

Operating Financial Review

GROUP OVERVIEW

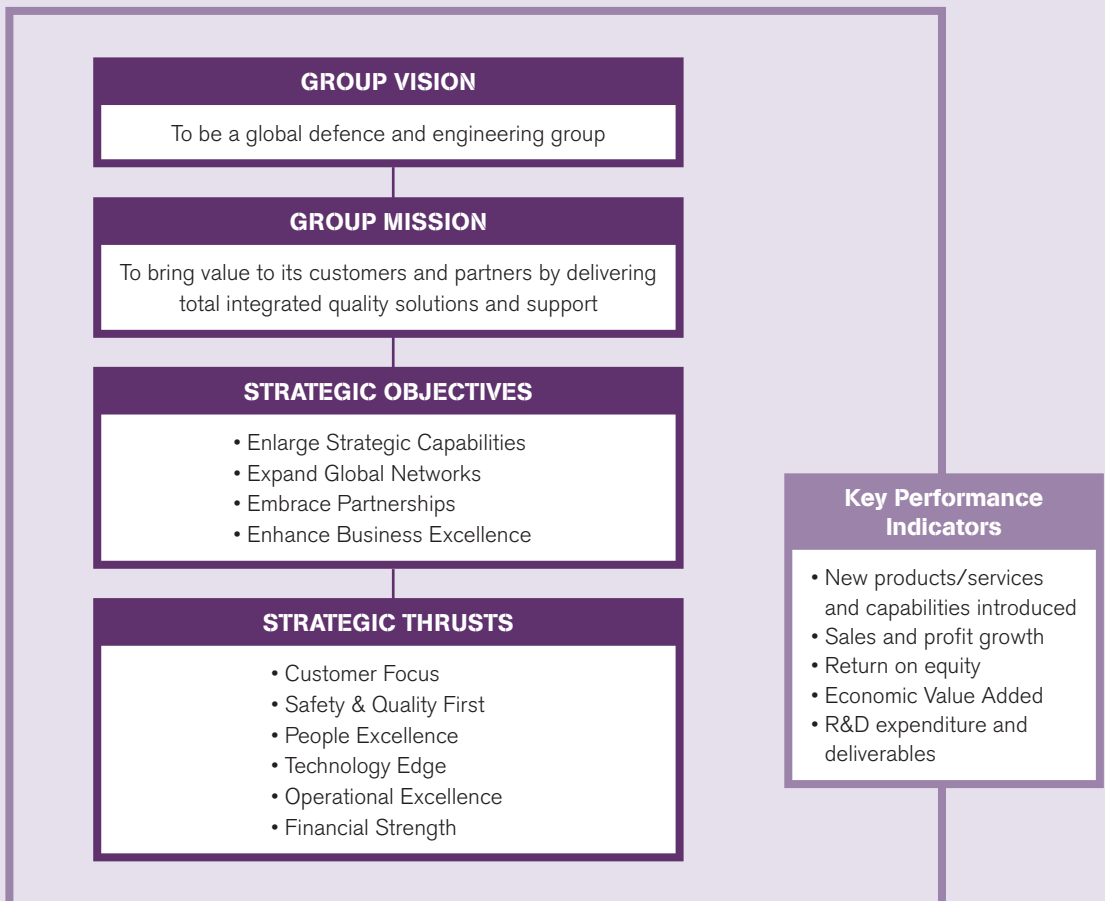
Group History and Overview

ST Engineering was formed in December 1997 through the merger of four public listed companies – ST Aerospace, ST Electronics, ST Automotive and ST Marine – within the then Singapore Technologies Group. In early 2000, the Group acquired the Chartered Industries of Singapore group of companies and merged it with ST Automotive to form ST Kinetics.

Each of these entities has over 30 years of operating history and is a leading and established player in its respective industry. As a Group, ST Engineering is a well recognised provider of integrated defence and engineering systems and solutions, dedicated to meeting the needs of global customers.

Headquartered in Singapore, ST Engineering today has a staff strength of over 17,000, most of whom are located in Singapore and the US. It has also established a strong presence in other parts of the world, offering a comprehensive range of products and services through its four sectors, namely Aerospace, Electronics, Land Systems and Marine.

GROUP VISION, MISSION & OBJECTIVES



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GROWING THE GLOBAL FOOTPRINT

Cementing Presence in the US

The ST Engineering Group's US headquarters, Vision Technologies Systems (VT Systems), has today established operations in 20 locations throughout the US, Canada and Central America, with a total workforce of almost 4,000.

For 2006, VT Systems represented about 28% of the Group's revenues compared to 13% in 2001 when it was incorporated.

VT Systems has successfully completed seven acquisitions, contributing to the overall growth of the Group's four sectors. Acquisition of leading businesses has strengthened the Group's presence in the Americas through a pioneering range of solutions by the VT Systems group of companies.

VT Miltope continues to support the US military programme by delivering various models of its rugged computer notebook, which can withstand the rigours of field use and extreme temperatures. iDirect's ground-based satellite communications platform was used as a primary means of communications immediately following Hurricane Katrina in 2005, when terrestrial communications were disrupted. iDirect's products are also used in a tsunami warning system offered by the Survey of India.

VT Halter Marine's four fisheries survey vessels built for the National Oceanic and Atmospheric Administration (NOAA) are equipped with low acoustic signatures and are able to conduct multiple types of research in a single deployment – a combined capability unavailable in the private sector. VT SVC is America's leader in emergency response vehicles, combining innovative body design with integrated advanced communications systems.

VT Systems has also forged various teaming agreements and alliances aimed at organic growth, facilitating the access of engineering excellence from affiliates in Singapore to the US market. VT Systems' aerospace arm is part of a global network and a leading US third party provider of Maintenance, Repair and Overhaul (MRO) services for a wide range of commercial aircraft, bringing value to operators, OEMs and lessors through its broad range of capabilities. Moving forward, VT Systems will continue to align operations and leverage complementary

capabilities, not only among its US-based operating companies but also with the operations in Singapore and affiliates in other parts of the world. Initiatives to bring products to new markets, such as VT LeeBoy's specialty vehicles into China, and the sourcing of raw materials and components through bundling of demand across business units as well as low cost sources, are but three initiatives to synergise across platforms and borders.

Through acquisitions, partnerships and collaborations, VT Systems has grown to be the Group's largest presence outside of Singapore. VT Systems will continue to pursue profitable and growing companies with strong management teams that offer a strategic fit with ST Engineering's core business sectors, working towards the ultimate aim of spearheading the Group's long term business growth in the Americas.

Expanding in China

ST Engineering has firm presence in the booming China market, with representative offices in Beijing, Chengdu, Hong Kong, Guangzhou, Shanghai, Shenyang, Shenzhen and Yi Chun. With a China staff strength of almost 3,000, it has invested about US\$100m in the Aerospace, Electronics and Land Systems sectors there. These include an aircraft MRO facility and electronics R&D centre in Shanghai, a software development centre in Shenzhen, commercial automotive maintenance facilities in Guangzhou and Hangzhou, and production plants for construction and mining vehicles in Beijing and Guiyang and electronics systems manufacturing in Beijing and Chengdu.

The Group's current projects in China include rail and transportation work in Guangzhou, Suzhou and Beijing. In Beijing, the Group is installing an integrated traffic command centre system for the efficient management of major rail lines in the Chinese capital, making it the first Singapore company to win a major contract related to the 2008 Olympics.

ST Engineering is currently looking to expand its current presence in 16 cities, targeting upcoming second tier cities such as Nanjing, Ningbo, Suzhou and Wuxi.

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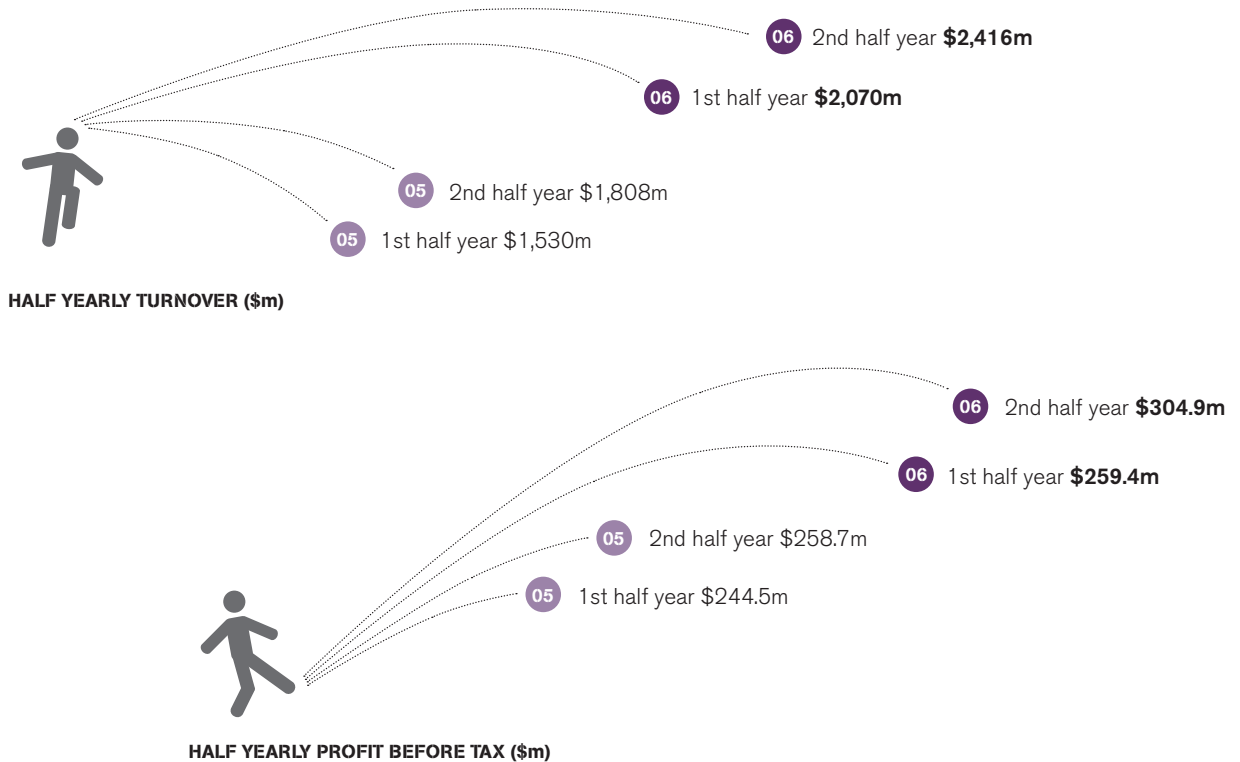
PERFORMANCE OF THE GROUP

a) Half yearly performance

IN \$m EXCEPT PER SHARE AMOUNTS	1H	2006 2H	FY	1H	2005 2H	FY
Turnover	2,070	2,416	4,486	1,530	1,808	3,338
EBITDA	259.5	333.9	593.4	216.0	254.1	470.1
EBIT	205.3	252.3	457.6	176.9	212.6	389.5
Profit before tax	259.4	304.9	564.3	244.5	258.7	503.2
Profit after tax and minority interests	198.3	246.8	445.1	189.4	206.9	396.3
Basic earnings per share (cents)	6.8	8.4	15.2	6.5	7.1	13.6
Net asset value per share (cents)	45.4	53.1	53.1	43.4	51.2	51.2

The Group's turnover for 2H2006 increased by 17% or \$346m compared to the first half. All sectors reported higher turnover in the second half vis-à-vis the first half.

The Group's Profit Before Tax (PBT) for 2H2006 increased by 18% or \$45.5m over the first half. All sectors reported higher PBT in the second half vis-à-vis the first half.



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b) Full year performance

Turnover

The Group's turnover of \$4,486m for FY2006 was higher than that of FY2005 by 34% or \$1,148m. All sectors reported higher turnover.



● Aerospace	37%
● Electronics	21%
● Land Systems	22%
● Marine	16%
● Others	4%

Profit

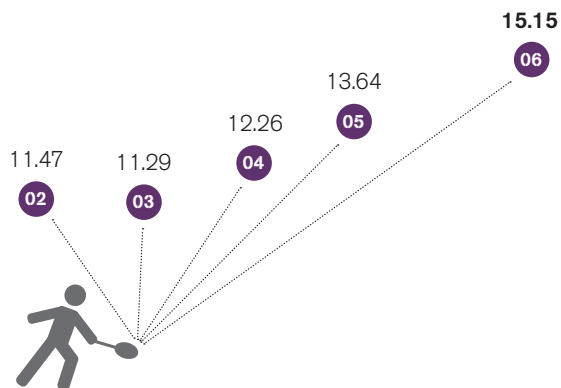
Group PBT for FY2006 of \$564.3m was higher than that achieved in FY2005 by 12% or \$61.1m. All sectors, except Marine sector, recorded higher PBT.



● Aerospace	54%
● Electronics	19%
● Land Systems	12%
● Marine	14%
● Others	1%

Earnings Per Share (EPS)

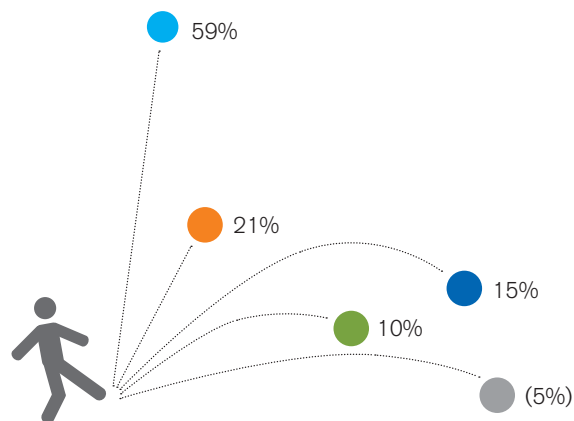
The Group's basic and diluted EPS for FY2006 were 15.15 cents and 15.00 cents respectively (FY2005: 13.64 cents and 13.54 cents respectively). The higher EPS was a result of higher profit after tax for FY2006.



EARNINGS PER SHARE (CENTS)

Economic Value Added (EVA)

The Group's EVA for FY2006 was \$327.8m, an increase of 13% or \$37.2m over FY2005. The Weighted Average Cost of Capital was 6.6% for 2006 (2005: 6.1%).



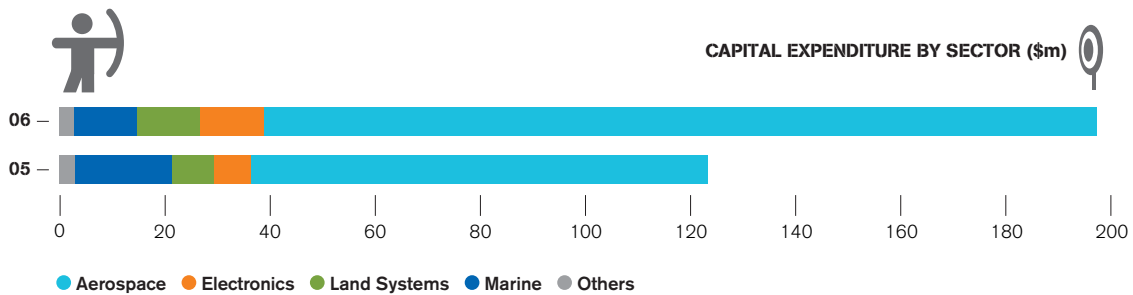
FY2006 EVA CONTRIBUTION BY SECTOR (%)

● Aerospace	● Electronics	● Land Systems
● Marine	● Others	

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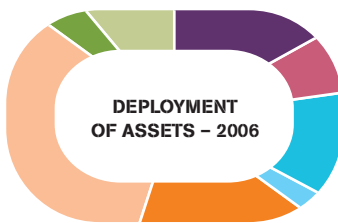
Capital Expenditure

The Group incurred capital expenditure of \$197.1m in FY2006. The addition of new hangars and related equipment and programme-related purchases such as engines for new capability setup and rotables by the Aerospace sector accounted for the bulk of the capital expenditure for the year. The details are shown in Note 7 to the Financial Statements.



Total Assets

As at end December 2006, total assets of the Group amounted to \$5.51b compared to \$4.57b as at end December 2005. The deployment of assets is as follows:



Property, Plant and Equipment	17%
Associated Companies & Investments	6%
Intangible Assets	10%
Deferred Tax Assets	2%
Stocks & WIP	20%
Debtors, Deposits & Prepayments	30%
Funds under Management	4%
Bank Balance & Other Liquid Funds	11%



Property, Plant and Equipment	10%
Associated Companies & Investments	8%
Intangible Assets	7%
Deferred Tax Assets	2%
Stocks & WIP	19%
Debtors, Deposits & Prepayments	40%
Funds under Management	7%
Bank Balance & Other Liquid Funds	7%

ST ENGINEERING



FACTS

- One of the largest companies listed in Singapore and one of Asia's largest defence and engineering groups, with an order book of \$7.4b and total assets of \$5.5b as at end 2006
- Global footprint in 20 countries and 35 cities, with over 100 subsidiaries, joint ventures and associated companies
- VT Systems, ST Engineering's US headquarters in Virginia, has extensive US operations across the Group's core businesses
- Component stock of the FTSE/ASEAN 40, MSCI Singapore Free Index, S&P Asia Pacific 100 and Straits Times Index
- 98 patents granted to date, with 259 patents filed
- Global workforce of over 17,000 with 4,592 engineering staff

CORE CAPABILITIES

- A global engineering group providing integrated solutions for the aerospace, electronics, land systems and marine industries
- Specialises in dual use technologies, with both military and commercial applications which traverse traditional industry lines
- Provides customised solutions through a network-centric approach that leverages the strengths of the Electronics sector and harnesses innovative technology

MAJOR DEVELOPMENTS IN 2006

- Continued to grow global operations, with strategic acquisitions and investments worth over \$230m
- Showcased latest technologies and solutions at Asian Aerospace 2006
- Expanded into new markets like Panama, Scandinavia and countries in the Middle East
- Launched the third successful Safety @ Work Creative Awards, a community programme to raise safety awareness

REVENUE IN \$m



PROFIT BEFORE TAX IN \$m



AEROSPACE SECTOR



CORE CAPABILITIES

- **Aircraft Maintenance & Modification**
 - Line and base maintenance
 - Technical services and maintenance planning
 - Modifications, conversions and refurbishment
 - Design, development and technology integration
- **Component & Engine Total Support**
 - Engine maintenance, repair and overhaul
 - Aircraft mechanical and avionics component repair
 - Materials and spares support and management

FACTS

- Offers Total Aviation Support in a wide range of services – airframe, engine and component maintenance; engineering design and technical services; and aviation materials and management services
- Ranked by Overhaul & Maintenance 2005 as the world's largest airframe maintenance provider with 6.7m commercial airframe manhours in 2004
- Worldwide network of facilities with diverse global customer base that includes many of the world's leading airlines, airfreight operators and military aircraft operators
- 6,517 staff

MAJOR DEVELOPMENTS IN 2006

- Completed acquisition of SAS Component stake and subsequently merged it with Airline Rotables Ltd, increasing total shareholding to 71.3%
- Signed lease agreement for new facility in Panama
- Secured contracts with Airbus and other new start-up airlines for Total Aviation Support programmes
- Redelivered 2,500th aircraft to long term customer, FedEx Express
- Added capacity to Changi and Seletar facilities in Singapore

REVENUE IN \$m



PROFIT BEFORE TAX IN \$m



ELECTRONICS SECTOR



CORE CAPABILITIES

- **Large-Scale Systems Group**
 - Intelligent transportation systems
 - Intelligent building management systems
 - Combat systems integration
- **Communication & Sensor Systems Group**
 - e-Government communications and infocomm technologies solutions
 - Satellite communications systems
 - Communications, microwave, radar and sensor systems
 - Intelligent traffic and fleet management systems
 - Info-security solutions
 - Electro-optics systems
- **Software Systems Group**
 - e-Government solutions
 - Digital animation and media
 - Mobile realtime and homeland security systems
 - Training and simulation systems

FACTS

- Specialises in rail transportation systems and solutions with projects in China, the Philippines, Singapore, Taiwan and Thailand
- One of the world's leading providers of satellite communications systems and solutions as well as multi-channel multipoint distribution systems
- Provides tracking and management systems for more than 50,000 vehicles in the region
- Provides e-Government systems and solutions for governments internationally
- Filed 50 patents, of which 25 have been granted since 1998
- 3,491 staff

MAJOR DEVELOPMENTS IN 2006

- Acquired 80% of MÅK Technologies – a US specialist in simulation software and toolkits
- Acquired 70% of PM-B – a mission-critical environment specialist based in Singapore
- Expanded operations into new markets in Albania, Qatar, Dubai and new regions in China
- Won contracts to provide rail solutions in Guangzhou and Beijing, China
- Launched exclusive collaboration agreement with SingTel to provide high-speed two-way broadband connectivity to the maritime industry
- Partnered Hewlett-Packard in a consortium shortlisted for Singapore's \$2b e-Government project
- Launched battlefield management system commissioned by the Singapore Armed Forces for its 3rd Generation networked fighting force on the Bionix II platform

REVENUE IN \$m



PROFIT BEFORE TAX IN \$m



LAND SYSTEMS SECTOR



CORE CAPABILITIES

- **Integrated Design**
 - Multi role military platforms
 - Weapon systems and advanced munitions
 - Surveillance, remote operations, avionics and fleet management systems
 - Military and homeland security protection solutions
 - Emergency response, commercial and specialty vehicles
- **Integrated Operations and Support**
 - Maintenance, repair and overhaul of vehicles, weapons and material handling equipment
 - Accident repair and vehicle inspection
 - Engineering analysis and industrial test services
 - Asset preservation and spares management
 - Training and agency representation
- **Integrated Production**
 - Contract manufacturing
 - Industrial services

FACTS

- Produces over 120 different types of specialty vehicles, including construction and mining equipment, multi-temperature trucks, distribution trailers and bodies
- World's largest manufacturer of commercial class asphalt pavers and beverage trucks
- Offers defence products that are geared for network-centricity and increased connectivity
- One of few manufacturers in the world to offer both 40mm weapon systems and a wide range of supporting ammunition
- 37 patents granted to date, with 56 patents filed
- 5,508 staff

MAJOR DEVELOPMENTS IN 2006

- Added VT LeeBoy, a leading US manufacturer of road construction and maintenance equipment, to its stable of specialty vehicles companies
- Formed Advanced Technology Research Centre, a 50-50 joint venture company with DSO National Laboratories, to undertake research and technology development in advanced materials for both defence and commercial applications
- Secured a three-year agreement from the Texas Government permitting any governmental or non-profit agency in Texas to purchase emergency vehicles from VT SVC without competitive bids
- The Bionix II infantry fighting vehicle entered into service with the Singapore Armed Forces

REVENUE IN \$m



PROFIT BEFORE TAX IN \$m



MARINE SECTOR



CORE CAPABILITIES

- **Project Management**
 - Turnkey shipbuilding
 - Ship upgrading and conversion
 - Weapon systems integration and installation
- **Inhouse Design Expertise**
 - Custom designed naval and commercial vessels using inhouse CAD/CAM facilities
 - Lightweight ship design
 - Stealth technology
- **Shipbuilding**
 - Extensive water jet expertise
 - Thin gauge steel and aluminium construction for naval vessels
- **Maintenance**
 - Overhaul and maintenance of high performance marine engines
- **Shiprepair**
 - Upgrading and retrofitting
 - Conversion of commercial vessels

FACTS

- Five shipyard facilities – two in Singapore and three in the US
- Track record in the design and construction of sophisticated naval and commercial vessels as well as high engineering content shiprepair services including ship conversions
- Designs and develops a variety of vessels including landing ship tanks, patrol vessels, feeder container vessels, platform supply vessels, fisheries survey vessels, articulated tug barges, and pure car truck carriers
- 1,412 staff

MAJOR DEVELOPMENTS IN 2006

- Delivered two locally built stealth frigates, *RSS Intrepid* and *RSS Steadfast*, and launched the fifth and final stealth frigate, *RSS Supreme*, for the Republic of Singapore Navy
- US operations secured contracts worth US\$649m to build a fisheries survey vessel, articulated tug barges, a SWATH vessel and a T-AGM(R) vessel
- Singapore operations secured contracts worth \$177m to build two RoRo vessels, two seismic research vessel conversions, a cutter suction dredger modification and a platform supply vessel conversion
- Launched the first two of four 1030 TEU container vessels

REVENUE IN \$m



PROFIT BEFORE TAX IN \$m



ST Engineering at a Glance

Aerospace

FLYING HIGH WITH TOTAL SUPPORT

In 2006, ST Aerospace maintained its leading position as the world's largest commercial airframe Maintenance, Repair and Overhaul (MRO) provider through the global expansion of existing airframe MRO operations. It also broadened its spectrum of aircraft components and engines maintenance capabilities.

To enhance the integration of its operations, ST Aerospace reorganised its core operations under two business segments – Aircraft Maintenance & Modification (AMM), which now includes the engineering and development capabilities; and Component & Engine Total Support (CETS), which includes the integration of components and engines MRO with rotables management and support.

Aircraft Maintenance & Modification (AMM)

In 2006, ST Aerospace's AMM business continued to extend its relationship with its core customers. New customers, both large and small, were added. It secured more work with key customers in Asia, Europe and the US, such as All Nippon Airways, FedEx Express, Japan Airlines, Northwest Airlines, UPS as well as Asiana Airlines, Copa Airlines, TransAsia Airways and many others.

During the year, ST Aerospace entered into a three-year agreement with Airbus that allowed Airbus to directly procure aircraft MRO services from any of ST Aerospace's global network of facilities.

Key milestones were also reached with long term customers as ST Aerospace celebrated the redelivery of the 2,500th aircraft to FedEx Express, 330th to Northwest Airlines, 300th to UPS, and 100th to Japan Airlines.

ST Aerospace's strategic partnership with the Republic of Singapore Air Force (RSAF) continued to grow through the

extension of its range of support. Following the success of the Transport Wings Course programme, the RSAF committed to a 20-year Rotary Wing Course (RWC) with ST Aerospace for the provision and maintenance of its helicopters. Through this RWC agreement, ST Aerospace acquired a fleet of six EC120 helicopters, began modifications to the aircraft and received certification from the Civil Aviation Authority of Singapore.

In the engineering and development arena, the group forged ahead with its engineering expertise in both technical services as well as design and development activities. Developing technical services capabilities enables ST Aerospace to undertake total support requirements for airlines under its Total Aviation Support. Its repertoire of technical services competencies includes maintenance planning, maintenance control, design and reliability engineering. This enhances civil aircraft operators' aircraft and equipment performance and lifecycle supportability, thus reducing customers' overall maintenance costs.

On the military engineering front, ST Aerospace continued to build on its range of proficiencies to undertake major engineering enhancements to military aircraft. It took to market its integrated suite of tactical enhancements for fixed and rotary-winged platforms. Featuring its military aircraft upgrade capabilities on board the Super Puma at Asian Aerospace 2006, the group demonstrated solutions that included systems and equipment such as a centralised communications, navigation and sensor management system, a digital moving map, a door gun system and an aircraft ship integrated secure and traverse system. The latter two were equipment designed and installed by ST Aerospace.

ST Aerospace also continued with developments on its indigenous FanTail and Skyblade unmanned platforms, which are now expanded into families of scalable mini Unmanned Aerial Vehicles (UAV) for use in home defence and other applications.

ST Aerospace, world's largest commercial airframe MRO, offers Total Aviation Support from its spectrum of airframe, components, engines and engineering capabilities.



Aerospace

Component & Engine Total Support (CETS)

In 2006, the CETS segment continued to add to its spectrum of repair and overhaul capabilities for both engines and components.

It completed the acquisition of SAS Component in March as part of its strategy to provide a spectrum of components support, particularly in Europe. This enabled CETS to develop a more holistic Total Aviation Support proposition and components track record.

The group made strides in maintenance capabilities for the CFM56-3 and CFM56-7B engines and completed the capability setup for the CFM56-7B. It also started developing the CFM56-5B MRO capability, including the construction of a new engine test cell. Its subsidiary, STA Engines, secured long term contracts from operators of the Boeing 737NG and Airbus A320, as well as military customers from as far as South America.

During the year, CETS added some 402 new repair capabilities, primarily on pneumatic, hydraulic, electrical and avionics components for commercial and military aircraft. To further add value to its components MRO activities, its subsidiary, STA Systems, embarked on an initiative to build its own designated engineering representative library.

The group maintained the confidence of major customers such as FedEx Express, Japan Airlines, UPS and many other air forces and airlines. Customers added include Adam Sky Connection Airlines (Adam Air), Aloha Airlines, Bangladesh Air Force, Peru Air Force, Shanghai Airlines, Xiamen Airlines and other airlines from China. ST Aerospace has also set up service centres through collaborations with Original Equipment Manufacturers (OEM) such as Parker Aerospace, Eaton and Hamilton Sundstrand.

The newly formed CETS offers Maintenance-By-the-Hour (MBH™) and Free2Fly™ services to customers. MBH™ is a trademarked service through STA Systems and STA Supplies in Singapore while Free2Fly™ is a trademarked material supply programme by SAS Component, the group's newly acquired European components business. Customers around the world can draw on capabilities within both groups, depending on their needs.

PERFORMANCE OF THE AEROSPACE SECTOR

Half Yearly Performance

Turnover of the Aerospace sector in 2H2006 of \$854m was \$35m higher compared to 1H2006. The increase in turnover came from the three business groups namely, AMM, Component/Engine Repair & Overhaul (CERO) and Engineering & Materials Services (EMS). The higher turnover in AMM was contributed by higher redeliveries in ST Aviation Services Co (SASCO). In CERO, higher sales were due to six months of sales from the newly acquired SAS Component in 2H2006 versus four months of sales included in 1H2006. In EMS, the turnover increase was due mainly to project milestone completions.

Compared to 1H2006, PBT for 2H2006 at \$168.9m was \$32.6m higher. AMM and EMS registered higher profits. The higher PBT in AMM was due to higher turnover and improved profitability, while the increased profit in EMS was due to maturity of funds under management as well as higher dividend income. The profit increase in these two business groups was partially offset by lower contributions from CERO as a result of post-acquisition business alignment initiatives and closure of the Stavanger facility at SAS Component.

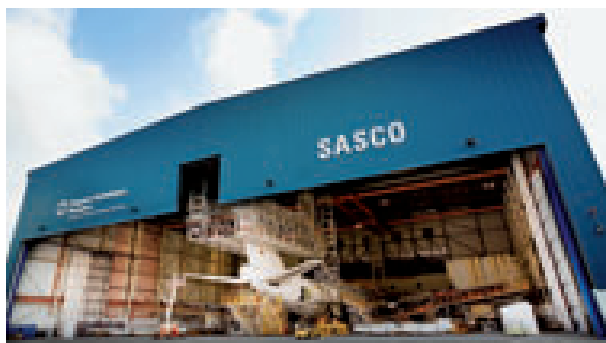
(from left to right)

In 2006, ST Aerospace inducted a new wide-body hangar at SASCO's Changi location.

ST Aerospace advanced on its engineering expertise to enhance customers' aircraft and equipment performance and life cycle supportability.

ST Aerospace made strides in maintenance capabilities for the B737 with the completed setup of its CFM56-7B MRO capability.

Newly acquired SAS Component merged with ARL for a more holistic Total Aviation Support proposition.



Aerospace

Full Year Performance

Aerospace sector's FY2006 turnover at \$1,673m was higher than that of FY2005 by 35% or \$437m. The higher turnover was due to higher redeliveries in AMM as well as the inclusion of sales from SAS Component in CERO, but these were partially offset by fewer project milestone completions and lower material sales in EMS.

Compared to FY2005, the Aerospace sector's FY2006 PBT of \$305.3m was higher by 20% or \$49.9m. The higher PBT was mainly attributable to improved profitability and higher turnover in AMM, but this was partially offset by lower contribution from CERO due to post-acquisition business alignment initiatives and closure of the Stavanger facility at SAS Component.

Major Acquisitions

2006 saw the integration of Airline Rotables Limited (ARL) with the newly acquired SAS Component, when ST Aerospace transferred its stake in Airline Rotables (UK Holdings) to SAS Component for US\$22.5m (about \$35.5m). The transaction raised ST Aerospace's shareholding in SAS Component from 67% to 71.3%.

Major Projects

ST Aerospace maintained a healthy order book in 2006 that included Passenger-To-Freighter (PTF) aircraft conversions, maintenance activities and engineering programmes.

Conversions for the MD-11 progressed steadily in 2006 for customers including FedEx Express and UPS. To date, the Aerospace sector has redelivered 42 converted MD-11 aircraft, with 12 completed in 2006.

Engineering achievements in 2006 included the initiation of engineering development efforts for the Boeing 757-200 PTF conversion programme for the Royal New Zealand Air Force. Designs for the required multi mission platform were reviewed and approved in 2006 for work to commence in 2007.

Maintaining its leadership in MRO services among Low Cost Carriers (LCC) and start-up airlines, ST Aerospace clinched contracts from five of six emerging airlines in China and added programmes by other major LCCs. Of notable mention was the award of a US\$635m (about \$1b) agreement with Airbus to provide Total Aviation Support (including aircraft line and light maintenance, components management and support, engineering and technical services) for Skybus Airlines' fleet of 65 Airbus A320 family of aircraft over a period of 12 years. Skybus Airlines is a new LCC in the US.

Expanding into new markets, ST Aerospace signed a Memorandum of Understanding (MOU) to set up an airframe MRO centre in Panama. A lease agreement with the Agencia del Área Económica Especial Panamá-Pacífico was signed for a new facility to commence operations in 2007. This latest addition of Panama Aerospace Engineering (PAE) would complement the sector's MRO centres in Mobile and San Antonio, as well as enhance the group's global network in the US, Europe and Asia Pacific. PAE would initially perform commercial aircraft maintenance and modification works on narrow-body aircraft and aim to progressively build a capacity of more than 1.2m manhours and a workforce of 1,000 skilled engineers and technicians.

Its China facility, STARCO, has been operational for two years and has successfully completed major works on over 120 aircraft for China Eastern Airlines, and other Chinese and international carriers. Within its first year of operations, STARCO was the first non Chinese MRO company to attain a certification from the US Federal Aviation Administration for the A310, A319/A320 and A330. In 2006, STARCO gained more approvals from the European Aviation Safety Agency and the Australian Civil Aviation Safety Authority, in addition to certification from the Chinese airworthiness authorities.



Electronics

TRANSFORMING THE WORLD WITH INTELLIGENT SOLUTIONS

Established in 1969, ST Electronics is a leading electronics and Information Communications Technology (ICT) systems house in the region. Currently marketing to more than 60 countries, the sector identified growth areas in e-Government and ICT, satellite communications and digital media.

Its Homeland Security (HLS) solutions, digital animation capability, intelligent building management and intelligent transportation solutions for infrastructure build up have become internationally accepted. In 2006, ST Electronics continued to extend its market reach into Qatar, Dubai, Albania and new regions in China.

Leveraging on China's growth, ST Electronics has set up operations in more than eight cities in China, including Beijing, Chengdu, Guangzhou, Yichun, Hong Kong, Shanghai, Shenyang and Shenzhen. It now targets second tier cities such as Nanjing, Ningbo, Suzhou and Wuxi. A production plant was set up by its Chengdu office and it is seeking new opportunities in the central-western region. ST Electronics also continued to tap on infrastructural opportunities in Dongbei, Huadong, Huanan and Huabei, as cities in these areas start to develop.

ST Electronics is part of a consortium with Hewlett-Packard, Cisco Systems, Microsoft and Accenture, that was shortlisted by the Infocomm Development Authority of Singapore for its \$2b IT outsourcing Standard ICT Operating Environment project for 60,000 civil servants, expected to be awarded in 2007.

ST Electronics' core business activities are organised into three key business groups.

Large-Scale Systems Group (LSG)

Over the years, ST Electronics has won rail transportation projects in China, the Philippines, Singapore, Taiwan and Thailand. This year, it further strengthened its foothold in China with new rail projects.

In the area of intelligent building management and security systems, ST Electronics won international contracts for the Grand Indonesia Jakarta, Thai Airways Building in Bangkok and a parking guidance system in Sydney. Recent awards for building security systems were for CCTV, fire protection and camera surveillance systems for Doha's old Souq for the 2006 Asian Games.

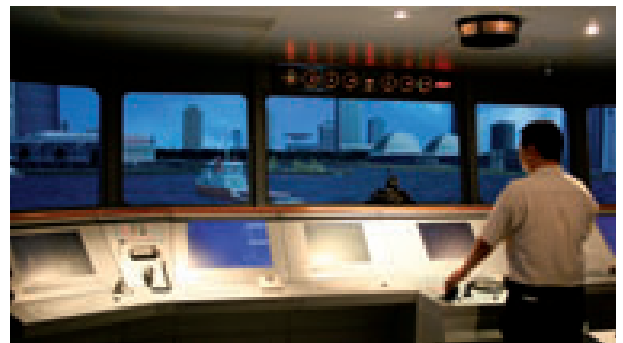
On the homefront, ST Electronics secured contracts for various combat systems for the Singapore Navy's frigates programme.

Communication & Sensor Systems Group (CSG)

ST Electronics continued to lend its transport management expertise in international events. Its cetrac® fleet telematics solution was used by buses to ferry delegates during Singapore 2006 in September. The highlight of this event was the annual meetings of the Boards of Governors of the International Monetary Fund and World Bank Group.

Together with iDirect, ST Electronics will support SingTel in its newly launched maritime satcom solutions for the Asian market. iDirect was selected to provide a communications platform for 600 sites in Mexico for Farmacias Similares' pharmacy chain.

The Full Mission Ship Handling Simulator can be configured to handle all types of vessels.



Electronics

VT Miltope received a contract for the F/A-22 integrated maintenance information system portable maintenance aid for the US Air Force.

Software Systems Group (SSG)

ST Electronics' e-Government and ICT solutions surged ahead during the year. It will be providing an information network system to the 16-member Regional Cooperation Agreement On Combating Piracy And Armed Robbery Against Ships In Asia (ReCAAP) – the first regional government-to-government agreement to combat piracy in Asia.

Together with CrimsonLogic, ST Electronics will be implementing the TradeXchange – a neutral and secure trade platform facilitating the exchange of information within Singapore's trade and logistics community.

The state-owned Qatar Security Services Company appointed ST Electronics to provide HLS consultancy.

The Electronics sector's digital animation focus has earned recognition from renowned names like Nelvana, Promenade Pictures and Weta. The Ten Commandments, its jointly produced digital animation movie with Promenade Pictures, will be launched in the US in 2007.

PERFORMANCE OF THE ELECTRONICS SECTOR

Half Yearly Performance

The turnover of \$527m recorded in 2H2006 was higher than that of 1H2006 by 24% or \$103m. All three business groups, namely LSG, CSG and SSG, contributed to the increased turnover.

The PBT of \$59.7m for 2H2006 was higher than that of 1H2006 by 33% or \$14.8m. At the business group level, the increase in profit was contributed by LSG due mainly to higher sales and better overall performance of overseas subsidiaries. CSG's profit was higher due mainly to higher sales, but this was partially offset by lower investment income. The increased profit for SSG was in line with its higher sales.

Full Year Performance

FY2006 turnover of \$951m for the Electronics sector was higher than that of FY2005 by 36% or \$250m. All three business groups contributed to the higher turnover with major contribution from CSG for the sales of satellite communication products and electro-optics equipment. Turnover for SSG was higher with the delivery and installation of educational multimedia laboratory systems in Kazakhstan and the milestone completions of a command and control system project, while milestone completions of the Land Transport Authority's (LTA) Circle Line project and Taipei and Kaohsiung MRT projects accounted for the higher turnover in LSG.

The Electronics sector's PBT for FY2006 at \$104.6m was 38% or \$28.6m higher than that of FY2005. Both CSG and SSG recorded higher PBT, while LSG had a lower PBT in FY2006 vis-à-vis FY2005. The higher PBT in CSG was due to increased turnover and investment income, while the higher PBT in SSG was in line with its higher turnover. LSG's lower PBT was due to higher loss incurred by an overseas subsidiary. Overall, the sector recorded higher investment and interest income in FY2006 vis-à-vis FY2005.

Major Acquisitions

ST Electronics acquired 80% of US-based MÄK Technologies, Inc in a bid to strengthen its simulation and digital media capability. MÄK's tools and toolkit will allow ST Electronics to market its simulation solutions for desktop training and digital animation games.



Electronics

ST Electronics acquired the remaining stake in TranSys to widen its transportation system capability. STELCOMMS was set up with the objective of growing its HLS business for communications systems in Asia Pacific. Fifty-one percent owned Brightspot Interactive Learning will provide an avenue for online e-training business in China and the region, while 70% owned PM-B will offer mission-critical and command and control capabilities for command/data centres, business continuity and disaster recovery sites.

Major Projects

ST Electronics continued to secure projects in new markets. These include an integrated tower information system and navigational aids for Kukes Airport of Albania, in addition to security systems in Qatar and China.

Its foothold in the Chinese rail market has expanded with two new contracts. A first-of-its-kind integrated traffic command centre system will enable the efficient management of major rail lines in Beijing, making ST Electronics the first Singapore company to win a major Beijing Olympics related contract. In December, it won a contract to provide automatic fare collection systems for Guangzhou MRT Lines 2 and 8 and Line 4 North extensions.

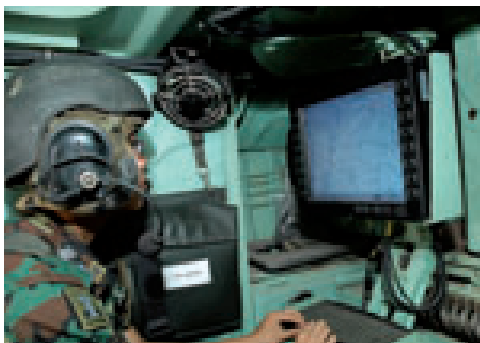
In Singapore, Comfort Transportation Pte Ltd appointed ST Electronics to provide a new wireless GPRS-based telematics system for its fleet of 15,300 taxis. This new system will be integrated into an existing system used by its CityCab fleet, implemented by ST Electronics in 2003.

The Singapore Prison Service will realise its long term goal of centralising all prison institutions network infrastructure for its new Changi Prison Complex Cluster B by 2008 with a system to be provided by ST Electronics. It will also be providing the Ministry of Home Affairs with electro-optics payloads for its Police Coast Guard vessels to aid in the surveillance of waters around Singapore.

The Singapore Civil Defence Force appointed ST Electronics to develop a HazMat incident management system, which will facilitate secured communications between fixed sites, mobile command posts, commanders and first responders on scenes to ensure comprehensive response to chemical threats.

ST Electronics was awarded a contract to deliver a 360-degree virtual aerodrome control simulator to the Singapore Aviation Academy, the training arm of the Civil Aviation Authority of Singapore.

In defence, the Electronics sector was instrumental in transforming the Singapore Armed Forces into a 3rd Generation networked fighting force. Its pioneering, multi role advanced combat simulator system was commissioned by the Republic of Singapore Air Force, enabling its pilots to train as an integrated force. ST Electronics' Battle Management System (BMS), which has been deployed on the BXII platform, was also commissioned this year. The BMS networks the fighting forces, providing a network-centric wireless communications systems for a truly 3rd Generation networked force.



*(from left to right)
HazMat management systems facilitate vital and secured communications for comprehensive response to chemical threats.*

ST Electronics provides electronics systems and solutions for major rail systems in China, the Philippines, Singapore, Taiwan and Thailand.

iDirect's solutions augment the group's end-to-end satcom offerings.

The Battlefield Management System deployed in the BXII provides better situational awareness for engagement.

Land Systems

BREAKING NEW GROUND IN SPECIALTY VEHICLES AND TECHNOLOGIES

ST Kinetics is one of South East Asia's largest defence companies, with a growing portfolio of products and services for the defence, homeland security and commercial markets.

The year saw the Land Systems sector expanding its markets and range of products, and actively aligning business operations to consolidate its commercial specialty vehicles business. It continued to serve the evolving needs of the defence and homeland security markets.

ST Kinetics is in two strategic business segments.

Integrated Systems and Services

ST Kinetics achieved several milestones in 2006, chief of which was the commissioning of its Bionix II (BXII) infantry fighting vehicle by the Singapore Armed Forces (SAF). The BXII was designed with greater lethality, survivability and enhanced connectivity, enabling better response in today's fast-moving battlefield. ST Kinetics also showcased its integrated system of systems solutions at two major exhibitions, namely Asian Aerospace in Singapore and Eurosatory in France. Its joint participation with the Defence Science and Technology Agency, DSO National Laboratories (DSO) and the SAF at such events, under the banner of "Task Force Singapore", demonstrated how the Singapore defence ecosystem can come together to leverage emerging technologies in support of a 3rd Generation SAF.

Internationally, ST Kinetics forged further alliances with major Original Equipment Manufacturers (OEM) to establish a foothold in key markets around the world. These included partnership agreements with Cornell University of the US and Metal Storm of Australia, and a joint venture with Kalyani Group in India. Through such collaborations, ST Kinetics expanded

its product range and strengthened its capabilities in areas like unmanned technologies and advanced 40mm ammunition products, reinforcing its position as one of the few OEMs in the world to offer a comprehensive suite of 40mm weapon systems and their supporting ammunition.

Responding to the growing needs for homefront security, ST Kinetics engaged with civil and law enforcement agencies, both locally and in the region, to offer solutions for window and wall protection, emergency response vehicles as well as perimeter defence. Through partnerships, it imported unique technologies and commercialised them for the security market. An example is the People Portal, which uses a patented non-intrusive detection capability belonging to EMIT Technologies, a partner from the US.

Specialty Vehicles and Services

The Land Systems sector is harnessing its engineering expertise and growing network in China and the US to realise its vision of becoming a major specialty vehicles player. It is tapping on its value engineering inputs, and ability to aggregate resources and seek cheaper sources of supply, to enhance its efficiency and competitive edge. In 2006, an international procurement centre was formed to tap on China's global sub-components supplier status to reduce product costs for ST Kinetics worldwide. The formation of a sales and distribution group enabled ST Kinetics to promote and market itself globally.

ST Kinetics stayed focused in China and the US, given their market size and growth potential. In China, ST Kinetics' joint venture companies, Beijing Zhonghuan Kinetics (BZK) and Guizhou Jonyang Kinetics (GJK), launched new dump trucks and excavator products to meet the rising demand for higher grade specialty construction vehicles.

The newly commissioned BXII infantry fighting vehicle demonstrates enhanced lethality, survivability and operational performance for today's fast-moving battlefield.



Land Systems

The newly acquired US-based VT LeeBoy, with its leadership position in commercial class asphalt pavers, brooms and related road construction and maintenance equipment, has significantly boosted the Land Systems sector's product range and strategic position in the construction market. The opening of its new and expanded production facility in Lincolnton, North Carolina, will provide ST Kinetics the capacity to meet its domestic and international growth needs in the years to come. Another US-based wholly-owned subsidiary, VT Specialized Vehicles Corporation (VT SVC), secured several contracts in 2006. It is the preferred or exclusive supplier to 15 of the top 20 US food service distributors with its range of multi-temperature trucks and trailer bodies. VT SVC expanded its homeland security offerings by selling a record number of emergency rescue bodies and trailers for municipal rescue departments.

In the automotive repairs business, ST Kinetics' STAR automotive centres in Guangzhou and Zhejiang responded well to the increased demand for quality after-sales service coupled with a growing car population in China. Both centres achieved authorised quality repair workshop status for the top five insurance companies in China and serve as independent damage assessment centres. In addition, STAR Automotive Centre (Zhejiang) secured a licence to import and export automotive spare parts in China for trading and repair, giving it an advantage over its competitors. In Guangzhou, STAR secured a major fleet maintenance contract from the Construction Bank of China.

PERFORMANCE OF THE LAND SYSTEMS SECTOR

Half Yearly Performance

Compared to 1H2006, 2H2006 turnover increased by 48% or \$194m to \$598m. This was largely due to higher delivery of Bronco and BXII as well as higher weapon export and specialty vehicles sales.

Compared to 1H2006, 2H2006 PBT increased by 53% or \$14.6m to \$42.3m. This was attributable mainly to higher turnover, but this was partially offset by higher operating expenses.

Full Year Performance

The Land Systems sector's FY2006 turnover of \$1,002m was higher than that of FY2005 by 67% or \$402m. The higher turnover was largely contributed by Automotive (Auto) and Munitions & Weapon (M&W). The higher turnover in Auto was the result of higher specialty vehicles sales, while higher weapon export and munitions sales accounted for the higher turnover in M&W.

Compared to FY2005, the Land Systems sector's PBT of \$70m for FY2006 was higher by 8% or \$5m. This was mainly due to higher PBT in M&W, but this was partially offset by lower PBT in Auto and Services, Trading and Others (S&T). M&W's higher profit was in line with higher turnover, while the lower PBT in Auto was due to product mix and lower investment income, but this was partially offset by contribution from its specialty vehicles business. For S&T, the lower profit was due to the share of lower profits from an associated company, CityCab, but this was partially offset by increased contribution from higher turnover.



Land Systems

Major Acquisitions

Through VT Land Systems, ST Kinetics acquired B. R. Lee Industries at an enterprise value of US\$135m (\$212m). The acquired entity, renamed VT LeeBoy, is a leader in the road construction and maintenance equipment market and the number one OEM in the US by unit volume for commercial class asphalt pavers and brooms.

The joint venture with Kalyani Group to collaborate in research, development and manufacture of military land-based products and solutions, specifically in the area of large calibre guns and small arms, marked ST Kinetics' entry into the Indian defence market. ST Kinetics holds a 26% stake while Kalyani's unit, BF Utilities, holds the remaining 74% stake.

ST Kinetics also established Advanced Technology Research Centre, a 50-50 joint venture company with DSO, for further research and technology development in advanced materials for defence and commercial applications.

In addition, ST Kinetics enlarged its stake in its STAR automotive centre in Zhejiang to 86.24%, increasing the total capital injection to RMB13m (about \$2.6m), in line with the business growth in China.

Major Projects

2006 saw the contractual delivery of major projects such as Bronco, BXII, SAR 21, Primus, Pegasus and munition products to the SAF. ST Kinetics also secured and delivered various munition and weapon contracts from overseas customers, penetrating new markets in the African continent and Latin America.

Another defence milestone was ST Kinetics' successful demonstration of a range of low velocity 40mm electrically ignited munitions jointly developed with Metal Storm. It also unveiled an array of products and competencies during Asian Aerospace that included a light armoured multi role vehicle, all terrain vehicle, multi role unmanned ground vehicle, new 40mm ammunition products and the People Portal, among others.

On the commercial front, specialised truck bodies and trailers, off-road dump trucks and excavators, road construction and maintenance equipment were successfully delivered to international customers.

ST Kinetics showcased its range of specialty vehicles at BAUMA, one of the world's largest exhibitions for the construction industry, held in Shanghai. It launched new dump trucks and excavators from BZK and GJK respectively, and introduced VT LeeBoy to the Chinese market. ST Kinetics also developed a new commercial articulated vehicle catered to search and rescue, mining, forestry as well as oil and gas industries around the world.

*(from left to right)
ST Kinetics' commercial articulated vehicle made its debut to potential customers in the mining, oil, gas, forestry, and search and rescue industries around the world.*

International partnerships with major OEMs like the Kalyani Group of India enable ST Kinetics to establish a foothold in key overseas markets and expand its product range.

The acquisition of VT LeeBoy, with its leadership position in commercial class asphalt pavers and brooms, enhanced ST Kinetics' range of specialty vehicle products for the construction industry.



Marine

RAISING THE BAR ON SHIPBUILDING AND SHIPREPAIR

ST Marine has been providing turnkey shipbuilding, ship conversion and shiprepair services to a worldwide customer base in the naval and commercial markets for over three decades. It has operations in Singapore and the US, under VT Halter Marine.

The year for the Marine sector was highlighted by new products, expanding business from existing customers, and shiprepair projects requiring more engineering expertise. Collectively, these included customers like the Republic of Singapore Navy, US Army, National Oceanic and Atmospheric Administration, Crowley Maritime, Baggermaatschappij Boskalis BV, and China National Petroleum Corporation.

The wide ranging nature of the Marine sector's shipbuilding and shiprepair competencies allows it to attract quality projects, leveraging on its design and engineering expertise to customise ship design to meet the specific needs of customers. Some key new customers that have placed shipbuilding orders are the US Navy, Shreyas World Navigation, Louis Dreyfus Armateurs SAS and Hoegh Autoliners.

Shipbuilding

The sector continued its efforts to secure high value added contracts, capitalising on its knowledge and skills in designing and building sophisticated vessels, as well as project management skills acquired through highly complex and tightly scheduled projects such as the frigates programme.

In September 2006 alone, there were repeat orders for its US operations from existing customers amounting to about US\$450m (\$735m), attesting to the level of confidence and trust that customers have in VT Halter Marine.

Shiprepair

During the year, ST Marine's shiprepair business was highlighted by projects which required higher engineering expertise in both repairs and conversions, reflecting its reputation for customisation and design capabilities.

It also saw expanding business from blue chip maritime customers all over the world, particularly established European shipowners from the Netherlands, Belgium and Germany and customers from the US and Asia. The sector maintained its presence as a key player in the Singapore shiprepair market, especially for tankers, containers and dredgers.

PERFORMANCE OF THE MARINE SECTOR

Half Yearly Performance

The Marine sector's turnover for 2H2006 at \$365m increased by 8% or \$28m over 1H2006 turnover of \$337m due mainly to higher Shipbuilding turnover.

PBT for 2H2006 at \$41.9m increased by 11% or \$4.3m over 1H2006 due mainly to the higher turnover and other income.

Full Year Performance

FY2006 turnover of \$702m for the Marine sector increased by 6% or \$42m compared to FY2005, largely contributed by Shipbuilding and Shiprepair. The higher Shipbuilding turnover was mainly contributed by the US operations, VT Halter Marine, while the higher Shiprepair turnover was the result of a more active shiprepair market.

The Marine sector's PBT of \$79.5m in FY2006 was lower than that of FY2005 by 10% or \$8.4m. The lower PBT was due mainly to lower gross margins as a result of a different sales mix.



The first of the four feeder container vessels for the Transworld Group, OEL Singapore, was launched in June 2006.

Marine

Major Projects

In 2006, ST Marine delivered two of the five locally built frigates, *RSS Intrepid* and *RSS Steadfast*, to the Republic of Singapore Navy and launched the last frigate in the series, *RSS Supreme*.

ST Marine was awarded a \$120m contract for two high end RoRo vessels to transport Airbus A380 sections and components for assembly in Toulouse, France. The customers are Seaplane One and Seaplane Two SAS, a joint venture company of Louis Dreyfus Armateurs SAS of France and Leif Hoegh & Co AS (LH) of Norway.

Its US operations won a US\$199m (about \$315m) contract from the US Navy to construct a missile range instrumentation ship T-AGM(R). This is the first US Navy contract awarded to VT Halter Marine after it joined the ST Engineering Group.

The shipyard was commissioned to build a fourth fisheries survey vessel, worth US\$30m (about \$50m), for the National Oceanic and Atmospheric Administration. It has delivered two vessels so far. This customer also awarded VT Halter Marine a US\$15m (about \$23.7m) contract for a small waterplane area twin hull coastal mapping vessel.

It was also contracted to build four additional articulated tug barge units for Crowley Maritime worth about US\$240m (\$378m), bringing the total order from Crowley Maritime to ten vessels, two of which were delivered this year.

In November 2006, VT Halter Marine was awarded a US\$165m (about \$262.7m) contract by the US Navy to procure long lead time materials and equipment for the Egyptian Navy's fast missile craft project. This is in addition to an earlier contract of US\$28.8m (approximately \$49m) for ship design and brings the amount awarded for this project to date to US\$194m. The total amount for this project, for which VT Halter Marine is the prime contractor, could exceed US\$450m after Phase II is added to the contract.

In shiprepair, the Marine sector clinched two contracts to convert existing vessels to seismic research vessels. One was a \$17m contract to convert a fishing trawler for China National Petroleum Corporation's BGP, one of the world's leading onshore geophysical service contractors in China, and the other was a \$8m contract to convert a platform supply vessel for Seabird Exploration Norway AS.

It also won a \$32m contract for the modification and upgrading of a cutter suction dredger from its existing customer, Baggermaatschappij Boskalis BV, and launched the first two of the four feeder container vessels for Transworld Group.



The last of the series of five locally built frigates, RSS Supreme, was launched by Dr Ivy Ng (wife of Dr Ng Eng Hen, Minister for Manpower & 2nd Minister for Defence).

Operating Financial Review

DYNAMICS AND RISK FACTORS OF THE BUSINESS

INDUSTRY REVIEW

As the ST Engineering Group expands its global presence, more influencers come into play and with varying impact. A negative development in one country may open doors in another. This off-setting of influencers lends stability to the Group and diversifies its earnings base, while the spread of businesses buffers each other, moderating extreme gyrations.

Oil Prices

Although oil prices eased to below US\$60 level in late 2006, they remained high relative to previous years and continued to exert pressure on bottom lines, particularly in the aviation industry. Many major airlines, some still recovering from 9/11, also face a proliferation of Low Cost Carriers (LCC), which intensifies the competitive landscape. As a result, they may increase outsourcing as part of cost containment measures. This, together with the rise of LCCs, which generally do not have inhouse resources, benefits third party aircraft Maintenance, Repair and Overhaul (MRO) operators like ST Aerospace. Business from the low cost segment could augment work from the major airlines; the longer term concern is how the latter could further cap overheads.

For the specialty vehicles business, high oil prices could similarly have a dampening effect. While there are no immediate pressures on profit margins, should this trend continue, there could be a cutback on infrastructural development, such as the construction of roads. In addition, oil is one of the components of asphalt, which is used in road paving, and this could lead to higher raw material costs, further exacerbating potential for reduced demand.

Any slowdown in the US economy, combined with higher interest rates and oil prices, may have far reaching implications across industries, ranging from reduced infrastructure and property development to a shrinking of the aviation industry.

High oil prices, however, do benefit oil producers who would have greater need for offshore support vessels and tankers, and this may benefit the Marine sector.

Interest Rates

The effect of interest rates on ST Engineering's business is similar to that of oil. The Fed rates have been hovering at the 5.25% level since the second half of 2006, and any further hike would add to the cost of doing business. As the cost of doing business goes up, there could be cutbacks in investments or less appetite for business expansion. These could affect the demand for some of the Group's products, such as road construction vehicles, and food and beverage vehicles.

Given the Group's net cash position, the negative impact of the higher borrowing interest rates is largely mitigated by the higher bank deposit rates.

Raw Materials

Like oil, the cost of steel eased in 2006. The prices of steel and related materials, such as aluminium, could impact the Marine and specialty vehicles businesses. Locking in prices ahead of schedule, as well as capping our price offers based on a range of commodity prices, helps to mitigate the impact.

Currency Fluctuations

Fluctuations in the currencies of USD and Euro will be most felt as these are the Group's export currencies.

For USD denominated exports, weakness in USD relative to SGD could result in lower revenue. This negative impact would be partially cushioned by the lower SGD cost for materials and parts imports denominated in USD. Overall, this would have a negative impact on the bottom line. The currency fluctuation risk of the Group is mitigated by the Group's diversified portfolio of operating units located in different countries with different functional currencies. It follows that losses from movements in one currency could be offset by gains from movements in another currency and vice versa.

The Group's newly acquired components business in Denmark and Norway, SAS Component, conducts business in Euros. The strength of the Euro could have a negative impact on the demand of components which SAS Component supplies, however, a stronger Euro could contribute to higher Group earnings when translated into SGD.

Operating Financial Review

Labour Supply

Skilled labour is a concern in the Aerospace sector as there is a high demand for skilled technicians both in the US and in the growing China aviation industries. Training, manpower retention incentives and alternative sources of supply are some ways in which the Group overcomes this skilled labour shortage.

Defence Spending

Defence spending in Singapore has generally been increasing year on year. However, this does not necessarily translate into more orders from the Singapore Armed Forces (SAF). Like the armed forces of other countries, the SAF is purchasing in smaller quantities to keep pace with technological change.

Technological advances also mean that new equipment, such as fighter jets and the ever more efficient commercial aircraft, require less maintenance in their early years.

The Singapore government has introduced private-public partnerships, where public projects and services are outsourced to the private sector. This development brings new opportunities for the Group, particularly with its strong record in defence, government and public projects, ranging from transport and subway systems to homeland security and defence solutions. With emphasis on lowering total cost of ownership, the Group's commercial business helps to bring commercially available technologies and practices into the defence business.

In the US, the defence budget has also grown, in view of global geo-political unrest and the war on terror, including expenditure on homeland security. The US Navy has proposed increasing its current fleet to over 300 vessels, with US\$8.9b requested for building seven new ships*, and the US Coast Guard's budget for 2007 has allocated US\$1.06b to the 25-year long Deepwater programme to upgrade its fleet**

Training in the defence sector is also employing simulation techniques and programmes, in addition to ground combat exercises.

* source: American Shipbuilders dated March 2006

** source: Defence News dated 9 October 2006

Homeland Security

As terrorism continues to be the scourge of world communities, governments are increasingly aware of the need for homeland protection technologies. This awareness will take time to be translated into budgets and implementation and, in the longer

term, presents opportunities for sensor, biometrics, surveillance and monitoring technologies, as well as patrol vessels and fast interceptors to guard coastal waters.

Similarly, some of the Group's defence and homeland security products and technologies can be used in disaster recovery.

Emerging Markets

The Group's continued global expansion and inroad into new markets – South America, Africa, the Middle East, Central Asia – will further diversify its business, making the Group less dependent on traditional markets. The new markets can also serve as lower cost manufacturing or procurement bases for the Group. They are also potential new businesses for the Group in terms of infrastructure, such as transportation networks and intelligent buildings.

Free Trade Agreements, like the one between the Panama and Singapore governments, will further widen the scope of collaboration and economic exchange at various levels between nations.

Disasters

Being in new markets also exposes the Group to other risks, such as natural disasters and terrorism. For example, the Group's Aerospace and Marine's operations located along the Gulf Coast of the US are on hurricane watch each year from June to November, requiring preparedness and robust business continuity planning.

In the aftermath of a disaster, recovery operations often field emergency response equipment and vehicles. Post disaster operations see the rebuilding of infrastructure as people's lives slowly return to normal. New buildings, such as housing and schools, roads and other transportation systems benefit providers of expertise and equipment in these areas.

RISK MANAGEMENT

As the Group drives towards globalisation to expand its market, much effort has also been focused on the Group's aim to build a robust risk management practice. Such practice allows the Group to align its risk appetite and strategy; to identify, manage and monitor key risks; and to allocate resources more efficiently. A clearer understanding of risks also enables risks to be taken knowingly and optimally. This would not only minimise surprises and losses, but also enhance the Group's performance and competitiveness when faced with opportunities. The Group will

Operating Financial Review

continue to build a strong risk management culture as well as strengthen its existing risk management practices.

- **Risk Management Governance:** The Group's Risk Review Committee works with the management to ensure that the Group has adequately prioritised and addressed the risk management issues within the Group.
- **Risk Reporting Dashboard:** A structured dashboard that provides an overview of risk profile as well as key risk indicators and risk incidents to management and the Risk Review Committee. It enables the monitoring of key risks and appropriate mitigating actions being taken on a timely basis.
- **Risk Management Infrastructure:** Various enabling policies, methodologies, guides, checklists and IT applications are constantly being developed and improved in order to support the practice of risk management at both Group and business unit level.

a) Strategic and Operational Risk

The Group operates in 20 countries spread across the Asia Pacific, Europe, and North and South America. 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 2006, 23% of the Group's assets were in the US (2001: 5%). Revenue from customers located outside Asia increased from 26% of Group revenue in 2001 to 47% in 2006.

As part of its business strategy, the Group seeks to increase the proportion of its international business and customers, thereby achieving greater geographical diversification. Likewise, the Group also plans to raise the proportion of its commercial business while maintaining strong support towards the local defence business. The commercial business helps to bring commercially available technology and practices into the defence business, thereby allowing for more cost effective systems and solutions. A more diversified base of commercial and military customers will reduce the risk of customer concentration.

b) Investment Risk

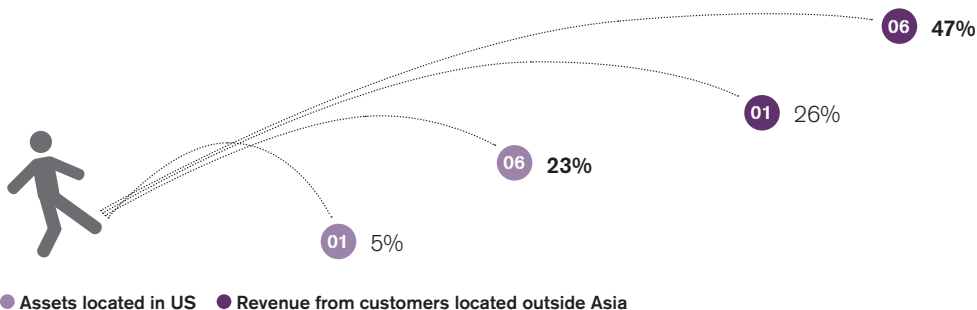
The Group seeks to grow its businesses on three fronts: through organic growth of its existing capabilities and capacities; through development of new capabilities; and through acquisition or joint ventures of business entities or operating assets.

Investment activities, ranging from the identification of targets to conducting 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 are placed with reputable banks, financial institutions and a related corporation. The Group manages its interest rate risk on its interest income by placing the cash balances in varying maturities and interest rate terms.

For loans taken by the Group, long term interest rate swaps are taken to mitigate short term interest rate risk.



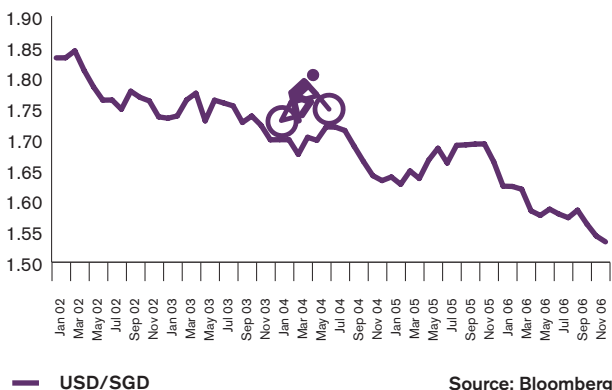
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d) Foreign Exchange (FX) Risk

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 operations of its local subsidiaries which are transacted in foreign currencies.

The Group enters 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 USD.

FOREIGN EXCHANGE



e) Derivative Financial Instrument Risk

The Group uses 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 placed funds with fund management companies, with investments in quoted equity shares and bonds. 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 are 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 has 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 collateral 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.

i) Acts of God and/or War Risk

The Group manages this risk through the development of business continuity plans so as to ensure quick recovery and resumption of critical business functions after a disruption. These plans have been communicated and the management has gone through simulated exercise of these plans. Regular reviews of these plans are performed to ensure that they stay relevant. Most contracts signed also include force majeure clauses to mitigate risk from Acts of God.

j) Legal and/or Political Risk

Legal risk is managed through standardised contracts with terms and conditions that are pre-approved. Any deviation will be vetted and approved by appropriate party level of management. The management also vigilantly monitors the respective country's business practices, environmental issues, political impact on the projects and overall business.

k) Reputation Risk

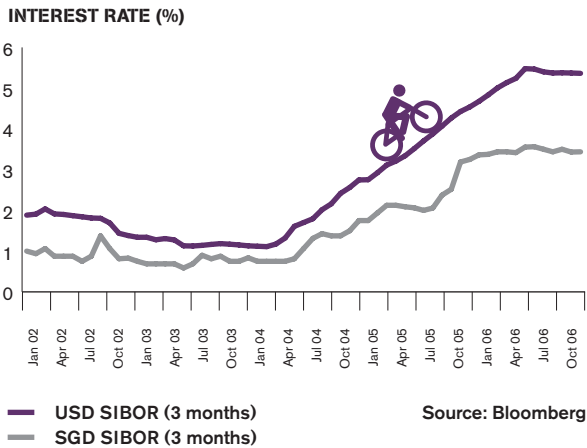
Recognising the importance of providing timely and key information to our stakeholders, the Group put in place a communications programme to ensure effective communication with our stakeholders at all times.

Operating Financial Review

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 \$1.2b as at end 2006, a one percentage point movement in effective fixed deposit rates is estimated to result in an annual \$12m change in interest income for the Group. Likewise, a one percentage point movement in effective borrowing rate is estimated to result in an annual \$8.9m change in interest expense, based on the Group's borrowings of \$890m as at end 2006.



b) Gross Profit Margin

At the 2006 turnover of \$4.49b, a one percentage point movement in the gross profit margin of the Group will lead to a \$44.9m change in gross profit for the Group. The many different programmes undertaken across the Group, with their accompanying variations in margin, have the effect of reducing the Group-wide impact of specific project fluctuations.

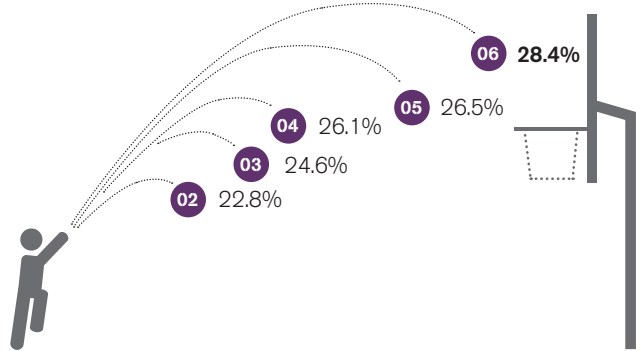
c) Others

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

SHAREHOLDER RETURN

Return On Equity

The Return On Equity (ROE) improved 1.9 percentage points to 28.4% in 2006, as a result of higher profit after tax and minority interests.

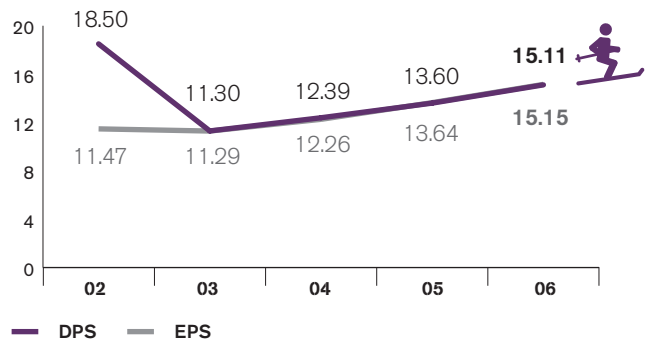


RETURN ON EQUITY

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

The proposed dividend for 2006 of \$445.1m is higher than the 2005 dividend of \$399.5m paid in April 2006. The recommended 2006 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 coming AGM. The proposed 2006 dividend of \$445.1m represents 100% of the earnings for FY2006.

DIVIDEND/EARNINGS PER SHARE



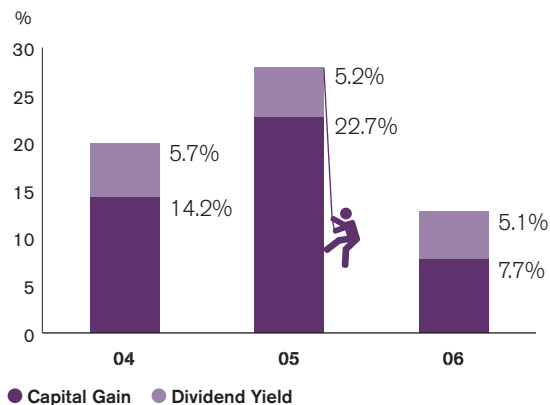
Operating Financial Review

Total Shareholder Return for ST Engineering Shares

In 2006, ST Engineering shares generated a total shareholder return of 12.8% for its shareholders. This consists of 5.1% of dividend yield and 7.7% of capital gain for the period. Over the last four years, ST Engineering has been able to consistently generate good total shareholder returns for its shareholders with more than 5% of dividend yield and healthy appreciation in its share price.

In 2007, the ST Engineering Board will adopt a dividend policy, which is based on a half yearly ordinary dividend payout, and plans to declare a first interim ordinary dividend payout starting from the announcement of the half year results ending 30 June 2007.

To maximise shareholder value, management will continue its policy of paying a high level of dividends to return excess cash generated from the operations, provided the cash is not required for major 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 EGM, 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 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 where feasible 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 the 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.

Operating Financial Review

Insurance

Where appropriate, the Group manages its insurance risks on a Group basis to leverage 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 Industrial 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 with advice and recommendations from insurance brokers to manage the insurance risk with specific risk management programmes covering the prevention of fire and the adoption of behaviour based safety practices, among others.

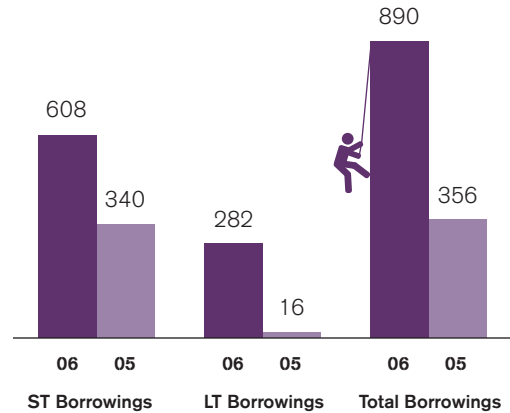
Funding and Borrowings

The Group funds its investments and operations through a mixture of shareholders' funds, advance payments from customers, and some borrowings. Its borrowings amounted to \$890m, about 57% of its shareholders' funds.

Long term borrowings amounted to \$282m and the balance is of a short term nature. The long term borrowings comprise mainly terms loans taken by SAS Component and an Industrial Revenue Bond, issued by ST Mobile Aerospace Engineering, to fund the initial purchase of plant and machinery for the facilities located at Mobile, Alabama in 1990; both entities are subsidiaries of the Aerospace sector. The short term loans are denominated in USD at a floating rate that commensurates with the Group's Aaa credit rating from Moody's. The rationale of borrowing in USD is to create a natural currency hedge position for the Group's investments denominated in the currency.

The Group's interest cover stays at a healthy 13 times, with a gross debt-to-equity ratio of 0.57.

BORROWINGS (\$m)



CASH FLOWS AND LIQUIDITY

Operating Activities

In 2006, the net cash generated from operating activities amounted to \$460m. In 2005, the net cash generated from operating activities amounted to \$303m. The improvement of \$158m in FY2006 in net cash from operating activities was largely due to higher operating profits and favourable working capital movements, with positive variances in trade debtors, advance payments to suppliers and other creditors, accruals and provisions, but these were partially offset by the negative variance in stocks and work-in-progress.

Investing Activities

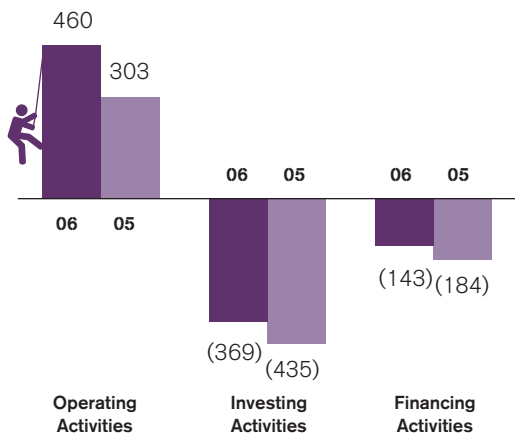
The \$369m net cash used in investing activities in FY2006 was lower by \$66m compared to FY2005. This was mainly the result of much higher proceeds from the sale and maturity of investments, but these were partially offset by a higher cash outflow for the purchase of property, plant and equipment.

Financing Activities

The \$143m net cash used in financing activities in FY2006 was lower than that of \$184m in FY2005 by \$41m. This was largely due to a higher cash inflow from bank loans, but this was partially offset by a higher cash outflow for the payment of dividend to shareholders and interest expense.

Operating Financial Review

CASH FLOW (\$m)



Cash and Cash Equivalents

As at 31 December 2006, the Group's cash and cash equivalents stood at \$1.2b, comparable to that of FY2005. The cash and cash equivalents are centrally managed by the Treasury Unit and the majority of the funds were invested in liquid assets such as fixed deposits and placements with a related corporation. The cash and cash equivalents as at yearend is adequate to fund the committed and planned capital expenditure, as well as to service the Group's borrowings. Notwithstanding the Group's current positive cash and cash equivalents 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, for financing significant merger and acquisition deals.

ACCOUNTING POLICIES

The Group's significant accounting policies are presented in Notes to the Financial Statements, Note 2 (pg 112 to 126). The Group has applied the same accounting policies and methods of computation in the preparation of the financial statements for the current reporting period compared with the audited financial statements as at 31 December 2005.

PROSPECT FOR 2007

The global economy in 2006 was shrouded with uncertainties caused by the high and volatile oil prices and the risk of a US economic slowdown. Fortunately, the economy ended the year relatively unscathed. Financial markets around the world started positively in 2007, with many stock market indices reaching record highs. The geo-political tensions in the Middle

East remain and the high oil prices are likely to persist and continue to be volatile. The risk of economic slowdown in the US and the re-emerged threat of a bird-flu pandemic continue to cause uncertainties in the global economy. As the Group continues its expansion into the global market, the impact of external risks on overall performance remains. Barring unforeseen circumstances, the Group expects to achieve a higher turnover and PBT in 2007.

In the Aerospace sector, high fuel prices and intense competition, especially from LCCs, will continue to exert pressure on the cost structure of the aviation industry. This could facilitate MRO outsourcing trend, as legacy airlines are compelled to improve operating cost efficiency. The sector will focus on airframe heavy maintenance and modification work, Total Aviation Support and implementing the recently secured seven-year FedEx Express Passenger-to-Freighter conversion contract. It will set up the required capabilities to support the operation of Skybus Airlines in the US. Through SAS Component in Europe and the expanding component support operations, the sector will continue its efforts to increase its presence in the global components and material services market.

With the enhanced simulation and digital media capabilities following the acquisition of MÄK Technologies, the Electronics sector will strengthen its market position and further broaden its customer base in 2007. iDirect will continue to extend the sector's presence in the US and enable the sector to offer a full suite of satellite communications services globally.

The Land Systems sector will continue its strategy of growing its international businesses by expanding its sales and distribution network, developing niche products and fostering local partnerships in the global market. The sector will continue to apply its engineering capabilities to its commercial automotive businesses, and create synergies and operating efficiencies from its specialty vehicles companies in the US and China.

The Marine sector succeeded in securing a few large contracts last year. Coupled with ongoing projects, these will keep the yards in Singapore and the US well utilised in 2007. The US yards had resumed full operations in 2006 after the disruption caused by Hurricane Katrina in August 2005. Apart from seeking new contracts and developing new products, the sector will concentrate on delivering its commitments to the customers and continue to pursue business opportunities in the naval and government industries, and niche segments of the commercial market.