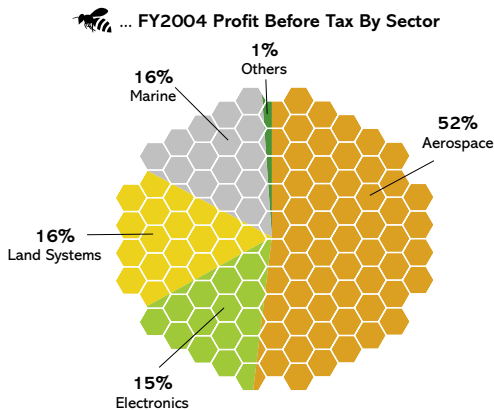
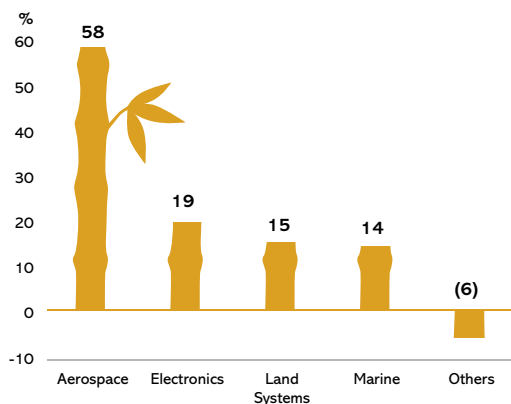
The Group's basic and diluted EPS for FY2004 were 12.40 cents and 12.36 cents respectively (FY2003: 11.29 cents and 11.27 cents respectively). The higher EPS was a result of higher profit after tax for FY2004.



**(d) Economic Value Added (EVA)**

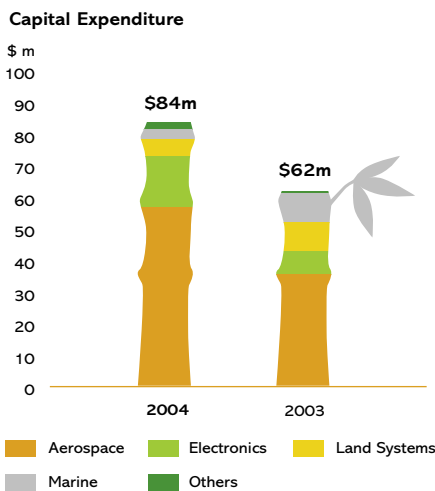
The Group's EVA for FY2004 was \$238.7m, a decrease of \$2.2m or 1% over FY2003. The Weighted Average Cost of Capital (WACC) was 7.4% for 2004 (2003: 6.5%).

FY2004 EVA Contribution By Sector



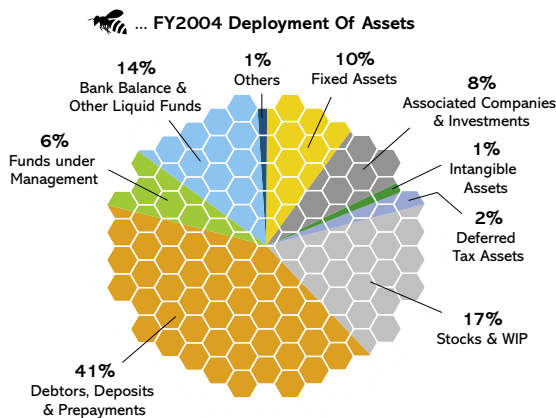
(e) Capital Expenditure

The Group incurred capital expenditure of \$84m in FY2004. The purchase of new hangars and related equipment, and rotables by the Aerospace sector as well as the acquisition of a new building by the Electronics sector contributed to the bulk of the capital expenditure for the year. The details are shown in note 8 to the financial statements.

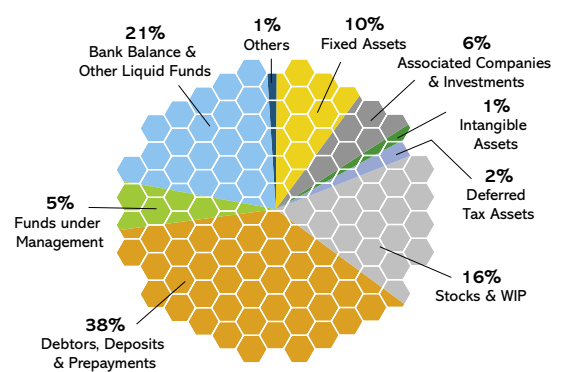


(f) Total Assets

As at end December 2004, total assets of the Group amounted to \$4.06b compared to \$4.12b as at end December 2003. The deployment of assets is as follows:



**... FY2003 Deployment Of Assets**



(g) Major Acquisitions

**Aerospace sector**

STARCO set up a commercial aircraft repair facility in Shanghai, China, and was granted a business licence by the Shanghai's State Administration for Industry and Commerce to commence operations in January 2005. ST Aerospace's planned share of investment was US\$35.8m, of which US\$5.37m has been invested.

In May, ST Aerospace increased its equity stake in Bournemouth Aviation Services Company (BASCO) from 60% to 81%, reinforcing ST Aerospace's commitment to serve the European aviation market.

In December, ST Aerospace acquired Singapore Technologies Pte Ltd's 50% shareholding in ST Aviation Resources (STAR), making STAR a wholly-owned subsidiary.

**Electronics sector**

In January, ST Electronics increased its stake in Sino Stride Technology (Holdings) (SST) from 9.96% to 19.92% through the exercise of an equity option for HK\$28.5m (\$6.3m). SST has a leading market position in Zhejiang province, China, in intelligent building systems integration. The increase in ST Electronics' equity stake underlined a growing partnership in the area of infrastructure projects in Chinese cities.

In February, ST Electronics (Shanghai) invested RMB2.55m in a newly incorporated company, ST Electronics-PCI, for a 51% equity stake. This tie up with Pacific City International Holdings (PCI) and Guangzhou PCI is to help ST Electronics (Shanghai) develop and grow its business in South China.

In March, iTS Technologies, a wholly owned subsidiary of STTS, took up a 51% equity stake in a newly incorporated company, Prescient Systems & Technologies (Prescient). The total investment in Prescient was \$3.8m. The investment in Prescient is to help accelerate ST Electronics' entry in the international market for new training instrumentation systems.

To further extend its software development capabilities, SES acquired a 21.35% equity stake in ECS for a cash consideration of \$24.8m in September. This investment will allow SES to augment its end to end mission critical IT infrastructure solutions. It will also enhance SES' marketing network in Asia through ECS' regional distribution channels.

In November, SES also set up a wholly owned subsidiary, Xinke Information Systems (Xinke), in Shenzhen, China. This was to tap into the abundant competitive talent pool in China to support its software work and to provide public safety solutions to Shenzhen and Guangzhou. Xinke will be SES' platform to capitalise on the growth potential in the global outsourcing business and tap the business opportunities in China's public safety market.

#### (h) Major Projects

##### **Aerospace sector**

Despite the aviation downturn over the last few years, ST Aerospace has a robust order book that includes PTF aircraft conversions, maintenance work and development activities. Also, with almost three

decades of support to the RSAF, ST Aerospace is its strategic partner and has been meeting its exacting requirements and demand for leading edge technologies.

External major military projects embarked in 2004 included the US Pacific Airforce C-130 programme for depot maintenance work; the acquisition and refurbishment of UH-1H helicopters for the Philippines Air Force; and a fleetwide avionics standardisation programme for one of its customers. ST Aerospace has also launched new products, especially in the Unmanned Aerial Vehicles (UAV) arena. This included the launch of its Fantail (rotary wing) and Skyblade II UAVs for surveillance activities.

In 2004, the engineering and development arm of ST Aerospace filed six patents.

For commercial aviation work, ST Aerospace continued to work closely with its blue chip customers such as FedEx Express, Japan Airlines, Northwest Airlines, All Nippon Airways, United Parcel Service (UPS) and United Airlines. New customers, both large and small, continued to be added. This further positions the company as a global service provider.

In the engineering and modification segment, the sector continued to undertake more PTF modifications and design and development programmes. On PTF conversions, ST Aerospace has started development on variants of the B757 PTF including a 15 pallet configuration and marketing its 14<sup>1</sup>/<sub>2</sub> pallet configuration on an approved Boeing Supplemental Type Certificate (STC). More MD-11 conversions were performed in 2004 and in addition to UPS, customers such as CEA, EVA Airlines and Lufthansa Cargo have been added.

## PTF Conversions Completed Todate

B757SF	17 for DHL completed in 2003
MD-11	18 of 38 orders redelivered to various customers

In the LCC market, ST Aerospace's Maintenance By the Hour (MBH™) and TAS programmes continued to attract new customers. In addition to AirAsia and Valuair, Jetstar Asia became the latest customer for a TAS programme. This was to support its fleet of A320s, scheduled to reach eight by 2005. The contract, worth about US\$47m (\$77m) over five years, covers line, light and base maintenance and engineering and technical services, as well as components management and support.

In 2004, AirAsia also extended ST Aerospace's engines MBH™ support to its fleet of B737 aircraft. The contract, worth US\$63.5m (\$104m), is for services for 10 of AirAsia's aircraft powered by CFM56-3 engines.

The Engines business continued to firmly establish its position as a MRO and MBH™ provider for the military aviation market as well as the CFM56 and JT8 market. ST Aerospace continued to invest in components repair and overhaul capabilities to support military and commercial customers globally. These engines and components capabilities also add an important dimension to the sector's MBH™ and MRO programmes by assuring good turnaround time and responsive support to customers with the same exacting standards of quality and service which they have come to expect.

### Electronics sector

Major orders secured during the year include the Automotive Telematics System in Thailand (\$163m), the Taipei MRT/MCT Communications Systems project (\$61.4m), the Mexico Multi-channel Multipoint Distribution System (MMDS) access control downconverters contracts (\$17m), and the Guangzhou MRT Automated Fare Collection system project (\$15m).

The major projects contributing to the full year turnover included the LTA's and Manila's Light Rail Transit Authority's LRT/MRT projects; the Hong Kong Fire Services project; simulator projects; a Command and Control System project; the supply of MMDS and the delivery of radio communications equipment.

### Land Systems sector

2004 saw the contractual delivery of major projects such as the Bronco All Terrain Tracked Carrier, SAR 21 Assault Rifle and Primus 155mm Self Propelled Howitzer and munitions products to the SAF.

In February, a Memorandum Of Understanding (MOU) was signed with Lockheed Martin for joint cooperation in the design, development and production of manned and unmanned ground systems.

Overseas, the Bronco continued to undergo rigorous evaluation trials by potential customers in Africa and Europe as well as in a NATO country. In July, a contract was awarded by Finland to conduct a feasibility study for its Future All Terrain Vehicle programme.

In December, ST Kinetics entered into two JV agreements for STAR to set up premier automotive centres in Guangzhou and Hangzhou, subject to regulatory approvals. This follows the signing of two MOUs in June. The two centres will service the provinces of Guangdong, Jiangsu and Zhejiang.

In December, ST Kinetics also divested its 50.8% stake in its subsidiary, Solectria, in a share exchange agreement for approximately 10% of the common shares of Azure Dynamics. This will expand ST Kinetics' capabilities and product offerings in the area of hybrid electric technologies.

**Marine sector**

In 2004, ST Marine launched the first locally built frigate in July and stepped up production for the frigate programme.

**Locally Built Frigates – Completed Milestones**

Frigate 2 'RSS Intrepid'	Frigate 3	Frigate 4	Frigate 5	Frigate 6
Launched Jul 2004	Keel Laid Nov 2003	Keel Laid May 2004	Keel Laid Nov 2004	Plate Cut Sep 2003

In the US, VT Halter Marine delivered an Offshore Supply Vessel to a leading offshore operator in the US. VT Halter Marine had also secured a number of shipbuilding projects during the year and these are currently in progress. Major shipbuilding contracts secured included two Articulated Tug Barge (ATB) units for Vessel Management Services, a subsidiary of Crowley Maritime, two Harbour Tugs for Lockheed Martin, a Stevedoring Crane Barge for Tide Leasing Company and a double ended Passenger/Vehicle Ferry for Nantucket Steamship Authority.

**DYNAMICS AND RISK FACTORS OF THE BUSINESS**

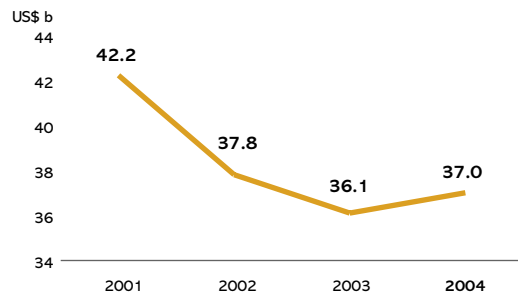
**REVIEW OF BUSINESS ENVIRONMENT**

**Aerospace sector**

Since 2001, the aviation industry has been hit by the multiple impact of a general world economic slowdown, 9/11, the war in Iraq, SARS, and the hefty increase in fuel prices. These have dampened air travel in most parts of the world. While passenger load factors have since recovered somewhat, due to better global economic growth, airlines continue to experience reduced frequency of flights and lower yields. Hence, while some airlines are recovering to profitability or reduced losses, airlines in general continue to re-engineer their operations in the face of more competition and the rise of LCCs.

The MRO industry is reported to have shrunk by 14% from 2001 levels due to reduced flying hours, retirement of maintenance intensive older aircraft and postponement of non obligatory maintenance and modification work. Many MROs have experienced difficult times and some have gone out of business. Nevertheless, overcapacity exists in the industry.

 ... MRO Market Value



Source: Overhaul & Maintenance Magazine, April 2004

Despite these problems, ST Aerospace maintained its position as a premium provider of third party MRO through the strong support from its customers around the world.

From an industry viewpoint, while uncertainties continue, established airlines are expected to continue to restructure their operations to focus on core businesses and outsource MRO to reduce operating costs. This is a business model adopted by the LCCs from their inception.

In anticipation of the long term trend for airlines to increase outsourcing of MRO, ST Aerospace has been putting in place a global network of MRO facilities and new capabilities to meet this demand.

ST Aerospace continues to position itself as the preferred partner to airlines and freight operators, able to meet their requirements from discreet work packages outsourcing to a full spectrum outsourcing including TAS programmes.

### Electronics sector

The environment that ST Electronics operates in is highly dynamic. The challenges that it faces include keeping abreast of technological advances to guard against obsolescence, maintaining strategic alliances with reliable partners and having adaptable and agile marketing strategies for the different countries in which it has interests. ST Electronics also has to deal with margin erosions due to low pricing strategies adopted by local players.

The recovering economies in the region present opportunities in infrastructural projects. With better public finances, regional governments are beginning to focus on infrastructure projects as part of their economic development strategy. Asian countries especially are focussing on improving transportation infrastructure to ease traffic conditions in major cities. However, the Asian financial crisis has made many governments realise that they need to manage large projects more efficiently by engaging the private sector through public private partnerships.

This region is vulnerable to terrorist attacks. Since terrorism is transnational, dealing with the threat of terrorism requires tight coordination between various internal and external agencies. Therefore, protection of key installations and soft targets such as shopping centres, hotels and rail network becomes essential. There is also extensive interest in maritime and port security.

Against this backdrop, ST Electronics is well positioned to offer its systems and solutions to meet the demands for homeland security. ST Electronics' strengths lie in its domain expertise in large-scale systems integration and project management, real time and mission critical software solutions, wireless and data communications, and a full spectrum of multi platforms training solutions.

As a technology-based company, ST Electronics' key strategic pillar is innovation. Since 1998, ST Electronics has filed 35 patent applications of which 15 have been granted.

ST Electronics was part of the Infrared Fever Screening System team which won the 2004 US Tech Museum Award (Health Category). The award recognised the team, including members from Chartered Electro-Optics and the Defence Science & Technology Agency, for adapting military technology to commercial use in a creative way. The system developed was used worldwide as the frontline defence against SARS during the outbreak last year. Innovation, coupled with strong market and technology partnerships, will continue to be leveraged upon as the company's competitive strengths for success.

### Land Systems sector

Defence sales for this sector is not expected to grow over the next few years as defence forces shift their focus from conventional platforms and munitions to smaller quantities of weapon systems with more sophistication and higher technology content. While ST Kinetics continues to build on these newer capabilities and solutions, it has also started leveraging on its existing know how and capacity to secure business from local organisations such as the Civil Aviation Authority of Singapore, the Singapore Civil Defence Force and the Singapore Police Force.

With homeland security gaining greater emphasis, ST Kinetics has embarked on several initiatives to develop its homeland security business. These include forging alliances with foreign and local partners via joint product development projects as well as investments in capabilities and markets.

Major export sales will take time to materialise as the sector continues its efforts to secure some of the major platform programmes that are in the pipeline.

The economic growth in China and the region continues to present opportunities especially in commercial automotive and related infrastructure and urban service industries. ST Kinetics will continue to position itself and leverage on related investments worldwide to enter these growing markets. Concurrently, it will continue to seek and pursue growth opportunities in the global specialty vehicles business.

### Marine sector

The sector's thrust in the commercial market is to target niche market segments where its past and present product offerings and the ability to provide customised solutions give it a unique competitive advantage. VT Halter Marine's construction of a PCTC for Pasha Hawaii Transport Lines was one such example. This vessel was successfully launched in October.

In the naval and government shipbuilding segment, ST Marine continues to provide support to its major customers as well as to seek new markets globally. Here again, ST Marine can offer a suite of tailor made designs and solutions. The frigate newbuilding programme is in full swing, with the first locally built frigate launched in July.

The frigate programme attests to ST Marine's capability in building sophisticated vessels and will position ST Marine among the leading players in the market. The challenging demands of this project will move it up the scale of competency in project management and further sharpen its technical expertise. ST Marine was successful in securing a contract to build a Landing Supply Craft for the Ministry of Interior, Kuwait. In the US, VT Halter Marine was also successful in securing shipbuilding contracts in the naval and government sector. During the year, VT Halter Marine was occupied with the construction of two LSVs for the US Army and two FSVs for NOAA.

Overall, the Marine sector has positioned itself as a designer and builder of technically sophisticated vessels, capable of delivering customised solutions to its customers. At the same time, ST Marine continually improves its cost structures by enhancing its production processes for better productivity. This is done to gear ST Marine to be globally competitive.

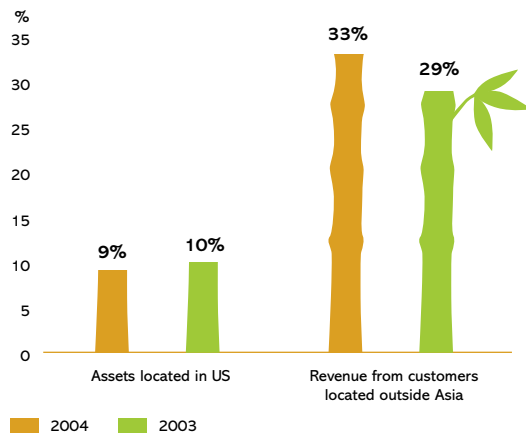
Keen competition also exists in the shiprepair segment of ST Marine's business from lower cost shipyards such as those in China. This is especially so for standard shiprepair services such as steelwork, pipework, hull blasting and painting. Again, ST Marine's response was to identify and create a niche for itself in jobs requiring high engineering content and high value added services such as ship conversions and in shiprepair work where quality, reliability and quick turnaround are key. ST Marine continued to secure significant projects in the dredger as well as chemical tanker repair markets. ST Marine's ability to provide competitively priced, quality shiprepair services within a fast turnaround time continue to be strong selling points for winning new customers and servicing repeat customers.

### RISK MANAGEMENT

#### (a) Operational Risk

The Group operates in 15 countries spread across the Asia Pacific, Europe and the US. As part of the Group's plan to grow its business internationally, it will continue to focus on increasing its operating activities and presence in Europe, Greater China and the US. In 2004, 9% of the Group's assets was in the US. Revenue from customers located outside Asia has increased from 26% in 2001 to 33% in 2004.

Assets & Revenue (extracts)



As part of its business strategy, the Group seeks to increase the percentage of its international business and customers, thereby achieving greater geographical diversification. Likewise, the Group also plans to raise the proportion of its commercial business compared to its defence business. A more diversified base of military and commercial customers will reduce the risk of customer concentration.

As the Group expands its business globally, it has also geared up its risk management capabilities. Incidents like 9/11, the accounting improprieties at several large US corporations, the appearance of SARS in the region and the threat of terrorism clearly signal that risk management is a 'must do' and not a 'can do' action.

During 2004, the Group's Risk Review Committee, comprising five directors and a co-opted member, met on four occasions to review the significant risks of the four business sectors in the Group and its risk management policies. The risks reviewed included operational risk, financial risk, strategic risk, and other liability risks.

Risk management is an ongoing process. It needs constant monitoring and maintenance to be effective. To this end, the management team is developing a robust enterprise risk management framework. Results from this work are expected in 2005.

A team was also formed to develop a project risk management framework for the Group's major projects. Such projects are usually high in financial value and sophisticated in nature. The team rolled out a project risk management manual and trained the project management staff from the various business sectors.

#### (b) Investment Risk

The Group seeks to grow its businesses via three fronts: through organic growth of its existing capabilities and capacities; development of new capabilities; and through acquisition of business entities or operating assets or through JVs.

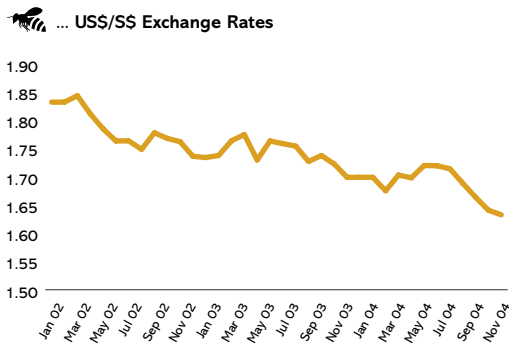
Investment activities, ranging from identification of targets to the conduct of due diligence, are supported by a dedicated team of investment professionals and augmented by external professionals for specialised services. The business proposals are guided by a given set of internal investment criteria, evaluated by senior management and endorsed by a Business Investment and Divestment Committee before seeking final Board approval.

#### (c) Interest Rate Risk

The Group's cash balances were placed with reputable banks, financial institutions, and a related corporation. The Group managed its interest rate risk on its interest income by placing the cash balances in varying maturities and interest rate terms.

**(d) Foreign Exchange (FX) Risk**

The Group's FX risk arises both from its subsidiaries operating in foreign countries, which generate revenue and incur costs denominated in foreign currencies and from those operations of its local subsidiaries which are transacted in foreign currencies.



Source : Bloomberg

The Group entered into forward FX contracts to hedge against its FX risk resulting from anticipated sale and purchase transactions denominated in foreign currencies, primarily in Euro and US dollars.

**(e) Derivative Financial Instrument Risk**

The Group used forward FX and options to hedge its net foreign currency exposures in the management of FX risk. These derivative instruments are used for hedging and not for speculative transactions in foreign exchange.

**(f) Market Risk**

The Group has investments in quoted equity shares and bonds, and has placed funds with fund management companies. The market value of these investments will fluctuate with market conditions. To mitigate market risk, the Group's funds with fund managers are guaranteed 95% to 100% of their

principal values at the end of the fund management period. Also, before a fund manager is allocated funds for management, its management capability and financial strength is carefully considered.

**(g) Liquidity Risk**

To manage liquidity risk, the Group monitors its net operating cash flow and maintains an adequate level of cash and cash equivalents and secured committed funding facilities from financial institutions. In assessing the adequacy of these facilities, management reviews its working capital requirements.

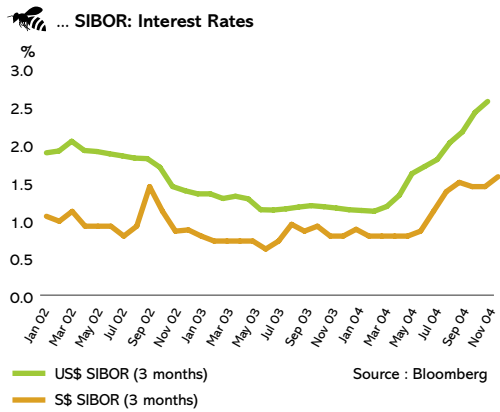
**(h) Credit Risk**

Credit risk, or the risk of counterparties defaulting, is managed through the application of credit approvals, credit limits and monitoring procedures. Where appropriate, the Company or its subsidiaries obtain collaterals from customers or arrange master netting agreements. Cash terms, advance payments, and letters of credit or bank guarantees are required for customers of lower credit standing.

**SENSITIVITY ANALYSIS**

**(a) Interest Rate**

The Group's cash and cash equivalents as well as funds under management are largely invested in fixed deposits and fixed income securities. Movements in interest rates will therefore have an impact on the interest and investment income for the Group. Based on the Group's cash and cash equivalents of \$1.5b as at year end 2004, a one percentage point movement in effective fixed deposit rates is estimated to result in an annual \$15m change in interest income for the Group.



#### (b) Gross Profit Margin

At 2004 turnover of \$2.95b, a one percentage point movement in the gross profit margin of the Group will lead to a \$29.5m change in gross profit for the Group. The many different programmes undertaken across the Group with the accompanying variations in margins have the effect of reducing the Groupwide impact from specific project fluctuations.

#### (c) Others

Other risk factors that will have an impact on turnover and net profits tend to be sector or project specific. Hence, it is not practical to perform sensitivity analysis in such instances.

### PROSPECTS FOR 2005

2004 saw encouraging economic growth in the global economy though weakness remains in some sectors. It was a year when the Group continued its efforts to grow its external wing and build up its order book. Moving into 2005, the global economic outlook is uncertain and the Group continues to be exposed to external risks, which could affect its businesses. For 2005, barring unforeseen circumstances, the Group expects to achieve a higher turnover and modest growth in PBT.

In Aerospace, the aviation industry remains challenging due to higher oil prices and continued competition from LCCs. Legacy airlines in particular may respond to cost pressures by outsourcing some of their MRO needs. The sector will continue its focussed drive to serve its customers better and to reach out to new customers. These would be achieved through extending the reach of the sector's operations, continued investments to develop new capabilities and increased focus on customer needs.

On the back of a healthy order book, the Electronics business will continue its strategy of growing its international business by focussing on customer relationship management, the development of niche offerings and local partnerships in the global market. These initiatives are designed to seek and secure more business deals and possibly help to increase its strategic investments in China, India and the Middle East.

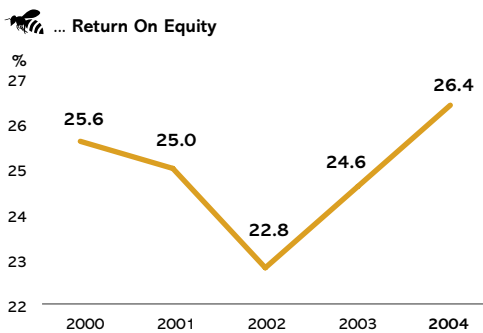
In Land Systems, the focus remains to develop the commercial automotive businesses, building on BZK and commencing operations of the automotive centres JVs in China. The sector will continue with its efforts to explore acquisition opportunities in commercial specialty vehicles in North America.

In Marine, the yards in Singapore and US will continue its focus on production activities to meet the scheduled deliveries of the various newbuilding programmes and improving its operational efficiency in 2005. The sector will continue to pursue opportunities in the naval and government sectors and segments of the commercial market and grow its order book.

## SHAREHOLDER RETURNS

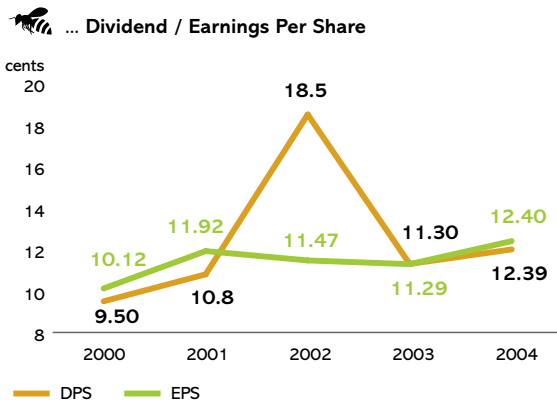
### Return On Equity

The Return On Equity (ROE) improved 1.8 percentage points to 26.4% in 2004, as a result of higher profit after tax and minority interest as well as a lower level of shareholders' funds, subsequent to the dividend payment of \$326.5m in April 2004.



### Dividend Per Share (DPS) and Earnings Per Share (EPS)

The proposed dividend for 2004 of \$358.3m is higher than the 2003 dividend of \$326.5m paid in April 2004. The recommended 2004 dividend took into consideration the Group's present cash position, positive cash flow generated from operations, and projected capital requirements. Payment of the dividends is subject to the approval of the shareholders of the Company at the forthcoming Annual General Meeting.



The proposed 2004 dividend of \$358.3m represents 100% of earnings for FY2004.

To maximise shareholders' value, management will continue its policy of paying a high level of dividends to return excess cash generated from the operations, if the cash is not required for investments in the future. These investments may include potential mergers and acquisitions and the building of new facilities and capabilities to expand the existing operations.

### Share Purchase Mandate

In the coming Extraordinary General Meeting, the Company will again seek shareholders' approval to renew the Share Purchase Mandate for the purchase of up to 10% of the number of ordinary shares in the capital of the Company. The share purchase can be effected either through market purchases or off market purchases. The financial impact of various share purchase scenarios will be presented in a circular to members.

The purpose of the Share Purchase Plan is to give the Company the flexibility to undertake the share purchase exercise expeditiously. The Share Purchase Plan provides the Company an alternate avenue to reward shareholders apart from the traditional dividend payment route.

## FINANCIAL REVIEW

### Treasury Policy and Capital Structure

The Group's Treasury Unit seeks to minimise the Group's financial risk, to ensure sufficient liquidity to meet the day to day operational needs and to invest the cash and cash equivalents within the guidelines approved by the Board of Directors.

### Cash and Foreign Exchange Management

The Group adopts the strategy of centralised cash management, where the excess cash of its business entities are swept to the Treasury Unit, which centrally manages the investment of the funds. Similarly, the

FX requirements of the business entities are managed centrally. The business entities hedge their material FX exposures arising from sales and/or purchases in currencies other than the functional currencies. Their FX requirements are matched internally by the Treasury Unit and this procedure enables the Group to offset and minimise FX risk within the Group. The Treasury Unit then hedges unmatched FX requirements with external counterparties.

The aim of Treasury Unit's cash management and FX management strategies is to maximise the returns of the Group's cash resources and to minimise FX exposures and associated costs. The most common financial instruments used to manage the FX exposures are forward FX contracts and currency options.

### Insurance

Where appropriate, the Group manages its insurance risks on a Group basis to leverage on its position with the general insurance market.

The Group reviews its insurable risk profile continually and makes the necessary adjustments on risk retention to optimise the coverage and cost. This is done with advice and support from selected insurance brokers. Major group insurance policies include Industry Special Risk, Liabilities and Workmen Compensation, designed to protect the Group against properties risk, liabilities for its products and services, and workplace accidents respectively. The aviation and marine businesses have specialised insurance programmes.

The Group adopts a proactive strategy to manage the insurance risk with specific risk management programmes covering the prevention of fire and the adoption of Behavioural-Based Safety practices, among others.

### Funding and Borrowings

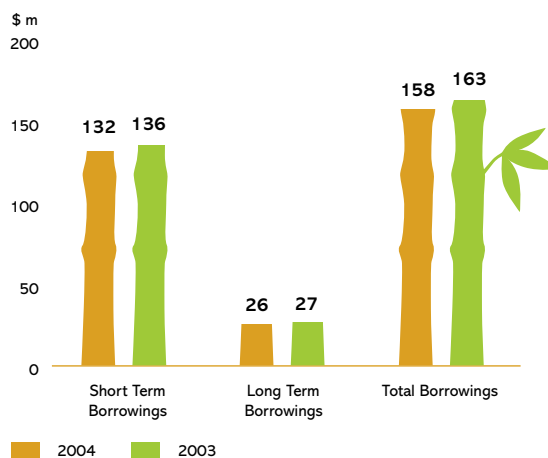
The Group funds its investments and operations through a mixture of shareholders' funds, advance payments from customers, and some borrowings.

Its borrowings amount to \$158.1m, about 12% of its shareholders' funds.

Long term borrowings amount to \$26.3m and the balance is of a short term nature. The long term borrowings comprise mainly an Industry Revenue Bond issued by an Aerospace sector's subsidiary, Mobile Aerospace, to fund the initial purchase of plant and machinery for the facilities located at Mobile, Alabama in 1990. At this point in time, given the Group's existing cash and cash equivalents profile and relatively low level of borrowings, there is no requirement to tap the long term debt market. The short term loans are denominated in US dollars at a floating rate that is commensurate with the Group's Aaa credit ratings from Moody's. The rationale of borrowing in US dollars is to create a natural currency hedge position for the Group's investments in the currency.

The Group's interest cover stays at a healthy 108 times, with a gross debt-equity ratio of 0.12.

### Borrowings



### CASH FLOWS AND LIQUIDITY

#### Operating Activities

For 2004, the net cash generated from operating activities amounted to \$174.4m. In 2003, the net cash generated from operating activities amounted

to \$210.8m. The reduction of \$36.4m in FY2004 in net cash from operating activities was largely due to working capital movements with negative variances in stocks and work in progress, trade debtors, other debtors, deposits and prepayment, trade creditors as well as other creditors, accruals and provision, but these were partially offset by positive variances in progress billings in excess of work in progress and advance payments from customers.

### Investing Activities

The cash outflow from investing activities in FY2004 was higher than that of FY2003. This was mainly the result of higher cash outflow for purchases of fixed assets, investments, associated companies and JVs as well as lower dividends from associated companies and lower proceeds from sale and maturity of investments, but these were partially offset by a lower outflow for acquisition of subsidiaries.

### Financing Activities

In respect of cash flow from financing activities, the lower dividend payout by the Company in 2004 compared to 2003 resulted in a lower cash outflow in financing activities.

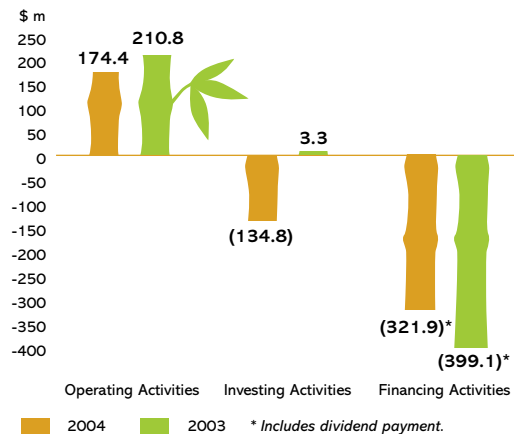
### Cash and Cash Equivalents

As at 31 December 2004, the Group's cash and cash equivalents stood at \$1.5b, which is \$0.3b lower than that of FY2003. The cash and cash equivalents are centrally managed by the Treasury Unit in ST Engineering and the majority of the funds were invested in liquid assets such as fixed deposits, floating rate notes and placements with a related corporation. The cash and cash equivalents as at yearend is adequate to fund the committed and plan capital expenditure as well as to service the Group's borrowings.

Notwithstanding the Group's current positive cash and cash equivalent position, it has established short term financing facilities with various financial institutions

for bridging finance. Such liquidity facilities can be tapped when requirements arise, in particular, financing significant merger and acquisition deals.

### Cash Flow



## ACCOUNTING POLICIES

The Group's significant accounting policies are presented in Notes to the Financial Statements, note no. 2 (pg 119 to 126). The Group has applied the same accounting policies and methods of computation in the financial statements for the current reporting year compared with the audited financial statements as at 31 December 2003, except for the early adoption, with effect from the financial year beginning 1 January 2004, of the following new and revised Singapore Financial Reporting Standards (FRS) issued in July 2004 by the Council on Corporate Disclosure and Governance (CCDG):

FRS 103	Business Combinations
Revised FRS 36	Impairment of Assets
Revised FRS 38	Intangible Assets

The financial statements were prepared in accordance with the Singapore Financial Reporting Standards as required by the Companies Act.