Preliminary Results

QINETIQ

24 May 2018

Our strategy is delivering – second year of growth

Results for the year ended 31 March 2018

	Statutory results		Underlying* results	
	2018	2017	**2018**	2017
Revenue	**£833.0m**	£783.1m	**£833.0m**	£783.1m
Operating profit	**£141.0m**	£132.7m	**£122.5m**	£116.3m
Profit after tax	**£138.1m**	£123.3m	**£109.0m**	£103.8m
Earnings per share	**24.4p**	21.5p	**19.3p**	18.1p
Full year dividend per share	**6.3p**	6.0p	**6.3p**	6.0p
Total funded order backlog			**£2,005.4m**	£2,178.7m
Total orders			**£687.4m**[1,2]	£1,676.7m
Orders excluding LTPA amendments			**£587.2m**[2]	£675.3m[3]
Net cash flow from operations	**£132.4m**	£111.9m	**£126.5m**	£111.9m
Net cash			**£266.8m**	£221.9m

* Definitions of the Group's 'Alternative Performance Measures' can be found in the glossary.
[1] Includes value associated with work to be performed under the interim LTPA arrangement for twelve months beginning 1 April 2018
[2] Includes share of Joint Ventures
[3] FY17 orders included £109m 11-year NCSISS contract and £55m Strategic Enterprise contracts

Delivered second year of organic growth

- Revenue up 6%, 3% on an organic basis
- Underlying operating profit up 5%, assisted by £8.7m non-recurring trading items (2017: £7.4m), broadly flat on an organic basis
- Solid orders performance, excluding multi-year orders in FY17
- 103% underlying cash conversion pre-capex
- Underlying EPS up 7%; 5% increase in full year dividend

Driving growth through strategy implementation

- Selected to be Engineering Delivery Partner for UK Ministry of Defence (MOD)
- Down-selected on first phase of robotics program of record for US Department of Defense (DoD)
- Grown international share of revenue from 21% to 27% in 2 years
- Announced acquisition of E.I.S. Aircraft Operations, a German airborne training business

Priorities for FY19

- Conclude repricing of the Long Term Partnering Agreement (LTPA) with UK MOD
- Win further campaigns and build on successful down-selects
- Accelerate international growth in selected countries
- Continue investment driving sustainable growth

Steve Wadey, Group Chief Executive Officer said:
"This has been a year of significant progress for QinetiQ. We delivered a strong operational performance in FY18, with a second successive year of organic growth and an increasing contribution from our international businesses overcoming the profit headwinds in the UK on single-sourced work.

"Our strategy is delivering as we continue to transform QinetiQ into a more customer focused and international company, well placed to deliver further long-term growth. With more than two thirds of our FY19 revenue under contract, we enter the year in a position of strength and are maintaining expectations for Group performance".

Preliminary results presentation:

There will be a presentation of the preliminary results at 0900 hours UK time on 24 May 2018 at the London Stock Exchange, 10 Paternoster Square, EC4M 7LS. Registration for the webcast is available at: www.QinetiQ.com/investors where the presentation will also be available. An audiocast of the event through which participants will be able to ask questions will also be available by dialling + 44 20 3936 2999 (access code: 008838).

About QinetiQ:

QinetiQ is a leading science and engineering company operating primarily in the defence, security and critical infrastructure markets. We work in partnership with our customers to solve real world problems through innovative solutions delivering operational and competitive advantage. Visit our website www.QinetiQ.com. Follow us on LinkedIn and Twitter @QinetiQ. Visit our blog www.QinetiQ-blogs.com.

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Basis of preparation:

Throughout this document, certain measures are used to describe the Group's financial performance which are not recognised under IFRS or other generally accepted accounting principles (GAAP). The Group's Directors and management assess financial performance based on underlying measures of performance, which are adjusted to exclude certain 'specific adjusting items'. In the judgment of the Directors, the use of adjusted performance measures (APMs) such as underlying operating profit and underlying earnings per share are more representative of ongoing trading, facilitate meaningful year-to-year comparison and, therefore, allow the reader to obtain a fuller understanding of the financial information. The adjusted measures used by QinetiQ may differ from adjusted measures used by other companies. Details of QinetiQ's APMs are set out in the glossary to the document.

Year references (FY18, FY17, 2018, 2017) refer to the year ended 31 March.

Chief Executive Officer's Review

We are pleased with the progress we have made in FY18 reversing five years of falling revenue with a second year of organic growth. We delivered 3% organic revenue growth and grew our international revenue to 27% of revenue compared to 21% two years ago. Overall, underlying earnings per share increased 7%, cash conversion was strong and we continued to grow our dividend progressively with a 5% increase for the full year. The progress we have made demonstrates QinetiQ's ability to capitalise on the opportunities in our markets as well as our growing international presence.

Through international growth, we were able to overcome well-flagged headwinds in the UK from the lower baseline profit rate set by the Single Source Regulations Office (SSRO), which made for a tougher trading environment in FY18. Whilst this headwind is expected to intensify in FY19, with the anticipated repricing of the remainder of the Long Term Partnering Agreement (LTPA) which was not part of the December 2016 amendment, we expect the headwind will moderate in FY20 and beyond enabling growing revenue to deliver increased profitability.

We are making progress in a number of ways that are as a direct result of our strategy.

We have engaged with our core customers to help them achieve their objectives of maintaining or increasing their capabilities while also driving cost efficiencies. Our ability to respond to our customers' challenges has enabled us to deliver greater value to them and create opportunities for us. This is a reflection of the more agile and customer-focused organisation that QinetiQ has become, driven by our people. This change in approach has increased the level of bidding activity for a number of new opportunities with the UK Government.

We are investing into our core contracts, such as the LTPA, allowing us to modernise our facilities and the services we offer. This makes them more relevant to our customers for Test and Evaluation (T&E) and Training and Rehearsal (T&R) against current and future threats. By investing in our contracts we can extend their duration, increasing our long-term visibility, and attract a growing number of international customers.

We are becoming a truly international company, expanding the skills and experience honed in the UK to support customers in attractive international markets. We have increasing opportunities within some of the largest and fastest growing defence, security and critical infrastructure markets. We have made two successful acquisitions to date that are helping accelerate our progress and create revenue synergy opportunities across the Company. They are integrating well into our operations and we are pleased with their performance to date. QinetiQ is providing vital advice and support in modernising or developing indigenous defence capabilities across the globe, leveraging our core expertise.

We are at the forefront of innovation, and are better than we have ever been at effectively deploying real, commercial innovation. From advanced future laser weaponry to autonomous robotics to innovative approaches to business models and contracting, we are leading innovation in support of our customers' objectives.

We have been disciplined on costs, ensuring we remain efficient in how we resource and structure our Company. Our investment programme significantly increases capability and reduces the operating costs of a number of our facilities. We appointed six new senior leaders to the Executive Committee over the past two years, and we have improved our internal structures, modernising them to deliver efficiencies and enhancing our ability to operate at pace. We are now far better able to deploy our people and their skills to best support our customers and reduce costs.

And finally, we remain financially strong. We have one of the strongest balance sheets in UK defence and we are reinvesting the cash we generate back into the Company to support our long-term growth ambitions. As well as supporting our international expansion, this investment delivers an attractive return in its own right.

Strategy

Our strategy was developed in anticipation of the market conditions we see today and is designed to reinforce our leading position in the UK T&E market, increase our international exposure and draw upon our ability to innovate. The three components of the strategy, while presented distinctly, are interlinked and mutually reinforcing. Delivery of the strategy will enable us to better support customers and deliver long-term, sustainable growth and returns to our shareholders. As the trusted partner to UK defence, our UK credentials enable us to establish relationships with international customers. Investing in modernising our UK T&E reinforces QinetiQ's credentials and is a competitive advantage when bidding for international work.

UK defence test and evaluation

With our origins in UK Government, QinetiQ plays a unique role in UK defence. Defining and supporting this set of capabilities is the LTPA. It is our largest contract and underpins much of the defence test and evaluation capability in the UK.

Our strategy is to invest in and modernise this unique capability, enabling us to meet our customers' growing demand for more complex and integrated testing and training. This approach provides us with a strong foundation, securing UK customers and growing international users. Being a leader in UK T&E is also critical to supporting our international ambitions. Our ability to win work internationally is in part built upon our credibility within our UK home market. Our work within UK T&E also enables us to grow into near adjacent markets such as cost-effective training.

Highlights during the year included:

- We are investing in modernising our air ranges and test aircrew training facilities with new advanced tracking radar and aircraft, delivering significant operational and cost benefits. The investment enabled us to sign contracts with the Swiss defence procurement agency and with the Royal Netherlands Air Force, the latter to train Dutch test pilots and flight test engineers until at least 2022.
- The investment allows us to deliver larger and more complex training exercises, such as Formidable Shield. Led by the US Navy, and incorporating forces from eight countries, over 18 months QinetiQ managed every aspect of the planning and delivery of the exercise to evaluate the ability to track and destroy long-range ballistic missiles.
- Working in partnership with the MOD and MBDA, the manufacturer of the Brimstone 2 missile, and using our facilities at MOD Aberporth, we provided the capability assurance required to ensure that the missile can be integrated safely onto Typhoon, expanding the aircraft's capabilities and allowing for the timely retirement of Tornado.
- With our partners Atkins and BMT, we have been invited by the UK MOD to negotiate the Engineering Delivery Partner (EDP) programme on a sole source basis. This is a significant arrangement through which the MOD will procure its engineering services. Discussions with the MOD are ongoing and we are actively embracing our customers' challenges, innovating service delivery and business models, and building on the successful track record of our Strategic Enterprise approach.

Focus for FY19:

Our focus areas for FY19 include repricing of the remainder of the LTPA which was not part of the December 2016 amendment, covering the operation and management of 15 sites and facilities and representing approximately £100m in annual revenue. We are confident of concluding constructive discussions with the MOD in FY19 and have put in place an arrangement for the interim period under existing LTPA contract terms. We will also continue our investment into our air ranges and test aircrew training facilities, and invest in the digitisation of our capabilities to enable real-time data transfer and evaluation.

International

We have made significant strides in becoming a truly international company. Over the last two years we have increased our international share of revenue from 21% to 27%.

Our international 'home countries' of the US and Australia have performed well with the US achieving good order performance and Australia delivering record orders for the third consecutive year. Outside of our home countries, we have made good progress in the Middle East where there is a growing customer requirement for capability integration to complement many years of platform acquisition.

Highlights during the year included:

- We achieved record orders in Australia in FY18 as we continued to transform the business to become a leading partner to defence support acquisition and sustainment programmes. Building on our eight year partnership with the Australian Department of Defence's Science and Technology Group managing their scientific engineering services facility, we secured our second T&E facilities operations contract in the country.
- In North America we maintained good momentum, winning significant orders for maritime systems. In March, we were down-selected for the first phase of a significant program of record for robotics, with a total budget of approximately US$400m in the form of an indefinite-delivery / indefinite quantity contract over seven years. QinetiQ is one of two remaining bidders with a decision on the final stage expected towards the end of FY19.
- The Middle East is a key growth region for QinetiQ as we support countries in the region to develop their defence capabilities and ensure the security of critical national infrastructure. We have established key partnerships with local companies and government agencies to accelerate the delivery of services and products within the region accordingly. This approach allows us to move with greater pace and is well aligned with our customers' objectives to develop indigenous capabilities and skills.
- Since the implementation of the strategy, we have made two very successful acquisitions which enhance our overall offer and increase our international footprint. We were pleased to announce in April 2018, our intention to acquire a third business which enhances our airborne training services and grows our international footprint further.
    - Good organic growth in Australia was complemented by better than expected revenue contribution from RubiKon, the integrated logistics support business we acquired in January 2017. The acquisition strengthened our position in the market enabling us to take on broader programmes of work for our customers and enhancing our technical expertise and domain knowledge.
    - The strategic rationale for our acquisition of QinetiQ Target System (QTS) in December 2016, was to complement our T&E offer through the addition of threat representation products and services, accelerate our international expansion and to enhance our capabilities in unmanned systems. During FY18 we have been extremely pleased with QTS's performance as part of QinetiQ, enhancing our ability to leverage their offering and meeting our profitability expectations in addition to enhancing the overall margins of the division.
    - In April 2018, we were pleased to announce the €70m acquisition of E.I.S. Aircraft Operations, a high-growth provider of airborne training services based in Germany, delivering threat representation and operational readiness for military customers. The company generated €20.1m revenue and €5.4m EBITDA in the year to 31 December 2017 and further enhances our training and T&E capabilities as well as providing an entry into the German market and the wider European defence market. The acquisition is expected to complete towards the end of H1 2019, subject to legal and regulatory approvals.

Focus for FY19

Our focus in FY19 is to build on the momentum achieved in FY18, continuing to accelerate the growth in our home countries, deepening our new relationships in the Middle East and leveraging the investment we have made in our export sales team to win more business. In the US, we will continue to rigorously pursue significant opportunities in our robotics and maritime capabilities. Once completed, we will leverage our recently announced acquisition of E.I.S. Aircraft Operations, to deliver international revenue synergies and enhance our overall customer offer.

Innovation

We are a company which is founded upon innovation. Our people, using their extensive technical and scientific expertise, innovate to overcome some of the most challenging problems our customers face. A core part of our strategy to grow QinetiQ is to build on this technical expertise with commercial innovation, and to apply this approach across all our activities and geographies, as a major source of competitive advantage.

Highlights during the year included:

- In FY17 we established business winning campaigns supported by investment and strategic partnering to drive growth. These are focused on T&E, engineering services, training, mission assurance, information insight and experimentation. In FY18 we were down-selected for five major campaign areas, including as Engineering Delivery Partner (EDP) with the MOD, a framework through which the UK MOD will procure its engineering services.
- Our success on EDP was built on the innovative Strategic Enterprise model for the delivery of aircraft engineering services for the MOD that has now been in operation for more than two years. In FY18, we successfully added the evaluation of a missile system to the programme, our first non-aircraft related work.
- The space industry continues to grow rapidly, and QinetiQ is at the forefront of some of the innovative technology that is critical to its success. In FY18, we signed a €25m contract with the European Space Agency (ESA) to develop the International Berthing and Docking Mechanism (IBDM), which positions us to become the international standard for spacecraft berthing and docking globally.
- We opened our Dragonworks facility, which will serve as a test bed for all technologies associated with high-energy lasers for military and commercial applications. Based on research we undertook and working in partnership with MBDA and Leonardo, we are leading the next phase of disruptive directed energy weapon systems.

Focus for FY19

Our focus in FY19 will be to build on the success to date of our campaign approach, converting down-selects into contract awards. We will continue our internal research and development investment focusing on major customer opportunities including the digitisation of our T&E services.

Outlook – FY19

We enter FY19 with confidence, having delivered a second successive year of organic revenue growth.

In the UK, the impact of changes to single source pricing regulations to QinetiQ is expected to intensify this year with the anticipated repricing of the remainder of the LTPA which was not part of the December 2016 amendment.

The Group’s Global Products division has shorter order cycles than EMEA Services and its performance is dependent on the timing of shipments of key orders. As a result of its strong FY18 orders performance and pipeline of opportunities, we expect the division to make continued progress in

FY19 with further organic growth partially offset by a translational impact from foreign exchange at current rates.

FY19 cash flow will reflect continued investment including capital expenditure of £80m - £100m, the majority of which will be invested into the LTPA and returned over the contract life, as well as an anticipated working capital outflow of £15m - £25m.

Overall we are maintaining expectations for Group performance in FY19, excluding non-recurring trading items, with an approximate £6m profit headwind on UK single-sourced revenue. We anticipate continued modest organic revenue growth in FY19, with the associated profit improvement largely offset by the impact of foreign exchange at current rates.

Outlook – longer term

Our performance in FY18 demonstrates that we can create opportunities for growth, provided we are customer focused, innovative and competitive. In the UK, our customers have the challenge of overcoming new threats within the constraints of tight budgets. We are well placed to help support our customers develop their capabilities while also delivering efficiencies. Through our international businesses, we are operating in attractive and growing markets that provide long-term growth opportunities.

Based on changes to the profit rate for single source contracts and our contract mix, we expect a reduction in the headwind to our EMEA Services division's profitability in FY20 and onwards, enabling growing revenue to deliver increased profitability.

Steve Wadey, Chief Executive Officer, 24 May 2018

Chief Financial Officer's Review

Overview of full year results

We delivered a strong financial performance in FY18, building on the strategic progress we have made over the past two years. The performance is all the more encouraging given the well flagged headwinds we face in the UK on single-sourced work. While we are making good progress, we continue to maintain our financial discipline and a rigorous focus on cost control and cash generation. Consequently, we enter FY19 well positioned with good revenue visibility and a strong balance sheet, which provides the resources to continue to invest in our organic capabilities and take advantage of attractive bolt-on acquisitions where there is a strong strategic fit.

Revenue was up 6% at £833.0m (2017: £783.1m), including a strong contribution from the QinetiQ Target Systems (QTS) and RubiKon businesses which were acquired in FY17. Revenue grew by 3% on an organic basis, with a 4% increase in EMEA Services more than offsetting a 4% decline in Global Products, reflecting its lumpy revenue profile.

Orders in the year excluding LTPA amendments totalled £587.2m (2017: £675.3m) and grew 15% excluding the £109m 11-year NCSISS contract and £55m Strategic Enterprise contracts awarded in the prior year. This increase was driven by a strong performance in Global Products and the contribution of the QTS and RubiKon businesses acquired in FY17 offsetting a small decline in EMEA Services. Key orders won in FY18 included US maritime systems contracts totalling more than US$50m and €25m for a spacecraft docking mechanism with the European Space Agency.

At the beginning of the new financial year, 69% of the Group's FY19 revenue was under contract, compared to 74% at the same point last year. The change is a reflection of lower value, shorter dated orders during FY18, an increasing international mix within the business, which is typically shorter dated, and an overall increase in expected revenues. The FY19 revenue cover includes the work to be performed under the interim LTPA arrangement with the MOD for the 12 months beginning 1 April 2018.

Underlying operating profit was up 5% at £122.5m (2017: £116.3m), assisted by £8.7m (2017: £7.4m) non-recurring trading items including: £5.3m credit relating to the release of engine servicing obligations; £4.7m credit related to settlement of a contractual dispute; £2.7m charge relating to property liabilities and a number of other contract-related releases. Excluding these non-recurring trading items, the QTS and RubiKon acquisitions and the effect of foreign exchange, underlying operating profit for the Group was broadly flat. This included a £3.4m reduction in EMEA Services driven by the lower baseline profit rate for single source contracts, in line with our expectations. Global Products underlying operating profit grew by 19% (6% on an organic basis) driven by improved profitability in OptaSense and high margins in the QTS business.

Total operating profit was £141.0m (2017: £132.7m), including £14.6m (2017: £18.4m) recognised on the disposal of property and £5.9m (2017: nil) on the sale of intellectual property.

Underlying profit before tax increased 5% to £122.1m (2017: £116.1m) in line with the increase in underlying operating profit, with underlying net finance costs at £0.4m (2017: £0.2m).

Total profit before tax increased to £144.8m (2017: £131.5m) due to the higher underlying profit before tax, the £5.9m sale of intellectual property and £4.2m (2017: cost £1.0m) finance income related to the defined benefit pension asset.

Specific adjusting items

Specific adjusting items, shown in the 'middle column', at the profit after tax level amounted to a total credit of £29.1m (2017: £19.5m). This included a profit of £14.6m (2017: £18.4m) recognised on the disposal of property, £5.9m (2017: nil) on the sale of intellectual property, £4.2m (2017: cost £1.0m) finance income related to the defined benefit pension asset, and £6.4m (2017: £4.1m) of tax movements, predominantly relating to the recognition of deferred tax assets in respect of tax losses and internally generated intellectual property. This was offset by £2.6m (2017: £1.0m) amortisation of acquired intangible assets reflecting a full year's ownership of the QTS and RubiKon businesses.

Net finance costs

Net finance income was £3.8m (2017: cost £1.2m). The underlying net finance cost was £0.4m (2017: £0.2m) with additional income of £4.2m (2017: cost £1.0m) in respect of the defined benefit pension asset reported within specific adjusting items.

Tax

The total tax charge was £6.7m (2017: £8.2m). The underlying tax charge was £13.1m (2017: £12.3m) with an underlying effective tax rate of 10.7% (2017: 10.6%). The effective tax rate continues to be below the UK statutory rate, primarily as a result of the benefit of research and development expenditure credits (RDEC) in the UK. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to any tax legislation changes, the geographic mix of profits, the future recognition of unrecognised tax losses and the assumption that the benefit of net R&D expenditure credits retained by the Group remains in the tax line. Future recognition of unrecognised tax losses will also affect future tax charges.

Deferred tax assets of £7.6m have been recognised in the period (2017: £3.7m), with the income statement credit classified as a specific adjusting item. These assets are in respect of US net operating losses and the recognition of tax deductible intellectual property assets in the UK, whereas the prior year related to an element of the Group's UK non-trade loan relationship deficits. Together with a £1.2m tax effect of the pre-tax specific adjusting items, the total specific adjusting items tax credit was £6.4m (2017: £4.1m).

At 31 March 2018, the Group had unused tax losses and surplus interest costs of £118.0m (2017: £141.7m) which are available for offset against future profits. A deferred tax asset is recognised in respect of £17.0m of US net operating losses (2017: nil) and £7.7m (2017: £20.2m) of UK losses. No deferred tax asset is recognised in respect of the remaining £93.3m of losses/interest costs due to uncertainty over the timing of their utilisation.

The current tax liability is £8.9m as at 31 March 2018 (2017: £43.7m). The decrease in the liability is primarily due to the settlement of a tax liability in the US related to an unfavourable court decision in respect of the tax treatment of the Group's acquisition of Dominion Technology Resources, Inc. in 2008. The tax settlement was funded through a recovery under an insurance policy (the receivable for which had previously been included within trade and other receivables).

Cash flow, working capital, capex and net cash

Underlying net cash flow from operations was £126.5m (2017: £111.9m). This included a £14.2m working capital unwind, of which £6.8m was due to non-recurring trading items, and £12.4m of pension deficit repair contributions, which are expected to fall to c.£2.5m from FY19 onwards. This resulted in a cash conversion* of 103% (2017: 96%).

Net cash flow associated with capex increased to £54.5m (2017: £32.9m) with an additional non-cash £25.9m capex creditor, which will be settled in the first half of 2019. After paying tax and net interest of £15.7m the Group generated free cash flow of £56.3m (2017: £76.4m).

As at 31 March 2018, the Group had £266.8m net cash (2017: £221.9m). The increase was primarily due to the £56.3m free cash flow and £23.1m cash inflow from property disposals offsetting £34.5m of dividends.

Total committed facilities available to the Group at year end, consisting of a revolving credit facility which is currently undrawn, amounted to £237.3m (2017: £245.7m), the decrease being solely due to foreign exchange movements (the facility containing a USD denominated component).

Capital allocation

Priorities for capital allocation are:
1. Organic investment complemented by bolt-on acquisitions where there is a strong strategic fit;
2. The maintenance of balance sheet strength;
3. A progressive dividend; and
4. The return of excess cash to shareholders.

Capital expenditure increased to £80.4m (2017: £32.9m) to support the development and modernisation of capabilities for long-term UK MOD contracts and expansion into high growth, international markets. Capital expenditure is expected to be in the £80m-£100m range in FY19 with the capex associated with the LTPA recovered in full under existing LTPA contract terms.

Earnings per share

Underlying basic earnings per share increased by 7% to 19.3p (2017: 18.1p) benefiting from the higher underlying profit before tax and the reduced share count following the completion of the £50m share buyback in FY17. Basic earnings per share for the total Group (including specific adjusting items) increased 13% to 24.4p (2017: 21.5p).

The average number of shares in issue during the year, as used in the basic earnings per share calculations, was 565.2m (2017: 573.9m) and there were 565.4m shares in issue at 31 March 2018 (all net of Treasury shares).

Dividend

The Board proposes a final FY18 dividend per share of 4.2p (2017: 4.0p) making the full year dividend 6.3p (2017: 6.0p). The full year dividend represents an increase of 5% in line with the Group's progressive dividend policy.

Subject to approval at the Annual General Meeting, the final FY18 dividend will be paid on 31 August 2018 to shareholders on the register at 3 August 2018.

In future, the Board will announce the full year dividend at the preliminary results for the year in question, with the interim dividend expected to represent one third of the prior full year dividend.

Pensions

In the UK the Group operates a defined benefit pension scheme. The Scheme is closed to future accrual and there is no on-going service cost. The Scheme is in a very healthy position with the most recently completed actuarial valuation showing a surplus of £139.7m (as at 30 June 2017) and on an accounting basis under IAS19 the net asset position was £316.2m as at 31 March 2018 (2017: £156.0m). As at year end the Scheme is hedged against approximately 85% of the interest rate risk and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis. Full details are set out in note 13.

IFRS 15 implementation

The adoption of accounting standard IFRS 15 for our FY19 financial year is not expected to have a significant impact on QinetiQ's reported financial performance, given the nature of our contracts and the existing method of accounting (using 'percentage of completion' accounting for service contracts as opposed to milestone accounting). The Group completed an assessment on FY18 revenue with the conclusion that the impact would not be material if the new standard was adopted for FY18.

David Smith, Chief Financial Officer, 24 May 2018.

Trading Environment

UK

In the UK, the Modernising Defence Programme (MDP) is underway to understand the threats the UK faces, optimise how UK MOD works and determine the capabilities required to meet national security priorities. The UK Government's commitments on overall defence spending await the results of the MDP review, with the initial themes of the review expected to be reported in July 2018. Secretary of State for Defence, Gavin Williamson, has said that the review will not necessarily be "fiscally neutral" and he will be aiming for budget increases if the review concludes there is a need for additional personnel and equipment to meet the threats identified.

It is likely that the outcome of the MDP will present opportunities and challenges for us as we are well placed to support our customers in reducing procurement and operational costs as well as risks. We also support our customers by applying our skills to overcome emerging security threats in the land, sea, air, space and cyberspace environments.

US

The US has by far the largest defence budget globally and is likely to see a top-line budget increase of more than 10% in 2018 to $670.7bn, and then a further 2% increase in 2019.

The National Defence Strategy published in January 2018 reinforced the need for investment and modernisation in US defence capability. As part of this, QinetiQ is well placed to support the advancement of robotic systems which are a key priority for future defence capabilities. In addition to a number of formal "Programs of Record" which provide a systematic approach to procurement of capabilities such as robotics, there are opportunities for greater robotic systems across the whole of US defence, and increasingly in other governmental agencies, such as the Police.

The requirement to enhance capability also reinforces the need to modernise test and evaluation capabilities which has the potential to create longer-term opportunities for QinetiQ in the US. During FY18 the US Navy ran a complex ballistic missile trial at the Hebrides range operated and managed by QinetiQ. Our investment in our core UK T&E capabilities supports our ability to build relationships in the US to help support their ambitious defence plans.

Australia

Modernising and enhancing defence capability is a key priority for the Australian Government which is reflected in its spending commitments. In Australia, defence budgets are expected to grow to 2% of GDP by 2021, three years earlier than the Government's 2013 election pledge. Defence expenditure is expected to see sustained growth of at least 3% to 4% a year over the remainder of the decade. QinetiQ has been able to build on its position in this attractive growth market both organically and through the acquisition of RubiKon, which provides specialised integrated logistics support to key programmes in support of Australia's defence objectives. Our strengthening relationship with the Australian Government is reflected in the award of our second T&E facilities operation contract, providing mine warfare engineering facilities and support at HMAS Waterhen. QinetiQ is well positioned for growth in Australia supporting defence procurement, research and development, T&E and operational support activities.

Broader international markets

A core part of QinetiQ's growth strategy is to take the products, skills and expertise developed in its home countries into attractive international markets. QinetiQ's role as a "customer friend", providing best advice and support on how to develop indigenous defence and security capabilities is proving to be an attractive proposition in high-growth markets.

In the Middle East, defence budgets have remained resilient. QinetiQ is positioned well to help support governments in the region with the development of indigenous defence capabilities. Our approach, creating in country presence through partnerships with local companies and governments, allows us to play a key role in the development of the local defence industry.

In Asia Pacific, as in the Middle East, governments are eager to develop their own defence industrial bases. Singapore, Malaysia and South Korea are all looking to either modernise the capabilities they have or enhance overall capabilities; systems in air, sea and missile defence being areas of key focus within the region. QinetiQ, building on its experience and credibility in the UK, is well positioned to support these nations to continue to enhance their own capabilities and develop their own defence industrial base.

Where references to international revenues are made within these results, they include non-UK revenues from both EMEA Services and Global Products.

Operating review

EMEA Services

	2018 £m	2017 £m
Total orders[(1)(3)]	**456.1**	1,522.3
Orders excluding LTPA amendments[(1)]	**355.9**	520.9
Revenue	**651.4**	613.5
Underlying operating profit	**94.3**	92.7
Underlying operating margin	**14.5%**	15.1%
Book to bill ratio[(2)]	**0.8x**	1.3x
Funded order backlog	**709.6**	813.6
Total funded order backlog[(3)]	**1,804.9**	2,019.8

(1) Includes share of orders from Joint Ventures
(2) B2B ratio is orders won divided by revenue recognised, excluding the LTPA contract and share of JV orders
(3) FY18 includes value associated with work to be performed under the interim LTPA arrangement for twelve months beginning 1 April 2018

Overview

EMEA (Europe, Middle East and Australasia) Services combines world-leading expertise with unique facilities to provide capability integration and assurance. Our core value proposition is built upon our expertise in capability integration, threat representation and operational readiness underpinned by long-term contracts that provide good visibility of revenues and cash flows. The division is also a market leader in research and advice in specialist areas such as C4ISR, weapons and energetics, cyber security and procurement advisory services.

Financial performance

Orders for the year were £355.9m (2017: £520.9m) due in part to the award in the prior period of the £109m Naval Combat System Integration Support Services (NCSISS) contract and £55m of Strategic Enterprise contracts. Excluding the impact of these multi-year contracts, acquisition contribution and foreign exchange, we saw slower H1 2018 orders offset in part by stronger order performance in H2 2018 resulting in an overall modest decrease of £12.7m for the year.

Revenue increased by 6% to £651.4m (2017: £613.5m) and increased by 4% on an organic constant currency basis, principally driven by the International and Maritime, Land & Weapons businesses.

At the beginning of the new financial year, 75% of EMEA Services' FY19 revenue was under contract, compared with 79% at the beginning of the prior year. The change is a reflection of lower value, shorter dated orders during FY18, and an increasing international mix within the business, which is typically shorter dated.

Underlying operating profit increased to £94.3m (2017: £92.7m). FY18 underlying operating profit was assisted by £7.7m (2017: £5.2m) non-recurring trading items including: £5.3m credit relating to the release of engine servicing obligations; £4.7m credit related to settlement of a contractual dispute; £2.7m charge relating to property liabilities and a number of other contract-related releases. Excluding these non-recurring trading items, the effect of foreign exchange and acquisitions, underlying operating profit fell by £3.4m due to the lower baseline profit rate for single source contracts, in line with our expectations.

Approximately 75% of EMEA Services revenue is derived from single source contracts. By investing in our core contracts and extending their duration we are reducing our exposure to future changes in the baseline profit rate set annually, and the methodology used by the Single Source Regulations Office, as well as securing longer term revenue visibility.

The baseline profit rate which applies to pricing discussions is a three-year rolling average. Whilst the input rate for FY19 increased from 6.44% to 7.94%, the overall three year rolling average, which forms the basis for pricing discussions in the year, decreased from 7.46% to 6.81% for FY19.

The impact of changes to single source pricing regulations to QinetiQ are expected to intensify this year with the anticipated repricing on the remainder of the LTPA which was not part of the December 2016 amendment, representing a headwind of approximately £6m to operating profit in the EMEA Services division for FY19. Based on changes to the profit rate for single source contracts and our contract mix, we expect a reduction in the headwind to our EMEA Services division's profitability in FY20 and onwards.

FY18 review

Air & Space (29% of EMEA Services revenue)

The Air & Space business de-risks complex aerospace programmes by testing systems and equipment, evaluating the risks and assuring safety.

- In March we announced the appointment of Dr Nic Anderson as Manging Director of Air & Space. Nic joined from Babcock where he was MD of Land Defence.
- We are building upon the investment made as part of the December 2016 amendment to the LTPA in test aircrew training. We have begun marketing the new enhanced offer, which utilises our new aircraft and syllabus, and in November 2017 signed the first multi-year contract with the Royal Netherlands Air Force for £6m. We have subsequently signed a contract with Armasuisse, which is responsible for defence procurement in Switzerland, and we are in close dialogue with a number of other potential customers.
- The business completed the implementation of Strategic Enterprise, securing customer endorsement and achieving Full Operating Capability, a major milestone under the contract. Strategic Enterprise has been a significant achievement for QinetiQ, with over £250m of orders placed under the framework since its inception. In addition, we have received positive customer response for the framework increasing customer satisfaction from 80% to 85%.
- Looking at ways to bring innovation to our service delivery, we have piloted a number of approaches with the Air Warfare Centre to deliver faster and more cost efficient test and evaluation to accelerate the ability to bring new or modified equipment into frontline service.
- The business continues to deploy significant resources to develop the gridded ion engine electric propulsion system to be used on ESA's BepiColombo mission to Mercury. This ambitious, multi-spacecraft mission remains scheduled to launch in October 2018 and the module has now been shipped to the launch site in French Guiana. Technical qualification of the electric propulsion system needs to be satisfactorily completed and accepted by the customer before approval can be given to launch.
- By actively embracing our customer challenges, and proposing innovative service delivery and business models, we have been invited by the UK MOD to negotiate the Engineering Delivery Partner (EDP) programme on a sole source basis. This is a significant arrangement through which the MOD will procure its engineering services, which we will deliver with Atkins and BMT.

Maritime, Land & Weapons (45% of EMEA Services revenue)

The Maritime, Land & Weapons business delivers operational advantage to customers by providing independent research, evaluation and training services.

- In May 2017, Steve Fitz-Gerald was appointed as Managing Director of Maritime, Land & Weapons. Steve joined from Marshall Aerospace and Defence Group where he was Chief Executive Officer.
- The investment in our air ranges we are making as part of the December 2016 amendment will allow us to deliver more complex trials and rehearsals to our UK and international customers. Large scale exercises, such as Formidable Shield, are a reflection of the increasing demand from customers to rehearse against increasing threat complexity.

- Using our facilities at MOD Aberporth, we worked in partnership with the MOD and MBDA, the manufacturer of the Brimstone 2 missile system, to provide the capability assurance required to ensure that the missile can be integrated safely onto Typhoon. This expands the aircraft's capabilities, enabling the timely retirement of Tornado which will ensure cost efficiencies for the MOD.
- We showcased the short-range engagement capabilities of the Sea Ceptor air defence system against Mirach aerial targets, which emulate the threat from missiles, from within 2km of the firing frigate. Sea Ceptor is in development for the UK MOD as the principal air defence capability for the Royal Navy's Type 23 and 26 frigates.
- We are delivering an increasing amount of work for international customers. In January 2018, we won an order from a key international customer to perform submarine research, modelling and testing at our Haslar site which provides world-class ocean and ship testing facilities.
- As part of an ongoing programme of work we provided test and evaluation services on the escape systems of the new class of submarines being built for the Italian Navy.
- Our credentials in delivering real innovation to our customers were recognised by our appointment to lead a new framework programme for naval research and development for the UK MOD. This is an innovative four-year framework programme providing the UK MOD with access to key industry, academia and SME expertise.
- Working with MBDA, the missile systems specialist, and the MOD, the business is developing a joint UK energetics strategy. As part of this strategy, we have secured a significant contract for weapon test and evaluation and completed the refurbishment of an Environmental Test Centre, a key facility at MOD Shoeburyness.
- Following successful delivery of the DragonFire design review, the MOD has agreed to place the second year of funding with the DragonFire consortium, formed of QinetiQ, MBDA and Leonardo. We provide world-leading high energy laser source expertise into the critical programme for the UK.

Cyber, Information & Training (CIT) (15% of EMEA Services revenue)

The CIT business helps government and commercial customers respond to fast-evolving threats based on its expertise in training, secure communication networks and devices, intelligence gathering and surveillance sensors, and cyber security.

- CIT's orders were lower in FY18 than the prior year, principally due to fewer research related orders from the UK MOD during the period.
- Following the appointment of James Willis as Managing Director of CIT in July 2017, the business is focused on bidding and winning more transformational deals with new customers, services and products. The strategy is focused on becoming the 'Mission Assurance Partner' to key strategic clients within the defence and security market. This will enable CIT to build its services and products portfolio to change the revenue profile from short term contracts to more multi-year service and product revenue streams. Major deals being bid for include work for client side support for Battlefield and Tactical Communications & Information Systems (BATCIS) with an estimated contract value of between £50m to £95m, the new Defence Operational Training (DOT) synthetic training environment, and continuation of the Rockwell Collins partnership for the next generation of position, navigation and timing (PNT) receivers.
- QinetiQ is bidding for Serapis, the replacement for the MOD's current communications and information systems R&D framework run by QinetiQ (CSIIS).
- During the period the business was awarded a £4m consultancy contract to the UK Space Agency utilising our experience in satellite communications.
- The business has developed a cyber test and evaluation service to enable organisations to test and rehearse cyber defence scenarios to better understand vulnerabilities and responses to them.
- QinetiQ is responding to customer needs and building a new capability hub in Lincoln to address new requirements for the Electronic Warfare community based around RAF Waddington.

International (11% of EMEA Services revenue)

Our International business leverages our expertise and skills developed in the UK and applies them to opportunities in attractive markets globally. Revenue derived from outside of the UK is reported in many of our businesses, and are not exclusive to our International business.

- FY18 marked a significant year for our business in Australia. Overall record orders were complemented with strategically significant contract wins and an increase in revenue of approximately one third. Earlier in the year we announced the award of our second test and evaluation facilities operations contract in Australia to run the Mine Warfare Maintenance Facilities at HMAS Waterhen in Sydney.
- Building on our January 2017 acquisition of RubiKon, an Australian specialist in integrated logistics services, we achieved an A$16m increase in our contract under AIR7000 to provide support relating to the procurement of maritime patrol aircraft in Australia.
- QinetiQ, as part of a consortium led by Nova Systems, has been down-selected by the Australian Department of Defence as one of four Major Services Providers (MSPs) enabling it to bid for larger strategic, capability and integrated work partner contracts.
- Our Advisory Services business increased its international consulting contract wins and entered a number of new Middle Eastern and European countries. As a result the business doubled the size of its order intake in 2018.
- In Sweden, we secured three new international customers at our Flight Physiological Centre that we operate on behalf of the Swedish FMV. The centre also conducted its first space mission training.
- Post the year end, we announced the acquisition of E.I.S. Aircraft Operations, a leading provider of airborne training services based in Germany. The acquisition will, subject to completion, enhance QinetiQ's international growth strategy, establishing a test and evaluation and engineering capability in Germany and enhancing our access to the broader European market.

Global Products

	2018 **£m**	2017 £m
Orders	**231.3**	154.4
Revenue	**181.6**	169.6
Underlying operating profit	**28.2**	23.6
Underlying operating margin	**15.5%**	13.9%
Book to bill ratio	**1.3x**	0.9x
Funded backlog	**200.5**	158.9

Overview

Global Products delivers innovative solutions to meet customer requirements and undertakes contract-funded research and development, developing intellectual property in partnership with key customers and through internal funding with potential for new revenue streams. The division is technology-based and has shorter order cycles than EMEA Services so can have a more lumpy revenue profile.

Financial performance

Orders increased to £231.3m (2017: £154.4m) including a total of more than US$50m orders for maritime systems in the US and a €25m spacecraft docking mechanism order from the European Space Agency.

The Global Products division had 51% of its FY19 revenue already under contract at the beginning of the new financial year compared with 55% at the same time last year, reflecting the shorter contract cycle of the division and an overall increase in expected revenues.

Revenue was up 7% on a reported basis at £181.6m (2017: £169.6m) driven by the impact of the acquisition of QinetiQ Target Systems. On an organic constant currency basis revenue declined by 4% due to lower robot sales.

Underlying operating profit increased to £28.2m (2017: £23.6m). Adjusting for the impact of the acquisition of QinetiQ Target Systems, foreign exchange movements and £1.0m (2017: £2.2m) of non-recurring trading items, underlying operating profit increased by £2.7m predominantly driven by improved profitability in OptaSense and high margins in the QTS business in the last quarter.

FY18 review

<u>QinetiQ North America (40% of Global Products revenue)</u>

QinetiQ North America (QNA) develops and produces innovative defence products specialising in unmanned systems, survivability and maritime systems along with products in related commercial markets.

- In a highly competitive field, we were unsuccessful on the US Department of Defense's (DoD) Man-Transportable Robotic System (MTRS Inc II) program of record. Despite this, we are well placed for the remaining programs and were pleased to be selected as one of two suppliers for the Engineering and Manufacturing Development (EMD) phase of Common Robotic System (Individual) program of record. The EMD phase will last approximately 10 months, during which time the DoD will test and evaluate robots from the two suppliers. The total budget for the program is approximately $400m in the form of an indefinite-delivery / indefinite-quantity contract over seven years.
- We secured over US$20m of orders during the period for Talon robots and more than US$20m of orders for our Q-Nets and Armor products.
- We won a total of more than US$50m orders for maritime systems in the US, including for aircraft launch and recovery equipment for the new class of aircraft carriers. Our ability to innovate was shown by the successful demonstration of our Dolphin system, allowing underwater full duplex acoustic communications.

<u>OptaSense (14% of Global Products revenue)</u>

OptaSense provides innovative fibre sensing solutions to deliver decision-ready data in multiple vertical markets.

- The performance of OptaSense improved as we saw the impact of returning confidence in the oil field market and its diversification into adjacent markets started to reap rewards.
- The move to a more customer aligned organisation since the beginning of the year has delivered higher quality orders with less reliance on R&D investments. Our industry leading and proven technology has continued to be a differentiator with major in-well acquisitions taking place in three continents as the focus on production and efficiency accelerates.
- OptaSense has made multiple significant deliveries to infrastructure customers during the year: the largest single system awarded (TANAP) has been delivered to Turkey; we have had significant deliveries into the Middle East region and the first significant award and first phase delivery into the US.
- Oil field activity in North America continues to increase while the adoption in the Middle East and Asia markets becomes more embedded.

Space Products (11% of Global Products revenue)

QinetiQ's Space Products business provides satellites, payload instruments, sub-systems and ground station services.

- During the year we were awarded a €25m contract from the European Space Agency for our innovative International Berthing and Docking Mechanism. We are engaged in discussions with other potential users of the system both in the commercial and governmental sectors for the supply of docking modules, potentially creating a new revenue stream for the business.
- The business secured a €3m contract with the European Space Agency for the preliminary design activities on the Altius earth observation satellite. This satellite will study the distribution of ozone in the earth's stratosphere.
- The business also secured a number of new contracts, the most significant of which was COLIS, a €6m project to build a Colloid Light Scattering instrument for investigating the effect of density and temperature on colloidal structures.

EMEA Products (35% of Global Products revenue)

EMEA Products provides research services and bespoke technological solutions developed from intellectual property spun out from EMEA Services. It also includes various product based acquired businesses including QinetiQ Target Systems.

- The performance of QinetiQ Targets Systems, which we acquired in December 2016, continues to exceed our expectations. During the year it won work from two new customers, the Republic of Korea Air Force and the Japanese Self Defence Force. It was also awarded a five year framework contract for the Dutch Navy for the majority of its portfolio of aerial, rotary and maritime targets in addition to a long-term framework with the US Targets Management Office. QTS reached production milestones with its Hammerhead and Banshee targets making them the most proliferated surface maritime and aerial target anywhere in the world.
- QinetiQ is supporting the Canadian government with trials of QinetiQ's counter-UAV system Obsidian. Obsidian uses state of the art radar technology and optics linked to a powerful management and tracking software tool to provide an industry leading solution to detect and track drones.
- Exploiting our research into metamaterials, we are collaborating with Isotropics Ltd in the development of electromagnetic lenses for use in electronically steered flat panel satellite antennas. This technology enables High Throughput Satellite communications in the growing areas of communications on the move and consumer broadband.
- QinetiQ is launching its new secure Iridium-based satcom phone for military, emergency services and users working in challenging environments such as oil & gas or mining. It will use a ruggedised design with encrypted data links to ensure global secure coverage for users.

Other finance items – foreign exchange

The Group's income and expenditure is largely settled in the functional currency of the relevant Group entity, mainly Sterling or US Dollar. The Group has a policy in place to hedge all material transaction exposure at the point of commitment to the underlying transaction. Uncommitted future transactions are not routinely hedged. The Group continues its practice of not hedging income statement translation exposure.

The principal exchange rate affecting the Group was the Sterling to US Dollar exchange rate and the Sterling to Australian Dollar rate.

	12 months to 31 March 2018	12 months to 31 March 2017
£/US$ - opening	1.25	1.44
£/US$ - average	1.33	1.30
£/US$ - closing	1.40	1.25
£/A$ - opening	1.64	1.87
£/A$ - average	1.71	1.74
£/A$ - closing	1.83	1.64

Principal risks and uncertainties

The Group continues to be exposed to a number of risks and uncertainties which management continue to assess, manage and mitigate to minimise their potential impact on the reported performance of the Group. An explanation of these risks, together with details of risk management and mitigation, can be found in the annual report which will be available for download at:
https://www.qinetiq.com/investors.

A summary of the significant risks and uncertainties is set out below:

- Reduced spending in the core markets in which the Group operates;
- Failure to execute the international strategy or adequately to mitigate specific risks arising from international business;
- Failure to create a culture of innovation or to invest adequately in, or create value from, our innovation investment;
- A future skills shortage;
- Group performance is adversely affected by application of the Single Source Contract Regulations;
- A breach of data security, cyber-attacks or IT systems failure could have an adverse impact on our customers' operations;
- The Group operates in highly regulated environments and recognises that its operations have the potential to have an impact on a variety of stakeholders; and
- A material element of the Group's revenue is derived from one contract (the LTPA contract).

Consolidated income statement
for the year ended 31 March

All figures in £ million	Note	**2018** Underlying*	**2018** Specific adjusting items*	**2018** Total	2017 Underlying*	2017 Specific adjusting items*	2017 Total
Revenue		**833.0**	**-**	**833.0**	**783.1**	**-**	**783.1**
Operating costs excluding depreciation and amortisation		(690.9)	-	(690.9)	(647.0)	(1.0)	(648.0)
Other income		9.7	21.1	30.8	9.2	18.4	27.6
EBITDA (earnings before interest, tax, depreciation and amortisation)		**151.8**	**21.1**	**172.9**	**145.3**	**17.4**	**162.7**
Depreciation of property, plant and equipment		(25.6)	-	(25.6)	(26.4)	-	(26.4)
Amortisation of intangible assets		(3.7)	(2.6)	(6.3)	(2.6)	(1.0)	(3.6)
Operating profit		**122.5**	**18.5**	**141.0**	**116.3**	**16.4**	**132.7**
Finance income	5	0.7	4.2	4.9	1.0	-	1.0
Finance expense	5	(1.1)	-	(1.1)	(1.2)	(1.0)	(2.2)
Profit before tax		**122.1**	**22.7**	**144.8**	**116.1**	**15.4**	**131.5**
Taxation (expense)/income	6	(13.1)	6.4	(6.7)	(12.3)	4.1	(8.2)
Profit for the year attributable to equity shareholders		**109.0**	**29.1**	**138.1**	**103.8**	**19.5**	**123.3**
Earnings per share							
Basic	7	19.3p		24.4p	18.1p		21.5p
Diluted	7	19.2p		24.3p	17.9p		21.3p

* Alternative performance measures are used to supplement the statutory figures. These are additional financial indicators used by management internally to assess the underlying performance of the Group. Definitions can be found in the glossary.

Consolidated comprehensive income statement for the year ended 31 March

All figures in £ million	**2018**	2017
Profit for the year	**138.1**	**123.3**
Items that will not be reclassified to profit and loss:		
Actuarial gain recognised in defined benefit pension schemes	143.6	183.3
Tax on items that will not be reclassified to profit and loss	(24.4)	(31.2)
Total items that will not be reclassified to profit and loss	**119.2**	**152.1**
Items that may be reclassified subsequently to profit and loss:		
Foreign currency translation (losses)/gains on foreign operations	(9.7)	12.2
Movement in deferred tax on foreign currency translation	(1.0)	-
Decrease in fair value of hedging derivatives	(2.2)	-
Movement in deferred tax on hedging derivatives	0.4	-
Fair value losses on available for sale investments	(0.6)	(0.4)
Total items that may be reclassified to profit and loss	**(13.1)**	**11.8**
Other comprehensive income for the year, net of tax	**106.1**	**163.9**
Total comprehensive income for the year	**244.2**	**287.2**

Consolidated statement of changes in equity for the year ended 31 March

All figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Hedge reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
At 1 April 2017	**5.7**	**40.8**	**147.6**	**-**	**10.3**	**328.0**	**532.4**	**0.2**	**532.6**
Profit for the year	-	-	-	-	-	138.1	138.1	-	138.1
Other comprehensive income/(expense) for the year, net of tax	-	-	-	(1.8)	(10.7)	118.6	106.1	-	106.1
Purchase of own shares	-	-	-	-	-	(0.7)	(0.7)	-	(0.7)
Share-based payments charge	-	-	-	-	-	2.7	2.7	-	2.7
Dividends	-	-	-	-	-	(34.5)	(34.5)	-	(34.5)
At 30 March 2018	**5.7**	**40.8**	**147.6**	**(1.8)**	**(0.4)**	**552.2**	**744.1**	**0.2**	**744.3**
At 1 April 2016	**5.9**	**40.6**	**147.6**	**-**	**(1.9)**	**132.4**	**324.6**	**0.2**	**324.8**
Profit for the year	-	-	-	-	-	123.3	123.3	-	123.3
Other comprehensive income for the year, net of tax	-	-	-	-	12.2	151.7	163.9	-	163.9
Purchase of own shares	-	-	-	-	-	(0.7)	(0.7)	-	(0.7)
Purchase and cancellation of shares	(0.2)	0.2	-	-	-	(47.4)	(47.4)	-	(47.4)
Share-based payments charge	-	-	-	-	-	2.1	2.1	-	2.1
Dividends	-	-	-	-	-	(33.4)	(33.4)	-	(33.4)
At 30 March 2017	**5.7**	**40.8**	**147.6**	**-**	**10.3**	**328.0**	**532.4**	**0.2**	**532.6**

Consolidated balance sheet as at 31 March

All figures in £ million	Note	2018	2017
Non-current assets			
Goodwill		101.5	107.8
Intangible assets		41.1	34.7
Property, plant and equipment		269.0	238.8
Other financial assets		0.3	0.5
Equity accounted investments		2.2	1.5
Retirement benefit surplus	13	316.2	156.0
Deferred tax asset		6.4	5.4
		736.7	**544.7**
Current assets			
Inventories		38.1	28.9
Other financial assets		16.9	10.7
Trade and other receivables		150.3	175.6
Investment		0.7	1.3
Asset held for sale		1.2	-
Cash and cash equivalents		254.1	211.8
		461.3	**428.3**
Total assets		**1,198.0**	**973.0**
Current liabilities			
Trade and other payables		(334.9)	(322.1)
Current tax	6	(8.9)	(43.7)
Provisions		(6.0)	(6.2)
Other financial liabilities		(2.6)	(0.8)
		(352.4)	**(372.8)**
Non-current liabilities			
Deferred tax liability		(66.4)	(37.0)
Provisions		(14.3)	(17.8)
Other financial liabilities		(1.9)	(0.3)
Other payables		(18.7)	(12.5)
		(101.3)	**(67.6)**
Total liabilities		**(453.7)**	**(440.4)**
Net assets		**744.3**	**532.6**
Capital and reserves			
Ordinary shares		5.7	5.7
Capital redemption reserve		40.8	40.8
Share premium account		147.6	147.6
Hedging reserve		(1.8)	-
Translation reserve		(0.4)	10.3
Retained earnings		552.2	328.0
Capital and reserves attributable to shareholders of the parent company		**744.1**	**532.4**
Non-controlling interest		0.2	0.2
Total shareholders' funds		**744.3**	**532.6**

Consolidated cash flow statement for year ended 31 March

All figures in £ million	Note	2018	2017
Underlying net cash inflow from operations		**126.5**	**111.9**
Add back specific adjusting items: proceeds from sale of intellectual property	3	5.9	-
Net cash inflow from operations	8	132.4	111.9
Tax paid		(15.7)	(3.0)
Interest received		0.7	1.0
Interest paid		(0.7)	(0.6)
Net cash inflow from operating activities		**116.7**	**109.3**
Purchases of intangible assets		(8.5)	(2.2)
Purchases of property, plant and equipment		(46.0)	(30.7)
Proceeds from sale of property, plant and equipment		23.1	14.3
Acquisition of business and investment in joint venture		(1.6)	(65.7)
Investments in available for sale investments		(5.0)	-
Net cash outflow from investing activities		**(38.0)**	**(84.3)**
Purchase of own shares		(0.7)	(48.1)
Dividends paid to shareholders		(34.5)	(33.4)
Net cash outflow from financing activities		**(35.2)**	**(81.5)**
Increase/(decrease) in cash and cash equivalents		**43.5**	**(56.5)**
Effect of foreign exchange changes on cash and cash equivalents		(1.2)	4.8
Cash and cash equivalents at beginning of year		211.8	263.5
Cash and cash equivalents at end of year		**254.1**	**211.8**

Reconciliation of movement in net cash

All figures in £ million	Note	2018	2017
Increase/(decrease) in cash and cash equivalents in the year		**43.5**	**(56.5)**
Add back net outflows not impacting net cash		5.0	-
Change in net cash resulting from cash flows		48.5	(56.5)
Other movements including foreign exchange		(3.6)	3.9
Increase/(decrease) in net cash as defined by the Group		44.9	(52.6)
Net cash as defined by the Group at beginning of the year		221.9	274.5
Net cash as defined by the Group at end of the year	9	**266.8**	**221.9**
Less: other financial asset and liabilities	9	(12.7)	(10.1)
Total cash and cash equivalents	9	**254.1**	**211.8**

Notes to the financial statements

1. Significant accounting policies

Basis of preparation

QinetiQ Group plc is a public limited company, which is listed on the London Stock Exchange and is incorporated and domiciled in England.

The financial information included within the preliminary announcement has been prepared using accounting policies consistent with International Financial Reporting Standards (IFRSs) as endorsed by the European Union. The accounting policies followed are the same, subject to the changes noted below, as those published by the Group within its Annual Report for the year ended 31 March 2017 which is available on the Group's website, www.QinetiQ.com.

Accounting developments adopted by the Group in 2018 with no material impact on the financial statements

The following IFRS and EU-endorsed Standards and amendments, improvements and interpretations of published standards are effective for accounting periods beginning on or after 1 January 2017 and have been adopted with no material impact on the Group's financial statements:

– IAS 7 Cash flow statements – amendments to the Disclosure initiatives requires disclosure of changes in liabilities arising from financing activities. The Group does not currently have liabilities arising from financing activities to disclose in the cash flow statement. The adoption of the amendment has no impact on the Group

– IAS 12 Income taxes – amendments to the recognition of deferred tax assets for unrealised losses clarifies how an entity should evaluate whether there will be sufficient taxable profits against which it can utilise a deductible temporary difference. The Group already assesses the sufficiency of future taxable profits in a manner consistent with these amendments. The adoption of the amendment has no impact on the Group

– Annual improvement 2014-2016 cycle have been adopted with effect from 1 January 2017. No changes to the previously published accounting policies or other adjustments were required on the adoption of these amendments.

The preliminary announcement was approved by the Board of Directors on 24 May 2018. The financial information in this preliminary announcement does not constitute the statutory accounts of QinetiQ Group plc ('the Company') within the meaning of section 435 of the Act.

The statutory accounts for 2018 were approved by the Board of Directors on 24 May 2018 and will be delivered to the Registrar of Companies following the Company's Annual General Meeting on 25 July 2018. The financial information for 2017 is derived from the statutory accounts for 2017 which have been delivered to the Registrar of Companies. The auditors have reported on the 2018 and 2017 accounts. The reports were (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

In the income statement, the Group presents specific adjusting items separately. In the judgment of the Directors, for the reader to obtain a proper understanding of the financial information, specific adjusting items need to be disclosed separately because of their size and nature. Underlying measures of performance exclude specific adjusting items. Specific adjusting items include:

- amortisation of intangible assets arising from acquisitions;
- pension net finance income/expense;
- gains/losses on business divestments and disposal of property, investments and intellectual property;
- impairment of goodwill and other intangible assets;
- transaction costs in respect of business acquisitions;
- tax impact on the above items; and
- other significant non-recurring deferred tax movements.

All items treated as a specific adjusting item in the current and prior year are detailed in note 3.

Going concern basis

The Group meets its day-to-day working capital requirements through its available cash funds and its bank facilities. The market conditions in which the Group operates have been, and are expected to continue to be, challenging as spending from the Group's key customers in its primary markets in the UK and US remains under pressure. Despite these challenges, the Directors believe that the Group is well positioned to manage its overall business risks successfully. After making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going-concern basis in preparing its financial statements.

The Group is exposed to various risks and uncertainties, the principal ones being summarised in the 'Principal risks and uncertainties' section. Crystallisation of such risks, to the extent not fully mitigated, would lead to a negative impact on the Group's financial results but none are deemed sufficiently material to prevent the Group from continuing as a going concern for at least the next 12 months.

2. Segmental analysis

Operating segments
for the year ended 31 March

All figures in £ million	2018		2017	
	Revenue from external customers	**Underlying operating profit[1]**	Revenue from external customers	Underlying operating profit[1]
EMEA Services	651.4	94.3	613.5	92.7
Global Products	181.6	28.2	169.6	23.6
Total operating segments	**833.0**	**122.5**	**783.1**	**116.3**
*Underlying operating margin**		*14.7%*		*14.9%*

[1] The measure of profit presented to the Chief Operating Decision Maker is underlying operating profit (as defined in glossary).

Reconciliation of total operating segments to total on an organic, constant currency basis
for the year ended 31 March

All figures in £ million	2018		2017	
	Revenue from external customers	**Underlying operating profit**	Revenue from external customers	Underlying operating profit
Total operating segments	**833.0**	**122.5**	**783.1**	**116.3**
Less: contribution from acquired businesses^	(30.7)	(6.6)	-	-
Total operating segments on an organic basis	**802.3**	**115.9**	**783.1**	**116.3**
Adjust to constant prior year exchange rates	1.1	1.0	-	-
Total operating segments on an organic, constant currency basis	**803.4**	**116.9**	**783.1**	**116.3**
*Organic revenue growth at constant currency**	*3%*		*1%*	

^For the period of which there was no contribution in the equivalent period in the prior year which was pre-ownership by the Group.

* Definitions of the Group's 'Alternative Performance Measures' can be found in the glossary.

Reconciliation of segmental results to total profit
for the year ended 31 March

All figures in £ million	Note	2018	2017
Underlying operating profit		122.5	116.3
Specific adjusting items operating profit	3	18.5	16.4
Operating profit		**141.0**	**132.7**
Net finance income/(expense)	5	3.8	(1.2)
Profit before tax		**144.8**	**131.5**
Taxation expense	6	(6.7)	(8.2)
Profit for the year attributable to equity shareholders		**138.1**	**123.3**

3. Specific adjusting items

In the income statement, the Group presents specific adjusting items separately. In the judgement of the Directors, for the reader to obtain a proper understanding of the financial information, specific adjusting items need to be disclosed separately because of their size and nature. Underlying measures of performance exclude specific adjusting items. The following specific adjusting items have been (charged)/credited in the consolidated income statement:

All figures in £ million	Note	**2018**	2017
Gain on sale of property		14.6	18.4
Gain on sale of investment		0.6	-
Gain on sale of intellectual property		5.9	-
Acquisition costs		-	(1.0)
Specific adjusting items before interest, tax, depreciation and amortisation		**21.1**	**17.4**
Amortisation of intangible assets arising from acquisitions		(2.6)	(1.0)
Specific adjusting items operating profit		**18.5**	**16.4**
Defined benefit pension scheme net finance income/(expense)		4.2	(1.0)
Specific adjusting items profit before tax		**22.7**	**15.4**
Specific adjusting items - tax	6	6.4	4.1
Total specific adjusting items profit after tax		**29.1**	**19.5**

Reconciliation of underlying profit for the year to total profit for the year

all figures in £ million	**2018**	2017
Underlying profit after tax - total Group	109.0	103.8
Total specific adjusting items profit after tax	29.1	19.5
Total profit for the year attributable to equity shareholders	**138.1**	**123.3**

4. Profit before tax

The following items have been charged in arriving at profit before tax for continuing operations:

All figures in £ million	**2018**	2017
Cost of inventories expensed	25.4	23.2
Owned assets: depreciation	25.6	26.4
Foreign exchange loss	-	0.2
Research and development expenditure - customer funded contracts	284.3	272.8
Research and development expenditure - Group funded	25.8	33.6

5. Finance income and expense

All figures in £ million	**2018**	2017
Receivable on bank deposits	0.7	1.0
Finance income before specific adjusting items	**0.7**	**1.0**
Amortisation of deferred financing costs	(0.3)	(0.3)
Payable on bank loans and overdrafts	(0.7)	(0.6)
Unwinding of discount on financial liabilities	(0.1)	(0.3)
Finance expense before specific adjusting items	**(1.1)**	**(1.2)**
Specific adjusting items:		
Defined benefit pension scheme net finance income/(expense)	4.2	(1.0)
Net finance income/(expense)	**3.8**	**(1.2)**

6. Taxation

All figures in £ million	**2018**			2017		
	Underlying	**Specific adjusting items**	**Total**	Underlying	Specific adjusting items	Total
Profit before tax	**122.1**	**22.7**	**144.8**	**116.1**	**15.4**	**131.5**
Taxation (expense)/income	(13.1)	6.4	(6.7)	(12.3)	4.1	(8.2)
Profit for the year attributable to equity shareholders	**109.0**	**29.1**	**138.1**	**103.8**	**19.5**	**123.3**
Effective tax rate	10.7%			10.6%		

The total tax charge was £6.7m (2017: £8.2m). The underlying tax charge was £13.1m (2017: £12.3m) with an underlying effective tax rate of 10.7% for the year ending 31 March 2018 (2017: 10.6%). The effective tax rate continues to be below the UK statutory rate, primarily as a result of the benefit of research and development expenditure credits ('RDEC') in the UK.

Tax losses and specific adjusting items
Deferred tax assets of £7.6m have been recognised in the year (2017: £3.7m), with the income statement credit classified as a specific adjusting item. These assets are in respect of US net operating losses and the recognition of tax deductible intellectual property assets in the UK, whereas the prior year related to an element of the Group's UK non-trade loan relationship deficits. Together with a £1.2m tax effect of the other items impacting specific adjusting items PBT, the total specific adjusting items tax credit was £6.4m (2017: £4.1m).

At 31 March 2018 the Group had unused tax losses and surplus interest costs of £118.0m (2017: £141.7m) which are available for offset against future profits. A deferred tax asset is recognised in respect of £17.0m of US net operating losses (2017: nil) and £7.7m (2017: £20.2m) of UK losses. No deferred tax asset is recognised in respect of the remaining £93.3m of losses/interest costs due to uncertainty over the timing of their utilisation. The Group has £60.2m of time limited losses of which US capital losses of £26.2m will expire in 2020, £5.5m will expire in 2034, £20.3m in 2035 and £8.2m in 2036. A reduction in the US Federal rate of tax to 21% (from 35%) has been substantively enacted during the period. The deferred tax assets in the US have been calculated using this rate. Deferred tax in other jurisdictions has been calculated using the enacted future statutory tax rates.

Current tax liability
The current tax liability was £8.9m as at 31 March 2018 (2017: £43.7m). The decrease in the liability is primarily due to the settlement of a tax liability in the US related to an unfavourable court decision in respect of the tax treatment of the Group's acquisition of Dominion Technology Resources, Inc. in 2008. The settlement was funded through a recovery under an insurance policy (the receivable for which had previously been included within trade and other receivables).

Factors affecting future tax charges
The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to the impact of any tax legislation changes, the geographic mix of profits and the assumption that the benefits of net R&D expenditure credits retained by the Group remain in the tax line. Future recognition of unrecognised tax losses will also affect future tax charges.

7. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the year. The weighted average number of shares used excludes those shares bought by the Group and held as own shares. For diluted earnings per share the weighted average number of shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares arising from unvested share-based awards including share options.

for the year ended 31 March		2018	2017
Weighted average number of shares	**Million**	**565.2**	**573.9**
Effect of dilutive securities	Million	2.0	4.8
Diluted number of shares	**Million**	**567.2**	**578.7**

Underlying basic earnings per share figures are presented below, in addition to the basic and diluted earnings per share, because the Directors consider this gives a more relevant indication of underlying business performance and reflects the adjustments to basic earnings per share for the impact of specific adjusting items (see note 3) and tax thereon.

Underlying EPS

for the year ended 31 March		2018	2017
Profit attributable to equity shareholders	£ million	138.1	123.3
Remove profit after tax in respect of specific adjusting items	£ million	(29.1)	(19.5)
Underlying profit after taxation	**£ million**	**109.0**	**103.8**
Weighted average number of shares	Million	565.2	573.9
Underlying basic EPS	**Pence**	**19.3**	**18.1**
Diluted number of shares	Million	567.2	578.7
Underlying diluted EPS	**Pence**	**19.2**	**17.9**

Basic and diluted EPS

for the year ended 31 March		2018	2017
Profit attributable to equity shareholders	£ million	138.1	123.3
Weighted average number of shares	Million	565.2	573.9
Basic EPS – total Group	**Pence**	**24.4**	**21.5**
Diluted number of shares	Million	567.2	578.7
Diluted EPS – total Group	**Pence**	**24.3**	**21.3**

8. Cash flows from operations

All figures in £ million	**2018**	2017
Profit after tax for the year	138.1	123.3
Adjustments for:		
Taxation expense	6.7	8.2
Net finance (income)/expense	(3.8)	1.2
Gain on sale of investment	(0.6)	-
Gain on sale of property	(14.6)	(18.4)
Transaction costs in respect of acquisition of business	-	1.0
Amortisation of purchased or internally developed intangible assets	3.7	2.6
Amortisation of intangible assets arising from acquisitions	2.6	1.0
Depreciation of property, plant and equipment	25.6	26.4
Loss on disposal of plant and equipment	2.9	1.2
Share of post-tax profit of equity accounted entities	(0.3)	(0.5)
Share-based payments charge	2.4	2.1
Retirement benefit contributions in excess of income statement expense	(12.4)	(11.4)
Net movement in provisions	(3.7)	4.5
Increase in inventories	(10.8)	-
Decrease in receivables	19.0	2.9
Decrease in payables	(22.4)	(32.2)
Changes in working capital	(14.2)	(29.3)
Net cash flow from operations	**132.4**	**111.9**

Reconciliation of net cash flow from operations to underlying net cash flow from operations and to free cash flow

All figures in £ million	**2018**	2017
Net cash flow from operations	132.4	111.9
Less specific adjusting item: proceeds from sale of intellectual property	(5.9)	-
Underlying net cash flow from operations	**126.5**	**111.9**
Less: tax and net interest payments	(15.7)	(2.6)
Less: purchases of intangible assets and property, plant & equipment	(54.5)	(32.9)
Free cash flow	**56.3**	**76.4**

Underlying cash conversion ratio

	2018	2017
Underlying operating profit - £ million	122.5	116.3
Underlying net cash flow from operations - £ million	126.5	111.9
Underlying cash conversion ratio - %	**103%**	**96%**

9. Net cash

All figures in £ million	2018	2017
Current financial assets/(liabilities)		
Available-for-sale investment	15.7	10.4
Deferred financing costs	0.1	0.3
Derivative financial assets	1.1	-
Derivative financial liabilities	(2.6)	(0.8)
Total current net financial assets	14.3	9.9
Non-current financial assets/(liabilities)		
Deferred financing costs	-	0.2
Derivative financial assets	0.3	0.3
Derivative financial liabilities	(1.9)	(0.3)
Total non-current net financial (liabilities)/assets	(1.6)	0.2
Total financial assets/liabilities (net)	**12.7**	**10.1**
Cash and cash equivalents	254.1	211.8
Total net cash as defined by the Group	**266.8**	**221.9**

10. Financial risk management

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1 – measured using quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – measured using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). Level 2 derivatives comprise forward foreign exchange contracts which have been fair valued using forward exchange rates that are quoted in an active market; and

Level 3 – measured using inputs for the assets or liability that are not based on observable market data (i.e. unobservable inputs).

The Group's assets and liabilities that are measured at fair value, as at 31 March 2018, are as follows:

All figures in £ million	Level 1	Level 2	Level 3	Total
Assets:				
Available-for-sale investment	15.7	-	-	15.7
Current other investments	0.7	-	-	0.7
Current derivative financial instruments	-	1.1	-	1.1
Non-current derivative financial instruments	-	0.3	-	0.3
Liabilities:				
Current derivative financial instruments	-	(2.6)	-	(2.6)
Non-current derivative financial instruments	-	(1.9)	-	(1.9)
Total	**16.4**	**(3.1)**	**-**	**13.3**

The following table presents the Group's assets and liabilities that are measured at fair value at 31 March 2017:

All figures in £ million	Level 1	Level 2	Level 3	Total
Assets:				
Available-for-sale investments	10.4	-	-	10.4
Current other investments	1.3	-	-	1.3
Non-current other investments	-	-	0.1	0.1
Non-current derivative financial instruments	-	0.3	-	0.3
Liabilities:				
Current derivative financial instruments	-	(0.8)	-	(0.8)
Non-current derivative financial instruments	-	(0.3)	-	(0.3)
Total	**11.7**	**(0.8)**	**0.1**	**11.0**

For cash and cash equivalents, trade and other receivables and bank and current borrowings, the fair value of the financial instruments approximate to their carrying value as a result of the short maturity periods of these financial instruments. For trade and other receivables, allowances are made within the carrying value for credit risk. For other financial instruments, the fair value is based on market value, where available. Where market values are not available, the fair values have been calculated by discounting cash flows to net present value using prevailing market-based interest rates translated at the year-end rates, except for unlisted fixed asset investments where fair value equals carrying value. There have been no transfers between levels.

11. Dividends

An analysis of the dividends paid and proposed in respect of the years ended 31 March 2018 and 31 March 2017 is provided below:

	Pence per ordinary share	**£m**	**Date paid/payable**
Interim 2018	2.1	11.9	Feb 2018
Final 2018 (proposed)	4.2	23.7	Aug 2018
Total for the year ended 31 March 2018	**6.3**	**35.6**	
Interim 2017	2.0	11.5	Feb 2017
Final 2017	4.0	22.6	Sep 2017
Total for the year ended 31 March 2017	6.0	34.1	

The Directors propose a final dividend of 4.2p (2017: 4.0p). The dividend, subject to shareholder approval, will be paid on 31 August 2018. The ex-dividend date is 2 August 2018 and the record date is 3 August 2018.

12. Goodwill

All figures in £ million	**2018**	2017
Cost		
At 1 April	**220.4**	**171.5**
Acquisitions	-	28.4
Foreign exchange	(17.4)	20.5
At 31 March	**203.0**	**220.4**
Impairment		
At 1 April	(112.6)	(98.4)
Foreign exchange	11.1	(14.2)
At 31 March	**(101.5)**	**(112.6)**
Net book value at 31 March	**101.5**	**107.8**

Cash-generating units (CGU)

Goodwill is allocated across two cash generating units ('CGUs') within the EMEA Services segment and five CGUs within the Global Products segment. The Group previously disclosed four separate CGUs and one of those CGUs, 'EMEA Services' was an aggregation of several other CGUs that could be considered as CGUs in their own right. The Group has now disaggregated that CGU into three separate CGUs, being Boldon James, Commerce Decisions and Advisory Services. In Global Products, the Group also disaggregated one CGU into the two components of Target Systems and Space Products. The full list of CGUs that have goodwill allocated to them is as follows:

All figures in £ million	Primary reporting segment	2018
QinetiQ North America ('QNA')	Global Products	38.8
Target Systems	Global Products	24.1
Space Products	Global Products	5.8
Boldon James	Global Products	10.7
Commerce Decisions	Global Products	6.4
Australia	EMEA Services	5.9
Advisory Services	EMEA services	9.8
Net book value at 31 March		**101.5**

Goodwill is attributable to the excess of consideration over the fair value of net assets acquired and includes expected synergies, future growth prospects and employee knowledge, expertise and security clearances. The Group tests each CGU for impairment annually, or more frequently if there are indications that goodwill might be impaired. Impairment testing is dependent on management's estimates and judgments, particularly as they relate to the forecasting of future cash flows, the discount rates selected and expected long-term growth rates. Significant headroom exists in all CGUs and management considers that there are no likely variations in the key assumptions which would lead to an impairment being recognised.

Key assumptions
Cash flows

The value in use calculations generally use discounted future cash flows based on financial plans approved by the Board covering a three-year period. Cash flows for periods beyond these periods are extrapolated based on the last year of the plans, with a terminal growth-rate assumption applied.

Terminal growth rates
The specific plans for each of the CGUs have been extrapolated using a terminal growth rate of 1.0%-2.5% (2017: 2.0%-2.4%). The US terminal growth rate was 1.7% (2017: 2.0%). Growth rates are based on management's estimates which take into consideration the long-term nature of the industry in which the CGUs operate and external forecasts as to the likely growth of the industry in the longer term.

Discount rates
The Group's weighted average cost of capital was used as a basis in determining the discount rate to be applied, adjusted for risks specific to the market characteristics of CGUs, as appropriate on a pre-tax basis. This is considered an appropriate estimate of a market participant discount rate. The pre-tax discount rates applied to the cash flows of the QNA CGU and to the Target Systems CGU were 13.1% and 11.8% respectively. Discount rates ranging from 10.1% to 12.4% were applied to the cash flows of the other, less significant, CGUs.

Sensitivity analysis shows that the value of the terminal year cash flow, the discount rate and the terminal growth rates have a significant impact on the value of the discounted cash flow.

Significant CGUs
QinetiQ North America ('QNA')
The carrying value of the goodwill for QNA CGU, was £38.8m as at 31 March 2018 (2017: £43.4m). The recoverable amount of this CGU as at 31 March 2018, based on value in use and calculated using the assumptions noted above, is higher than the carrying value of net operating assets (of £47.3m). The key sensitivity impacting on the value in use calculations is the terminal year cash flows. These cash flows include certain assumptions about revenue and profit in respect of new product lines still to be launched and the success of winning certain government contracts. An increase in the discount rate by 1%, a decrease in the terminal growth rate by 1% or a decrease in the terminal year cash flows of £2.0m would not cause the net operating assets to exceed their recoverable amount.

Target Systems
The recoverable amount of this CGU as at 31 March 2018, based on value in use and calculated using the assumptions noted above, is higher than the carrying value of net operating assets (of £27.8m). The key sensitivity impacting on the value in use calculations is the terminal year cash flows. An increase in the discount rate by 1%, a decrease in the terminal growth rate by 1% or a decrease in the terminal year cash flows of £2.0m would not cause the net operating assets to exceed their recoverable amount.

13. Post-retirement benefits

Set out below is a summary of the financial position of the Group's defined benefit pension scheme. The fair value of the Scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the Scheme's liabilities, which are derived from cash flow projections over long periods, and thus inherently uncertain, are as follows:

All figures in £ million	**2018**	2017
Equities – quoted	115.8	284.0
Equities – unquoted	58.9	71.4
Liability Driven Investment	1,050.9	968.2
Corporate bonds	311.3	340.6
Alternative bonds – quoted	197.9	132.3
Alternative bonds – unquoted	35.0	-
Property fund	138.7	126.7
Cash and cash equivalents	80.2	3.1
Derivatives	1.8	-
Total market value of scheme assets	**1,990.5**	**1,926.3**
Present value of scheme liabilities	(1,674.3)	(1,770.3)
Net pension asset before deferred tax	**316.2**	**156.0**
Deferred tax liability	(58.6)	(31.4)
Net pension asset after deferred tax	**257.6**	**124.6**

Changes to the net pension asset/(liability)

All figures in £ million	**2018**	2017
Opening net pension asset/(liability)	156.0	(37.7)
Net finance income/(expense)	4.2	(1.0)
Net actuarial gain	143.6	183.3
Administration expenses	(1.0)	(1.5)
Contributions by the employer	13.4	12.9
Closing net pension asset	**316.2**	**156.0**

Assumptions

The major assumptions used in the IAS 19 valuation of the Scheme

	2018	2017
Discount rate applied to Scheme liabilities	2.60%	2.60%
CPI inflation assumption	2.25%	2.35%
Assumed life expectancies in years:		
Future male pensioners (currently aged 60)	88	89
Future female pensioners (currently aged 60)	90	91
Future male pensioners (currently aged 40)	90	91
Future female pensioners (currently aged 40)	92	93

The sensitivity of the gross Scheme liabilities to each of the key assumptions is shown in the following table:

Key assumptions	Change in assumption	Indicative impact on gross Scheme liabilities before deferred tax	Indicative impact on net pension asset
Discount rate	Increase by 0.1%	Decrease by £31m	Decrease by £11m
Rate of inflation	Increase by 0.1%	Increase by £34m	Increase by £17m
Life expectancy	Increase by one year	Increase by £46m	Decrease by £46m

The impact of movements in Scheme liabilities will, to an extent, be offset by movements in the value of Scheme assets as the Scheme has assets invested in a Liability Driven Investment portfolio. As at 31 March 2018 this hedges against approximately 85% of the interest rate and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis.

The above sensitivity analyses are based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method (projected unit credit method) has been applied as when calculating the pension liability recognised within the statement of financial position. The methods and types of assumption did not change.

The accounting assumptions noted above are used to calculate the year end net pension asset/liability in accordance with the relevant accounting standard, IAS 19 (revised) 'Employee benefits'. Changes in these assumptions have no impact on the Group's cash payments into the Scheme. The payments into the Scheme are reassessed after every triennial valuation.

The most recent completed full actuarial valuation of the Scheme was undertaken as at 30 June 2017 and resulted in an actuarially assessed surplus of £139.7m (relative to the technical provisions i.e. the level of assets agreed by the Trustee and the Company as being appropriate to meet member benefits, assuming the Scheme continues as a going concern). The next triennial valuation will be performed as at 30 June 2020.

The agreed recovery plan requires £2.5m per annum distributions to the Scheme until 25 March 2032, indexed by reference to CPI. Such distributions are from the Group's Pension Funding Partnership. The previous recovery plan required £13.0m contributions per annum until 31 March 2018, including £2.5m p.a. distributions to the Scheme, indexed by reference to CPI, from the Group's Pension Funding Partnership.

14. Own shares and share-based awards

Own shares represent shares in the Company that are held by independent trusts and include treasury shares and shares held by the employee share ownership plan. Included in retained earnings at 31 March 2018 are 7,934,634 shares (2017: 8,957,048 shares).

In the year ended 31 March 2018 the Group granted/awarded 3.7 million new share-based awards to employees (2017: 4.1 million).

15. Contingent liabilities and assets

Subsidiary undertakings within the Group have given unsecured guarantees of £30.1m at 31 March 2018 (2017: £46.1m) in the ordinary course of business.

The Company has on occasion been required to take legal action to protect its intellectual property rights, to enforce commercial contracts or otherwise and similarly to defend itself against proceedings brought by other parties, including in respect of environmental and regulatory issues. Provisions are made for the expected costs associated with such matters, based on past experience of similar items and other known factors, taking into account professional advice received, and represent management's best estimate of the likely outcome. The timing of utilisation of these provisions is uncertain pending the outcome of various court proceedings, ongoing investigations and negotiations. However, no provision is made for proceedings which have been or might be brought by other parties unless management, taking into account professional advice received, assesses that it is more likely than not that such proceedings may be successful. Contingent liabilities associated with such proceedings have been identified but the Directors are of the opinion that any associated claims that might be brought can be resisted successfully and therefore the possibility of any outflow in settlement is assessed as remote.

The Group has also not recognised contingent amounts receivable relating to property impairments in prior years that may potentially be recovered from the MOD. Recovery is subject to future negotiations. It is not considered practicable to calculate the value of this contingent asset.

16. Related party transactions with equity accounted investments
During the year there were sales to associates and joint ventures of £10.4m (2017: £3.4m). At the year end there were outstanding receivables from associates and joint ventures of £4.5m (2017: £0.4m).

17. Capital commitments
The Group had the following capital commitments for which no provision has been made:

All figures in £ million	**2018**	2017
Contracted	76.2	155.3

Capital commitments at 31 March 2018 include £74.3m (2017: £155.1m) in relation to property, plant and equipment that will be wholly funded by a third party customer under a long-term contract arrangements. These primarily relate to investments under the LTPA contract.

18. Post balance sheet event
Post year end, in April 2018, QinetiQ entered into an agreement to acquire E.I.S. Aircraft Operations ("Aircraft Operations"), currently part of E.I.S. Aircraft Group, for €70 million on a cash-free, debt-free basis.

Aircraft Operations is a leading provider of airborne training services based in Germany, delivering threat-representation and operational readiness for military customers. It generated €20.1m revenue and €5.4m EBITDA in the year to 31 December 2017.

The transaction is subject to certain regulatory and legal approvals and is expected to close towards the end of the first half of QinetiQ's 2019 financial year.

Following completion, Aircraft Operations will continue to be led by its existing management team. It will form part of QinetiQ's International business unit and will be reported within QinetiQ's EMEA Services division.

Glossary

C4ISR	Command, control, communications, computers, intelligence, surveillance and reconnaissance
CPI	Consumer Price Index
EBITDA	Earnings before interest, tax, depreciation and amortisation
EPS	Earnings per share
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
LTPA	Long Term Partnering Agreement: 25-year contract established in 2003 to manage the MOD's test and evaluation ranges
MOD	UK Ministry of Defence
SSRO	Single Source Regulations Office

Alternative performance measures ('APM's)

The Group uses various non-statutory measures of performance, or APMs. Such APMs are used by management internally to monitor and manage the Group's performance and also allow the reader to obtain a proper understanding of performance (in conjunction with statutory financial measures of performance). The APMs used by QinetiQ are set out below:

Measure	**Explanation**	**Note reference to calculation or reconciliation to statutory measure**
Organic growth	The level of year-on-year growth, expressed as a percentage, calculated at constant prior year foreign exchange rates, adjusting for business acquisitions and disposals to reflect equivalent composition of the Group	Note 2
Underlying operating profit	Operating profit as adjusted to exclude 'specific adjusting items'	Note 2
Underlying operating margin	Underlying operating profit expressed as a percentage of revenue	Note 2
Underlying net finance income/expense	Net finance income/expense as adjusted to exclude 'specific adjusting items'	Note 5
Underlying profit before/after tax	Profit before/after tax as adjusted to exclude 'specific adjusting items'	Note 6
Underlying effective tax rate	The tax charge for the year excluding the tax impact of 'specific adjusting items' expressed as a percentage of underlying profit before tax	Note 6
Underlying basic and diluted EPS	Basic and diluted earnings per share as adjusted to exclude 'specific adjusting items'	Note 7
Orders	The level of new orders (and amendments to existing orders) booked in the year. Includes share of orders won by joint ventures	N/A
Backlog, funded backlog or order book	The expected future value of revenue from contractually committed and funded customer orders	N/A
Book to bill ratio	Ratio of funded orders received in the year to revenue for the year, adjusted to exclude revenue from the 25-year LTPA contract due to significant size and timing differences of LTPA order and revenue recognition which may distort the ratio calculation.	N/A
Underlying net cash flow from operations	Net cash flow from operations before cash flows of specific adjusting items	Note 8
Underlying operating cash conversion or cash conversion ratio	The ratio of underlying net cash flow from operations to underlying operating profit	Note 8
Free cash flow	Underlying net cash flow from operations less net tax and interest payments less purchases of intangible assets and property, plant and equipment	Note 8
Net cash	Net cash as defined by the Group combines cash and cash equivalents with other financial assets and liabilities, primarily available for sale investments and derivative financial instruments.	Note 9
Specific adjusting items	Amortisation of intangible assets arising from acquisitions; impairment of goodwill and intangible assets; gains/losses on business divestments and disposal of property, investments and intellectual property; net pension finance income/expense; tax impact of the preceding items; and significant non-recurring deferred tax movements	Note 3