

QINETIQ

QinetiQ Group plc
Annual Report and Accounts 2018

MODERNISE BUILD INVEST



WHO WE ARE

QinetiQ is a leading science and engineering company operating primarily in the defence, security and critical infrastructure markets. We are an information, knowledge and technology-based company with the breadth and depth of more than 3,000 scientists and engineers and a wide array of unique facilities.

WHAT WE OFFER

We apply our strengths through three core offerings to customers which are increasingly relevant to provide solutions in today's rapidly changing security and economic environment.

Technology

We specialise in the creation of technology that is disruptive to give decisive advantage.

Services and products

Bringing together our own and others' technology and know how to provide distinctive specialist services and products.

Unique capability generation and assurance

We are integrated across the life-cycle, undertaking creative research and development, enabling test and evaluation and delivering readiness through training and rehearsal. We play a central role in delivering capability generation and assurance for our customers.

WHAT WE DELIVER

Operational and competitive advantage

These three core offerings allow us to deliver operational advantage in the military context, or competitive advantage in the commercial context.

On the front cover

A QinetiQ flight test instructor flying our first PC-21 during a training flight with Pilatus from their base in Stans, Switzerland prior to its delivery to Boscombe Down later this year.

OUR INHERENT STRENGTHS

- Deep domain knowledge and experience
- Close customer relationships
- Core science and engineering expertise
- Ability to develop and manage broad academic and industrial partnerships

KEY TO OUR SUCCESS

Is to proactively understand our customers' current and future needs and to create and enable solutions at greater pace to meet current threats, adjacent threats and emergent threats.

IN SIMPLE TERMS

Not only can we develop technology into capability, we can also tell you if that capability will work when it is critically needed.

FINANCIAL HIGHLIGHTS

	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
Net cash			£266.8m	£221.9m

* Alternative performance measures

Alternative performance measures are used to supplement the statutory figures. These are additional key financial indicators used by management internally to assess the underlying performance of the Group. Definitions can be found in the glossary on page 139.

Year references (FY18, FY17, 2018, 2017) refer to QinetiQ's fiscal year ending 31 March.

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 Visit the website at www.QinetiQ.com

AT A GLANCE

EMEA SERVICES

Combines world-leading expertise with unique facilities to provide capability integration and assurance. It does this through capability integration, threat representation and operational readiness, underpinned by long-term contracts that provide good revenue visibility and cash flows.

£651.4m
FY18 annual revenue

5,239
FY18 total employees

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Operating review

Air & Space

What we do
De-risk complex aerospace programmes by testing systems and equipment, evaluating the risks and assuring safety.

Approximate revenue
£185m

Key sites
Farnborough and Boscombe Down, UK.

Cyber, Information & Training

What we do
Help government and commercial customers respond to evolving threats based on our expertise in training, secure communication networks and devices, intelligence gathering and surveillance sensors, and cyber security.

Approximate revenue
£100m

Key sites
Farnborough, Malvern and Crewe, UK.

Maritime, Land & Weapons

What we do
Deliver operational advantage to customers by providing independent research, evaluation and training services.

Approximate revenue
£295m

Key sites
Farnborough, Boscombe Down, Shoeburyness, Fort Halstead, Hebrides, Aberporth, Pendine, West Freugh, Portsmouth Technology Park and Haslar, UK.

International

What we do
Our International business leverages our expertise and skills developed in the UK and applies them to opportunities in attractive markets globally.

Approximate revenue
£70m

Key sites
Australia, Sweden, Canada, Malaysia and Middle East.

GLOBAL PRODUCTS

Delivers innovative solutions and products to meet customer requirements. Undertakes contract-funded research and development, developing intellectual property in partnership with key customers and through internal funding with potential for new revenue streams.

£181.6m
FY18 annual revenue

826
FY18 total employees

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Operating review

QinetiQ North America

What we do
Develop and manufacture innovative defence products specialising in unmanned systems, survivability and maritime systems, along with products in related commercial markets.

Approximate revenue
£70m

Key sites
Waltham and Franklin, Massachusetts; Pittsburgh, Pennsylvania; and Virginia, USA.

Space Products

What we do
Provide small satellites, payload instruments, sub-systems and ground station services.

Approximate revenue
£20m

Key sites
Farnborough, UK and Antwerp, Belgium.

OptaSense

What we do
Provide innovative fibre sensing solutions to deliver decision-ready data in multiple vertical markets.

Approximate revenue
£25m

Key sites
Farnborough, Winfrith, Portishead, UK; Houston, USA; Calgary, Canada, and Dubai, UAE.

EMEA Products

What we do
Provide research services and bespoke technological solutions developed from intellectual property spun out from EMEA Services. QinetiQ Target Systems is reported in EMEA Products.

Approximate revenue
£65m

Key sites
Farnborough, Malvern, Haslar and Ashford, UK and Medicine Hat, Canada.

INVESTMENT CASE

UNIQUE CAPABILITIES CRITICAL TO NATIONAL SOVEREIGNTY...

- Key partner to UK defence
- Leading expertise and facilities

Over 3,000
scientists and
engineers
globally

34
sites across
the UK

...WITH INCREASING EXPOSURE TO ATTRACTIVE INTERNATIONAL MARKETS...

- High growth home markets in the US and Australia
- Growing presence in the Middle East and Europe
- Addressable market of >£8bn

27%
international
revenue

Record
orders in
Australia

2
recent
international
acquisitions

...AND A CLEAR STRATEGY FOR GROWTH...

- Lead and modernise UK test and evaluation
- Become a more international business
- Drive innovation

Facilities
benefitting from
investment

Larger
more strategic
contract wins

Pioneering
business models

...SUPPORTED BY A STRONG FINANCIAL PROFILE...

- Long-term contracts
- Cash generative model
- Strong balance sheet
- Ability to self-fund organic and inorganic investment
- Clear capital allocation policy

69%
of revenue
under contract

103%
cash
conversion

£267m
of net cash

...RESULTING IN INCREASING RETURNS TO OUR SHAREHOLDERS

- Sustainable increase in key financial metrics
- Progressive dividend policy

Return
to growth after
five years

6%
revenue
growth

7%
underlying EPS*
growth

5%
increase
in full year
dividend

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Strategic progress

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Business model

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Market themes

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CFO review

* Definitions of the Group's 'alternative performance measures' can be found in the glossary on page 139.

CHAIRMAN'S STATEMENT

POSITIVE PROGRESS



Mark Elliott
Non-executive Chairman

It is now two years since QinetiQ launched an ambitious strategy to modernise and grow our Company. This strategy aims to deliver growth, not just for the short term, but for the next 10 years or more. We are seeing positive and tangible evidence of this strategy delivering results. In line with our strategy, we are leading and modernising our core UK Test and Evaluation capabilities, becoming a more international business and innovating in a far more thoughtful and commercial way.

The progress we have made is all the more notable given the challenges in the UK market. In addition to the headwind from the Single Source Regulations Office this year, we have also felt some of the effects of a constrained defence budget in the UK. Our strategy was developed in anticipation of these factors, and our financial and operational performance demonstrates it is working.

This year has marked some real milestones for QinetiQ, and as a Board we are particularly proud of some of the key customer initiatives that were

achieved. From supporting the running of the largest ever European ballistic missile training exercise, enhancing the capabilities of the Typhoon aircraft or protecting over 1,800km of gas pipeline, QinetiQ is helping customers overcome some of their most difficult challenges. Our international growth continues to accelerate and now contributes 27% of revenue to our business. With a record breaking year in Australia, and good progress in North America and the Middle East we are supporting an increasingly diverse customer base.

Our investment ensures we remain able to support our customers' future needs

With our origins in the UK Government itself, QinetiQ has a set of capabilities and facilities that are unique for a public company and are critical to ensuring defence capability. While these skills and capabilities are unique, we must not be complacent. It is crucial we invest and modernise to ensure we continue to provide long-term value to our customers in the face of a rapidly changing threat environment. The defence and security landscape, like many other industries, is going through rapid change. Our investment both in facilities and our people ensures that our capabilities can support and guide our customers, both in the UK and internationally, through this change.

What supports our customers is the knowledge, skills and experience of our employees. We are an organisation of more than 3,000 scientists, engineers and technicians, many of whom are technical leaders in their respective fields. Our employees are instrumental in delivering our strategy, and we continue to invest in their development and ensure they are treated fairly.

A continued focus on good governance

As a Board, we are focused on ensuring good governance and oversight of the delivery of the strategy. In October, Board members spent two days with the executive team conducting a thorough review of our future strategy. Non-executive Directors also attend quarterly meetings of QinetiQ's top one hundred leaders, actively participating in discussions about the strategic direction of the Company. In addition to providing insight into the delivery of our strategy, these meetings provide an opportunity to oversee the development of the culture in the Company. The right culture enhances our ability to attract top talent, to deliver the strategy, and to

27%
of FY18 revenue from
international markets

5%
increase in full year dividend

A CLEAR AND DISCIPLINED APPROACH TO CAPITAL ALLOCATION

1 Investing for growth
Organic investment complemented by bolt-on acquisitions where there is a strong strategic fit

3 Dividend
Maintaining our progressive dividend in line with policy

2 Balance sheet
Maintaining the necessary level of balance sheet strength

4 Shareholder distributions
Returning excess cash to shareholders

effectively manage risk with the highest ethical standards. We continued our discussions with our Employee Engagement Group which gives us good insight into our employees' views and our culture. As a Board we are keen to develop a culture and organisation that is diverse, open to new ideas, acts swiftly, embraces constructive challenge, and one that draws upon our breadth of skills through collaboration to deliver value to our customers.

We are sensitive to our obligation to ensure our strategy is aligned to our shareholders' long-term interests. During the period, I met with many shareholders who, in total, represented approximately one third of our overall register to listen to their views. I also met with Institutional Shareholder Services Inc. (ISS), a provider of corporate governance and responsible investment solutions to a significant proportion of our shareholders. In particular, following last year's AGM, it was clear that we could have done better in explaining the link between business strategy and our new Remuneration Policy. The Board is firmly of the view that the new policy achieves the right balance in aligning management's interests with shareholders. We believe the policy allows the Board to set the right stretching targets on an annual basis, ensuring management are incentivised appropriately for the dynamic market in which we operate. While the initial targets are annual, the reward is then deferred for a further five years in the form of shares, and can be reduced if performance deteriorates during the vesting period, ensuring long-term alignment with shareholders. We have improved how we communicate the Remuneration Policy and its implementation in this year's Annual Report.

Full year dividend (p)

2018	6.3
2017	6.0
2016	5.7
2015	5.4
2014	4.6

4.2p

Final dividend to be paid on 31 August 2018 (2017: 4.0p).

Progressive dividend policy

Since 2010, we have consistently grown our dividend in line with our progressive dividend policy.

Annual General Meeting 2018

11am on 25 July 2018, at the offices of Ashurst LLP, Broadwalk House, 5 Appold Street, London EC2A 2H2.

Our strategy is supported by a clear and disciplined approach to allocation of capital

In support of our strategy we have a very clear capital allocation policy. Our priorities for capital allocation are: organic investment complemented by bolt-on acquisitions where there is a strong strategic fit; the maintenance of balance sheet strength; a progressive dividend; and the return of excess cash to shareholders.

In line with this policy, the Board proposes a final dividend of 4.2p per share for the year ended 31 March 2018 (2017: 4.0p), making the full year dividend 6.3p (2017: 6.0p). Subject to approval at the Annual General Meeting, the final dividend will be paid on 31 August 2018 to shareholders on the register at 3 August 2018. The full year dividend represents an increase of 5%, reflecting our commitment to a progressive dividend.

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.

Finally, I would like to thank my fellow Board members, executives and all employees at QinetiQ for their contribution over the past year.

Mark Elliott

Non-executive Chairman, 24 May 2018

CHIEF EXECUTIVE OFFICER'S REVIEW

STRATEGY DELIVERING SECOND YEAR OF GROWTH



Steve Wadey
Chief Executive Officer

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.

The progress we have made demonstrates QinetiQ's ability to capitalise on the opportunities this market can present as well as our growing international presence."

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



QinetiQ employees are real professionals who run ranges and have got specialisations that we wouldn't have anywhere else in UK defence."

Rear Admiral Paul Bennett
Assistant Chief of Naval Staff,
Royal Navy

Unique capabilities critical to national sovereignty: helping our customers prepare for emerging threats

Hosted by QinetiQ, and led by the US Navy, Formidable Shield brought together eight NATO countries in the Hebrides to test integrated air and missile defence capabilities. Through a series of live missile firings and demonstrations, the allies improved interoperability in live-fire integrated air and missile defence environments.

Utilising our MOD Hebrides Range, which is part of the Long Term Partnering Agreement (LTPA), over the 18 month planning process, we managed the command and control centre, supported the planning, data capture and analysis as well as the logistics and safety for what was the most complex exercise of its type ever conducted in the UK. In line with our strategy to lead and modernise Test and Evaluation, and supported by our investment, we can provide offerings which are more relevant to our customers, for training, testing and rehearsal against current and future threats.

Combining our unique facilities with the skills and experience honed in the UK, and deploying them to support customers broadens their appeal to a growing number of international customers.

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.

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

STRATEGIC PROGRESS

DELIVERING LONG-TERM, SUSTAINABLE GROWTH

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Delivery of the strategy will enable us to better support customers and deliver long-term and sustainable growth and returns to our shareholders.”

VISION

The chosen partner around the world for mission-critical solutions, innovating for our customers' advantage.

STRATEGY

Our integrated strategy is built on three mutually reinforcing pillars supported by our values.



UK

Lead and modernise the UK Defence Test & Evaluation enterprise, by working in partnership with Government and prime contractors.



International

Build an international company that delivers additional value to our customers by developing our home countries, creating new home countries and exporting.



Innovation

Invest in and apply our inherent strengths for customers' advantage in defence, security and critical infrastructure markets.

Objectives

- Improve customer focus and competitiveness
- Modernise and reinvigorate the LTPA for UK MOD
- Build agile, competitive test and evaluation services for industry
- Improve business winning approach through campaigns
- Grow our Cyber, Information & Training business
- Accelerate growth in our US and Australian businesses
- Establish key partnerships in the Middle East
- Win new export sales

VALUES

Integrity, Collaboration, Performance

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 & 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.

OUR STRATEGIC PILLARS

The three elements of the strategy, while presented distinctly, are interlinked and mutually reinforcing:



UK

Modernise

Lead and modernise the UK defence Test & Evaluation enterprise.



International

Build

Build an international company that delivers additional value to our customers.



Innovation

Invest

Invest in and apply our inherent strengths for our customers' advantage.



Highlights in 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 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 revenues 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 in 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

STRATEGIC PROGRESS CONTINUED



Investment in test pilot training is attracting international customers

Our £85m investment in modernising the UK's provision of test aircrew training is attracting international customers. The Royal Netherlands Air Force pilots will be the first to fly our new aircraft, purchased in 2017 and delivered in early 2018.

This commitment from the Royal Netherlands Air Force is an example of the benefits that investment in our core capabilities brings, in line with our strategy to modernise UK test aircrew training. The introduction of multi-year agreements raises exciting new possibilities for our customers, such as tailored courses, bespoke equipment and activities, and long-term cost savings. They provide extra certainty, which increases our ability to plan for future opportunities and accommodate customer requirements, giving a huge boost to the school's commercial appeal.

The new fleet comprises two Grob 120TP and two Pilatus PC-21 fixed wing aircraft, alongside four Airbus H125 helicopters. These aircraft will be complemented by new modular courses, featuring modern working environments, materials and teaching practices, including student-centred and distance learning.

5

Down-selected on 5 significant opportunities as the result of our campaign led approach to business winning

€25m

Contract with European Space Agency to develop innovative docking mechanism

6%

Revenue growth in FY18

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 in 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.

Q&A

ANSWERS TO SOME OF OUR INVESTORS' MOST FREQUENTLY ASKED QUESTIONS



Q How do you manage a change in the SSRO rate?

A: The Single Source Regulations Office (SSRO) is intended to ensure the UK Government receives value for money when there is only a single source for a particular service or product. Given our innate specialisms, and the critical nature of what we do, much of our work with the UK MOD falls into this category. We are mitigating our exposure to future changes by putting more of the work we undertake onto longer-term contracts, which is a key part of our UK T&E strategy. Approximately two-thirds of our SSRO regulated revenue is now on longer-term contracts. Additionally, by putting contracts onto a longer-term basis we create greater visibility to support investment. This investment helps us to better serve our customers, both in the UK and increasingly internationally, and is a key part of our growth strategy. We expect the headwind to intensify in FY19, with an anticipated repricing of the remainder of the LTPA, and moderate in FY20 and beyond.

Q How are cost pressures at the MOD impacting QinetiQ?

A: Given our long term contracts we typically start the year with over two-thirds of our revenues under contract. Where we felt some of the effects of pressures at the MOD was in our lower value, shorter cycle research work which attributed to lower orders in certain parts of EMEA Services during H1 2018, which was partially offset by stronger orders in H2 2018. We believe that cost pressures at the MOD present a long-term opportunity for QinetiQ as we are well placed to support our major customer in helping them realise efficiencies. Our active approach to helping address our customer challenges has created many larger opportunities on which we are actively bidding.

Q Why are you investing in core contracts like the LTPA?

A: We are investing in core contracts like the LTPA to support our strategy to drive growth through leading and modernising UK T&E. The LTPA investment added over £1bn to our order book and secures approximately half our core LTPA revenues until 2028. The investment acts as a platform for growth by creating more relevant and competitive T&E capabilities for the UK as well as international customers. The investment is financially attractive as we earn a return on sales with additional adjustments for risk and capital servicing, as well as recovering our investment over the duration of the contract through depreciation included in the qualifying cost base.

Q Where are the growth opportunities within QinetiQ?

A: There are three main areas of growth opportunities for us. By leading and modernising UK T&E we can grow our market share, win more work in adjacent sectors such as training, and attract a broader array of international customers. Internationally, we see strong growth opportunities for our services and products in attractive markets such as Australia, North America and the Middle East. We are well placed to help countries either develop their own indigenous defence capabilities, or modernise the capability that they have. Our focus on innovation and the products we have within our overall portfolio also offer the potential for significant growth. As a Company, we have been much more focused ensuring our innovation is applied in attractive commercial areas, and that we identify the best route to market, which is often in partnership with other organisations; see our Dragonworks case study as an example on page 88. This enables us to commercialise our IP better than we have done historically. Finally, our balance sheet enables us to take advantage of acquisition opportunities. Our focus is on bolt-on acquisitions with complementary capabilities that enable us to accelerate our growth. Overall, we believe we have an addressable market of over £8bn per annum to pursue across our businesses.

BUSINESS MODEL

CREATING SUSTAINABLE VALUE

Unique expertise and facilities

QinetiQ is a company of scientists and engineers essential to sovereign capability, both in the UK and increasingly internationally.

We combine the dedication and creativity of our people, our unique science and engineering expertise, and our distinctive modernised facilities to equip customers with powerful solutions to their most pressing challenges.

Customers choose us to protect, improve and advance their vital interests because of our...

People and domain know-how

Over

3,000

scientists, engineers and technicians

Approx.

90%

of our people in the UK, and 75% in the US have national security clearance

Technical expertise

Over

1,000

granted patents

Over

300

patents pending

Distinctive facilities

1 of 3

Our low speed wind tunnel is one of just three in the world

16

Our ocean basin at Gosport, Hampshire is the largest in Europe – it's the size of 16 Olympic swimming pools

A sustainable business model

Our unique position in the market

Our customers are predominantly in defence, security, and critical infrastructure in our home markets of the UK, US and Australia, with a growing international and commercial presence.

Our customer relationships and domain know-how have been developed over many years of working in partnership.

As we are predominantly a services business, valued for our independence, we occupy a unique position in the market and collaborate with prime contractors, service providers and a broad-based supply chain that includes specialist firms.

Sustaining our business model

As a company whose reputation and achievements are centred on our people, our future success is primarily dependent on our ability to recruit, develop, engage and retain exceptional employees.

Our business model is robust and sustainable because our knowledge base is constantly refreshed as we learn from experience, understand emerging customer requirements and invest in our future. This enables us to both sustain existing capabilities and create new ones to ensure we respond to customer requirements and stay ahead of the competition.

We are investing in our facilities to ensure they remain relevant to support our customers against current and future threats, ensuring longevity and sustainability in our business model.

Our strong balance sheet sustains our ability to grow organically and inorganically.

How we generate revenue

We deliver advantage to our customers when and where it really matters through the provision of services and technology-based products often combined in unique ways.

We operate two divisions:

- **EMEA Services** generates revenue through the provision of advice and services, particularly test and evaluation. The division is underpinned by long-term contracts providing good visibility of revenue and cash flows.
- **Global Products** delivers products and solutions supported by research and development which is often funded by customers. The division is technology-based and has shorter order cycles so can have a more variable revenue profile.

How we deliver benefits to key stakeholders

Customers

- Deliver mission-critical solutions
- Responsive and agile with the ability to innovate at pace
- Ensure value for money

Shareholders

Inherent strong cash generation allows us to invest in our organic capabilities to deliver:

- Sustainable growth in revenue, operating profit and high quality earnings
- A progressive dividend

Employees

- Rewarding careers in highly skilled areas
- Utilise expertise across QinetiQ

Within our two divisions, our business units are aligned to customer domains and all deliver a combination of services and products.

How we create value

We optimise for **greater capability at lower cost**, operating across the domains of air, land, maritime, cyber, and space, enabling faster transition from **concept to capability**, and providing **assurance throughout the lifecycle** of complex platforms, weapons and capability.

Our work helps our customers to achieve **operational and competitive advantage**, and by working closely with them to address their existing needs, we are able to **understand future requirements** for the next generation of capability.

Capability Generation & Assurance

Research & Experimentation/Test & Evaluation/Training & Rehearsal

What we deliver for our customers

Capability Integration

- Maximise and optimise capability output of our complex systems
- Enable information exploitation and multi-domain operations
- Support through-life capability generation

FY18 examples

Strategic Enterprise – [page 28](#)

We have been working with the MOD to deliver efficiency savings for the RAF by ensuring aircraft are safe to operate and continuously upgraded to maintain warfighting edge, and deliver efficiencies.

Threat Representation

- Provide effective threat and vulnerability assessments
- Lead in disruptive, cost-effective threat representation solutions
- Maximise use of simulation technologies and techniques

Live targets – [page 29](#)

We safely delivered trial aerial targets within 2km from HMS Argyll, surpassing the previous 5km minimum distance, providing a realistic threat against which the ship's anti-missile system could be tested.

Operational Readiness

- Ensure strategic management of ranges and facilities
- Support mission-critical operations and complex exercises in real-world environments
- Enable evidence-based decision-making in support of outcomes

Test aircrew training – [page 10](#)

This year, we signed a multi-year agreement with the Royal Netherlands Air Force to train test pilots on our new fleet of aircraft, complemented by modular courses delivered with a flexible, modern approach and environment.



Formidable Shield – [page 7](#)

In November 2017, Formidable Shield brought together eight NATO countries to test integrated air and missile defence capabilities through a series of live firings and trials. QinetiQ managed the command and control centre, as well as the logistics and safety for what was the most complex exercise of its type ever conducted in the UK.

Services & products

e.g. advice, intelligence, information systems, protection, unmanned systems, space systems

Technology

e.g. advanced materials, sensing, communications, cyber, analytics, autonomy, directed energy

Inherent strengths

Academic & industrial partnerships, science & engineering expertise, domain knowledge, experience

MARKET THEMES

KEY LONG-TERM TRENDS THAT AFFECT OUR MARKETS

KEY THEMES



Increasing complexity



Partnering for innovation



Value for money



Increasing complexity

- Growing global threats from state and non-state organisations
- Rapid data disruption
- Cyber risk threatening public and private sector

The nature and number of challenges our customers face, and the pace at which they evolve, have never been greater. A growing number of state and non-state based threats around the world make for a highly complex environment that our customers must plan, resource, test and train for. We are witnessing a so-called 'fourth industrial revolution', where data analytics, machine learning, autonomous systems and advancements in materials are fundamentally disrupting the way many markets operate. The defence, security and critical infrastructure markets are acutely exposed to this rapid change.

In defence, our customers are required to make long-term planning decisions and resource accordingly. Certain nations are choosing to exert their influence in the world through direct military action. Others are rapidly developing their ability to strike well beyond their own borders with the potential for nuclear delivery. Advancement in conventional capabilities is often run in parallel with offensive cyber capabilities, which can be achieved without the ethical or constitutional considerations most nations adhere to.

Given continued instability, terrorist groups are able to develop their own capabilities in the vacuum left by civil wars. The proliferation of military equipment in unstable and unpoliced areas has allowed terrorists the room to train, plan and coordinate for large scale attacks both within the region and more broadly. Porous borders facilitate the flow of information, people and weapons in support of such attacks. At the same time, technology, particularly within encrypted communications, allows individuals to plan and orchestrate relatively low-complexity attacks, with devastating consequences. These challenges are not exclusive to our defence customers. The environment in which our critical infrastructure customers operate is also growing increasingly complex. Well-publicised cyber-attacks during the course of FY18 highlight how all organisations are potentially vulnerable from state actors, organised crime or individuals.

How we are responding

Our strategy and commitment to lead and modernise UK Defence Test & Evaluation (T&E) allows us to support our customers in their preparations against a range of increasingly complex threats. This is complemented by the investment we are making, such as in our air ranges, ensuring we have the right capabilities to grow. Our ability to understand, emulate threats, test and evaluate the resilience of systems against threat scenarios helps our customers assess risk and develop informed mitigation plans. This understanding positions us well to support our customers in the development and delivery of critical training, a further growth area for QinetiQ.

Our ability to operate across all domains including air, sea, land, space and cyberspace is aligned with our customers' need to operate effectively in these environments. Our expertise in cyber security, and our understanding of innovation and the 'fourth industrial revolution', and how to evaluate and deploy the related technologies, helps our customers to contend with imminent threats and prepare for the future. Our research, development, test and evaluation activity is conducted across the procurement life-cycle from concept development through to operations. This provides us with the valuable insight necessary to support our customers in innovating to successfully achieve their missions.



Partnering for innovation

- Accelerating pace of innovation through partnerships
- Appetite to exploit ideas coming from outside defence
- Rapidly integrate new technologies into existing capabilities

The pace of change within the threat environment means our customers need to leverage innovation effectively to respond. Across the defence sector, government initiatives are under way in a number of nations including the UK, Australia and the US. These initiatives recognise that innovation in commercial and academic fields has begun to outpace that within defence. Governments are looking to partner effectively with organisations beyond their traditional supplier base to accelerate the pace of innovation in their own defence capabilities.

Through these initiatives, defence and critical infrastructure customers are seeking new approaches to innovation across the 'Defence Enterprise' in equipment procurement, support and operations, so that they can rapidly integrate new technologies into existing capabilities. Many customers are keen to harness the innovation that comes from universities and SMEs, particularly as the defence sector is no longer the sole, or primary, incubator of new technology. They are looking for assistance from organisations that understand their operational context and can collaborate to help them connect their supply chains and successfully exploit ideas coming from outside defence.

How we are responding

QinetiQ is a company that was founded upon innovation; and research and development, and test and evaluation form the core of our business. The breadth and depth of our people's technology and domain expertise, and our investment in their continued development, enables QinetiQ to deliver valuable advice, innovative solutions and services. Furthermore, as a predominantly service-based business, we are not encumbered by large product portfolios, supply chains or conflicts of interests. Accordingly, QinetiQ is ideally placed to act as an innovation integrator, acting as a convening facilitator between government, academia and wider industry to rapidly develop and deploy innovative solutions. Our strategy is to further develop our own R&D capabilities as well as creating valuable partnerships to deliver innovation effectively to our customers.



Value for money

- Customers have finite resources, but increasing requirements
- In some regions, defence budgets are growing
- UK defence budgets under pressure
- Customers are looking to the private sector to drive efficiencies

With finite resources, our customers are seeking ways to ensure they are able to deliver the capabilities needed to fulfil their obligations to protect. The breadth of threats and the speed of their evolution mean that value for money has never been more important. The evolution of threats means it becomes increasingly difficult to make longer-term plans for equipment procurement, and existing platforms require upgrades and/or modifications to ensure they have the necessary capabilities.

While defence budgets in some regions are increasing, ensuring value-for-money remains a key priority. In the UK, defence budgets remain under pressure and our customers are looking for support from the private sector to drive efficiencies.

How we are responding

Our strategy is to ensure that QinetiQ continues to offer value-for-money to its customers. By modernising UK Test and Evaluation, we not only make our facilities more relevant for the threat environment, but increasingly more cost-effective to run. Our understanding of system design and operation enables us to innovate with our customers and partners to generate efficiency savings across the procurement life-cycle.

Our International strategy creates opportunities for us to help deliver value to international customers, particularly in the Middle East, Australia and North America with best-in-class procurement and test and evaluation advice. This advice helps our customers develop their own indigenous defence capabilities in a cost-effective manner. Our strategic focus on innovation allows us to come up with solutions and products that enhance capabilities while remaining cost-effective. Effective partnering with other industry players and academia allows us to develop innovative business models that save money while enhancing delivery capabilities.

TRADING ENVIRONMENT

OUR ADDRESSABLE MARKET

By focusing on our core offerings and target markets, we have an addressable market of over £8bn per annum. Growth in QinetiQ comes from increasing our share in existing markets and leveraging our strengths into attractive adjacent ones.

>£8bn
per annum minimum
addressable market

¹ RDT&E = Research & Development and Test & Evaluation.

² ~£300m pa via Long Term Partnering Agreement (LTPA) with UK MOD.

³ Australia, Canada, New Zealand, France, Germany, Sweden, Saudi Arabia, UAE, Qatar, Turkey included. USA (\$73bn pa) excluded.

⁴ CAGR = Compound Annual Growth Rate.

Source: Jane's Market Forecast, FY18 market sizing (USD/GBP exchange rate of 0.76), UK MOD. QinetiQ market share based on FY18 revenue.

SIGNIFICANT GROWTH POTENTIAL

Services and products
(Defence, security and critical infrastructure)

Size ££bn pa
Growth +2-5% CAGR
Share <1% (£280m)

UK training

Size £1bn pa
Growth +1% CAGR
Share ~5% (£55m)

International training

Size £bn pa
Growth +1-3% CAGR
Share <1% (£8m)

UK RDT&E¹

Size £1.5bn pa
Growth +1% CAGR
Share ~30% (£450m)²

International RDT&E

Size £5.9bn pa³
Growth +4% CAGR
Share <1% (£40m)

Key

● Current market share ● Future market potential

The UK, US and Australia are our three home countries. We define 'home countries' as those in which we have our own indigenous industrial capabilities.

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.



A core part of QinetiQ's strategy is to take the products, skills and expertise developed in its home countries into attractive international markets."

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.

KEY PERFORMANCE INDICATORS

NON-FINANCIAL KPIS

Key performance indicators (KPIs)

During 2018, David Smith, Chief Financial Officer, led a review of the key performance indicators and other metrics that we use to monitor the performance of the Company and measure the progress of the implementation of our strategy.

As a result we have replaced the total Group profit after tax KPI with International revenue to better reflect the global growth strategy of the Group and also changed underlying operating cash flow to a pre-capex measure to bring into alignment with executive remuneration measures.

We now present customer satisfaction as a Net Promoter Score to facilitate comparability with companies in other sectors.

The objective of our strategy is to grow QinetiQ, delivering a sustainable increase in quality earnings to our shareholders. Progress is measured through a range of financial and non-financial key performance indicators. Measurements of customer satisfaction, health and safety and employee engagement underpin sustainability.

Measures such as orders, organic revenue growth, profitability and cash flow track financial performance.

Similar indicators are used to review performance in each of the Group's businesses.

 **Page 32**
Our People

 **Page 34**
Corporate responsibility

Net Promoter Score

63

2017: 45



Description

The Net Promoter Score is an internationally recognised metric for customer satisfaction.

The NPS score is calculated by deducting the percentage of customers who are detractors from the percentage who are promoters, and can therefore range from -100 to +100.

Rationale

Measuring customer satisfaction provides us with insight into our customers' views. Complemented with qualitative surveys, this provides us with actionable insights that enable us to improve our customer experience.

Performance this year

We made continued progress in FY18 and a score of 63 is deemed 'excellent' by international standards. In previous years we have reported a score out of 10. The equivalent result is 8.6/10 for FY18 compared to 8.2/10 in the prior year.

Link to strategy

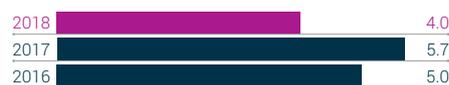
Achieving our ambition of becoming the chosen partner requires a relentless focus on meeting the needs of customers in both our home countries and overseas. Customer satisfaction is a metric used for the Bonus Banking Plan.

 **Page 6**
Our strategy

Health and safety (LTI)

4.0

2017: 5.7



Description

The Lost Time Incident (LTI) rate is calculated using the total number of accidents resulting in at least one day taken off work, multiplied by 1,000 divided by the average number of employees in that year.

Rationale

As a company it is imperative we operate with the highest level of safety. Not only is this the right thing to do for our people, but for our customers who entrust us with safety critical work.

Performance this year

Safety is a top priority and a number of initiatives were run in FY18 in line with our collective objectives. The implementation of our Safe For Life programme focuses on how we operate across the whole Group and supply chain. The reduction in LTI from 5.7 to 4.0 is an encouraging sign of progress in making QinetiQ a safe place to work.

Link to strategy

The safety, health and wellbeing of our people are intrinsically linked to our strategic success.

 **Page 32**
Our People

Apprentices and graduates (%)

4.8%

2017: 4.9%



Description

The total number of apprentices, graduates and sponsored students as a percentage of our UK workforce.

Rationale

As a knowledge based business it is critical to our long-term viability that we develop the next generation of employees. It is also a measure of our commitment to The 5% Club, an industry-led initiative of which we are a founding member, to grow the number of young people on early career schemes.

Performance this year

There was a slight decrease this year but we continue to focus on early careers as a key driver of our talent pipeline.

Link to strategy

As a business whose reputation and achievements are centred on our people, our future success is primarily dependent on our ability to recruit, develop, engage and retain exceptional employees.

Employee engagement is a metric used for the Bonus Banking Plan.

 **Page 32**
Our People

Employee engagement (Score out of 900)

592

2017: 596



Description

A measure of employee engagement (excluding QNA) on a scale of 0–900, based on the Best Companies Employee Survey. A separate survey is conducted in the US.

Through this survey, employees share their views about working at QinetiQ under the headings of management, leadership, company, personal growth, my team, giving something back, fair deal and wellbeing.

Rationale

The annual survey enables comparison between QinetiQ and other UK companies. The primary purpose of the survey is to provide guidance to Team Leaders about how they can improve employee engagement.

Performance this year

There has been a slight fall in the overall score and we will be working at local and organisational level to make improvements, and introducing a new digital engagement tool.

 **Page 32**
Our People

Voluntary employee turnover (%)

10.0%

2017: 9.0%



Description

This is a measure of the number of employees leaving the Company not at QinetiQ's instigation.

Rationale

Provides a measure of the Group's ability to retain employees.

Performance this year

Overall employee turnover increased by 1% during the period but remains broadly in line with our historic average.

 **Page 32**
Our People

KEY PERFORMANCE INDICATORS CONTINUED

FINANCIAL KPIS

Orders
(£m)

£587.2m

2017: £675.3m



Description

The level of new orders (and amendments to existing orders) booked in the year. Although new multi-year contracts can impact the reported orders number, the level of orders booked in the year is one indicator of future financial performance.

Rationale

This provides a measure of the Group's ability to replace completed contracts/business with new contracts/business.

Performance this year

Orders declined to £587.2m (2017: £675.3m), reflecting the fact that FY17 included the award of the £109m, 11-year renewal from the UK MOD for the Naval Combat System Integration Support Services (NCSISS), and £55m of Strategic Enterprise contracts. Excluding these multi-year contracts, orders increased by 15%.

The contribution from businesses acquired during 2017 was £32.0m.

Link to strategy

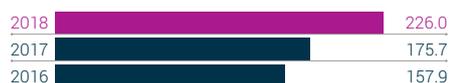
Order intake is an important measure of progress of the implementation of our strategy, the objective of which is to grow the Group, and is used for the Bonus Banking Plan. For Executive remuneration it is adjusted to exclude businesses acquired in the year.

 **Page 62**
Directors' Remuneration Report

International revenue
(£m)

£226.0m

2017: £175.7m



Description

This represents revenue derived from non-UK customers, recognised in the period.

Rationale

International revenue demonstrates the Group's capability to win and deliver work outside of its core UK customer base and thus reduce its dependence upon wider UK economic conditions and government spending patterns.

Performance this year

International revenue grew by 29% to £226.0m (2017: £175.7m) and includes £38.1m (2017: £9.2m) from the QTS and RubiKon businesses acquired in FY17.

Link to strategy

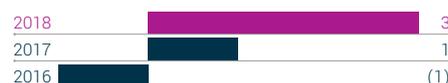
International revenue is an important measure of progress of the implementation of our strategy, a key element of which is accessing higher growth, international markets. It will be used as a performance measure for the FY19 Deferred Share Plan.

 **Page 62**
Directors' Remuneration Report

Organic revenue growth
(%)

3%

2017: 1%



Description

The Group's organic revenue growth is calculated by taking the increase in revenue over prior year pro-forma revenue, at constant exchange rates. It excludes the impact of acquisitions and disposals.

Rationale

Organic revenue growth demonstrates the Group's capability to grow market share and sources of revenue within its chosen markets before the effect of acquisitions, disposals and currency translation.

Performance this year

Revenue grew 6% to £833.0m (2017: £783.1m). Organic revenue growth, excluding the impact of foreign exchange and acquisitions, was 3% compared to 1% in FY17.

EMEA Services grew 4% organically and 6% when the full year impact of the 2017 RubiKon acquisition is included.

Global Products showed a 4% organic decline, reflecting its lumpy revenue profile, but 7% growth when the full year impact of the 2017 QTS acquisition is included.

Link to strategy

Organic revenue growth is an important measure of progress of the implementation of our strategy, the objective of which is to deliver sustainable growth.

* Definitions of the Group's 'alternative performance measures' can be found in the glossary on page 139.

Underlying operating profit*
(£m)

£122.5m

2017: £116.3m



Description

The earnings before interest and tax, excluding all specific adjusting items*.

Rationale

Underlying operating profit is used by the Group for performance analysis as a measure of operating profitability that is tracked over time. Specific adjusting items are excluded because their size and nature mask the true underlying performance year-on-year.

Performance this year

Underlying operating profit* increased to £122.5m (2017: £116.3m).

The Group benefitted from £8.7m (2017: £7.4m) of credits relating primarily to the release of engine servicing obligations for test aircrew training and settlement of a contractual dispute.

The contribution from businesses acquired during FY17 was £6.6m.

Link to strategy

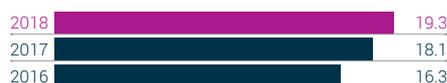
This measure is a reflection of the productivity of the Group's activities and is used for both the Bonus Banking Plan and the Deferred Share Plan. For Executive remuneration it is adjusted to exclude businesses acquired in the year.

 **Page 62**
Directors' Remuneration Report

Underlying earnings
per share (EPS)* (p)

19.3p

2017: 18.1p



Description

The underlying earnings, net of interest and tax, expressed in pence per share.

Rationale

Underlying EPS provides a measure of the earnings generated by the Group after deducting tax and interest. Specific adjusting items are excluded because their size and nature mask the true underlying performance year-on-year.

Performance this year

Underlying EPS grew 7% due to the contribution to operating profit from the businesses acquired in 2017 and the reduced share count, following the completion of the £50m share buyback in 2017.

Link to strategy

This is a measure of growth in quality earnings for our shareholders. It was used for the Performance Share Plan incentive scheme, adjusted to exclude the impacting acquisitions.

 **Page 62**
Directors' Remuneration Report

Underlying net cash flow
from operations* (£m)

£126.5m

2017: £111.9m



Description

This represents net cash flow from operations before cash flows of specific adjusting items.

Rationale

This provides a measure of the Group's ability to generate cash from its operations and gives an indication of its ability to make discretionary investments in facilities and capabilities and pay dividends to shareholders.

Performance this year

Underlying net cash flow from operations was £126.5m (2017: £111.9m) and included £14.2m relating to the unwind of working capital, of which £6.8m relates to non-recurring trading items.

Link to strategy

This is a measure of the cash-generative characteristics of the Group and is used for executive remuneration (adjusted to exclude businesses acquired in the year).

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Directors' Remuneration Report

* Definitions of the Group's 'alternative performance measures' can be found in the glossary on page 139.

PRINCIPAL RISKS

AN INTEGRATED APPROACH TO RISK MANAGEMENT

Risk management framework

Effective risk management plays an integral role in everything we do: ensuring we utilise the Group-wide risk management framework to inform our decision-making, support the successful delivery of our objectives and increase our operational efficiency.

Our strategic focus on commercial innovation and changes in our core customers' approach to risk are key business drivers shaping our application of risk management. Proposing innovative business models and taking a more outputs-based approach to existing and new contracts are examples of how we are taking on more risk to pursue opportunities, while simultaneously innovating for our customers' advantage.

Our risk management framework, including key responsibilities is shown to the right. The reports of the Audit Committee and Risk & CSR Committee can be found on pages 55 to 61. Details of the Group's system of risk management and internal control can be found in the corporate governance statement on pages 50 to 54.



QinetiQ risk appetite

The Board defines and reviews its tolerance of risk through establishing a clear risk appetite and setting appropriate delegations of authority to the executive and senior leaders. QinetiQ focuses on those critical risk areas necessary to achieve our strategic goals. The risk appetite is articulated by defining three categories which describe the balance of scrutiny and mitigation activity against likely benefit or reward:

Cautious

Avoidance of uncertainty – with negligible or low residual risk. Applying innovation prudently where the risks are fully understood.

Balanced

Preference for delivery options that have a low or moderate degree of residual risk. Applying innovation only where successful delivery is likely.

Eager

Willing to consider all delivery options despite greater inherent risk and eager to be innovative.

	Cautious	Balanced	Eager
Commercial			
Opportunities relating to increased market share where we have proven delivery into existing markets			██████████
Opportunities that translate proven delivery into new markets			██████████
Opportunities that translate new capability/delivery into existing customers		██████████	
Opportunities that involve new capability or delivery into new markets		██████████	
Operational			
Operational delivery		██████████	
Compliance with legal and regulatory requirements	██████████		

Risk register

The Group risk register consists of material risks relating to effective delivery of our strategy. The Board recognises that some risks may be affected by factors outside the control of the Company and also recognises that however robust the risk management processes are, they cannot provide absolute assurance and unknown risks may manifest without warning. The Company has processes in place to deploy appropriate management to such risks.

Note

The Transformation Programme risk included in the 2017 Annual Report has been retired following the successful completion of the initial Programme. However, focus remains on ensuring the subsequent changes are embedded.

Key

Proximity

-  0-1 years
-  1-2 years
-  2+ years

Velocity

-  Low
-  Medium
-  High

Strategic risks

UK Defence Test and Evaluation strategy

Risk

UK Government budget constraints lead to reduced spending in the core markets in which the Group operates. EU exit causes a loss of market confidence and reduction in collaborative EU funding.

Impact

A reduction in revenue and associated profitability from the Group's government and defence contracts.

Mitigation

Our strategy is focused on leading and modernising UK Test and Evaluation in support of our customers' objectives.

Proactive engagement with our major customers allows us to support their objectives and our investment into core contracts helps to ensure that we are able to provide the right services as the threat environment continues to evolve.

 Read more in the Strategic report on page 8

Metrics

- Customer satisfaction
- All financial KPIs

Responsibility

Group Director Business Development

Risk appetite

Eager

Likelihood/Impact

Medium/High

Proximity/Velocity



International strategy

Risk

Plans to grow our international business may be impacted by external influences outside of our control, such as geopolitical risks, or specific risks arising from working in new markets.

Impact

Unable to realise expected growth in the planned time-frames.

Mitigation

Our international strategy is focused on the markets we feel we have the best routes to access with the most appropriate products or services.

Adopting a focused approach ensures we can closely monitor our progress, adapting and responding as necessary.

We undertake extensive due diligence, taking the appropriate professional advice to ensure structural, regulatory, legal and political risks are understood and minimised.

We partner, where appropriate, with high-quality local businesses to leverage their infrastructure and de-risk the process.

 Read more about our addressable markets on page 16

Metrics

- All financial KPIs
- International revenue

Responsibility

Managing Director International

Risk appetite

Balanced to Eager

Likelihood/Impact

Medium/High

Proximity/Velocity



PRINCIPAL RISKS CONTINUED

Strategic risks

Innovation strategy

Risk

Failure to create a culture of innovation or to invest adequately in, or create value from, our innovation investment. As well as the risks arising from the introduction of disruptive technologies/alternative business models.

Impact

Negative impact on the Group's market position, competitiveness, and future growth.

Mitigation

We have a strong track record of innovation.

Our overall strategy helps us to ensure that we focus our innovation on areas with clear commercial opportunities.

We are focused on effective collaboration to find the best routes to market for our technology, such as our partnership with Rockwell Collins.

Our operating model, based on matrix working, helps to ensure that any internal barriers to collaboration and knowledge sharing are removed.

 Read more about our approach to innovation on page 15.

Metrics

- Customer satisfaction
- Employee engagement
- IRAD investment

Responsibility

Group Director Business Development

Risk appetite

Balanced

Likelihood/Impact

Medium/High

Proximity/Velocity



A material element of the Group's revenue is derived from one contract

Risk

The Long Term Partnering Agreement (LTPA) is a 25-year partnering relationship with UK MOD to provide test, evaluation, and training services. UK Government budget constraints could lead to a material change to the contract.

Impact

The LTPA directly contributes a material proportion of the Group's revenue and earnings.

Mitigation

Our aim is to provide our customer with the capabilities they need to test and train against current and future threats in a cost-effective manner – leading and modernising UK T&E.

As a business we have become more customer focused and we are applying this to understanding requirements for the remainder of the LTPA which we are in the process of negotiating.

Our recent investment into a core part of this contract continues to ensure it meets our customer's expectations and remains relevant in an evolving threat environment.

Metrics

- All financial KPIs except orders
- Customer satisfaction

Responsibility

Managing Director Maritime, Land and Weapons
Group Director Test & Evaluation

Risk appetite

Balanced

Likelihood/Impact

Medium/High

Proximity/Velocity



Single source contract regulations

Risk

Group performance is adversely affected by application of regulations from the Single Source Regulations Office (SSRO).

Impact

The regulations could have an adverse impact on the Group's financial performance.

Mitigation

Our strategy to lead and modernise UK T&E and invest in our core contracts allows us to put a greater volume of our UK single sourced work onto longer-term firm-price contracts, reducing the proportion of our revenues exposed to changes in the SSRO rate.

Our growing international business provides the opportunity for us to earn higher-margin work which further mitigates SSRO margin pressure on qualifying work within the UK.

QinetiQ continues to support a joint industry position in refining the SSRO framework and its practical application.

Metrics

- Customer satisfaction
- All financial KPIs

Responsibility

Chief Financial Officer

Risk appetite

Cautious

Likelihood/Impact

High/Medium

Proximity/Velocity



Operational risks

Recruitment and retention

Risk

The Group operates in many specialised engineering, technical and scientific domains where key capabilities and competencies may be lost through failure to recruit and retain employees or a lack of domain-specific graduates leads to a future skills shortage.

Impact

Delivery of business strategies, plans and projects would be impacted negatively.

Mitigation

Ensuring regular communication and greater connectivity for our people via the Employee Engagement Group, face-to-face communications, and the launch of the Global Portal, our new intranet.

Helping our people to develop and fulfil their potential via the QinetiQ Academy and clear succession planning.

Ensuring we have access to talent now and in the future such as the STEM outreach programme and as founding members of The 5% Club.

 Read more about our people on page 32.

Metrics

- Employee engagement
- Apprentices and graduates
- Voluntary employee turnover

Responsibility

Group Director Human Resources

Risk appetite

Balanced

Likelihood/Impact

Low/Medium

Proximity/Velocity



Significant breach of relevant laws and regulations

Risk

The Group operates in highly regulated environments and recognises that non-compliance has the potential to compromise our ability to conduct business in certain jurisdictions and would potentially have an impact on a variety of stakeholders.

Impact

Failure to comply with particular regulations could result in a combination of fines, penalties, civil or criminal action, suspension or debarment from government contracts, as well as damage to the QinetiQ brand.

Mitigation

Instilling the right behaviours and culture within QinetiQ is a key part in minimising the risks.

In addition, the Group's robust policy, procedures and mandatory training defines clear expectations for the Group and its employees.

Key areas of focus include: Safety of product and services, health, safety & environment, international trade controls, bribery and ethics, where the Group adopts a zero tolerance approach to bribery and corruption.

 Read more on page 34.

Metrics

- Health and safety
- Mandatory training compliance
- Commercial intermediary monitoring

Responsibility

Company Secretary/Group General Counsel

Risk appetite

Cautious

Likelihood/Impact

Medium/High

Proximity/Velocity



Security and IT systems

Risk

A breach of physical or data security, cyber-attacks or IT systems failure could have an adverse impact on our customers' operations.

Impact

Significant reputational damage, as well as the possibility of exclusion from some types of government contracts resulting in reduced orders, revenue and profit.

Mitigation

Data security is assured through a multi-layered approach that provides a hardened environment, including robust physical security arrangements and data resilience strategies.

Information systems are designed with consideration to single points of failure and comply with relevant accreditation standards. Mandatory security awareness training for all staff.

Metrics

- Cyber dashboard
- Security dashboard

Responsibility

Chief Financial Officer

Risk appetite

Cautious

Likelihood/Impact

Medium/High

Proximity/Velocity



PRINCIPAL RISKS CONTINUED

RISK MANAGEMENT IN ACTION



Using our risk appetite to inform our approach to international business

Our international business growth targets are ambitious and in order to achieve these we need to be clear about the specific risks we face and the level of risk we are prepared to accept (see 'International strategy' risk). We have a Balanced to Eager approach to opportunities where we are able to translate proven capabilities into new markets; with a preference for delivery options that have a high chance of success but a low or moderate degree of residual delivery risk.

Our approach to developing our presence in new markets has been to amalgamate local knowledge, business capability, regulatory awareness and cultural values, with our proven capability and technology. The most advantageous approach to achieving this outcome has been to utilise partnerships which deliver a solid platform for growth, minimising our capital investment requirements and deliver an accretive low risk value proposition. Minimising our residual risk exposure in this way strengthens the realisation of sustainable and profitable revenue growth for the International business.

Investing into the Long Term Partnering Agreement (LTPA) – Considering risk in how we deploy our capital

Considering the balance between risk and reward is a key part of determining how and where we deploy our capital. We have an Eager risk appetite for opportunities which increase market share where we have proven delivery into existing markets, ensuring we have considered all delivery options and are innovative.

The investment we are making into the LTPA is an example of how risk-based decision-making has been used to identify and progress an opportunity for the mutual benefit of our customer and our business, and is aligned to our strategy of leading and modernising UK T&E.

See risks 'UK Defence Test and Evaluation strategy' and 'A material element of the Group's revenue is derived from one contract'

This approach made strategic sense: the long-term contractual revenues, margin and capital repayment profiles, which provide a reasonable rate of return, were complemented by the opportunities to attract a growing share of international work to our UK facilities.



LONGER-TERM VIABILITY ASSESSMENT

Assessing the prospects of the Group

The Group's corporate planning processes involve the following individual processes covering differing time frames:

1. An annual Integrated Strategic Business Plan (ISBP) process that looks at the financial outlook for the following five years. This process commences with an assessment of the orders pipeline producing an Order Intake Scenario. A review of the phased delivery profile and the cost base required to support this enables generation of base-case, high-case and low-case profit forecasts. Capex and working capital requirements are also collected, reviewed, approved and a cash flow produced for the Plan period;
2. An annual budget process that covers the first year of the five-year planning horizon in detail;
3. A bi-annual forecast process to update the view of the first budget year (the year which would be in progress);
4. A rolling monthly 'latest best estimate' process to assess significant changes to the budget/forecast for the year in progress.

The corporate planning process is underpinned by assessing scenarios and risks that encompass a wide spectrum of potential outcomes, both favourable and adverse. The downside risk scenarios are designed to explore the resilience of the Group to the potential impact of all the significant risks set out on pages 22 to 25, or a combination of those risks.

The scenarios are designed to be severe but plausible, and take full account of the availability and likely effectiveness of the mitigating actions that could be taken to avoid or reduce the impact or occurrence of the underlying risks, and that realistically would be open to them in the circumstances. In considering the likely effectiveness of such actions, the conclusions of the Board's regular monitoring and review of risk and internal control systems, as discussed on page 60, is taken into account. It is assumed that existing, undrawn bank facilities could be re-financed before they mature in FY20.

Alongside the annual review of risk scenarios applied to the strategic plan, performance is rigorously monitored to alert the Board and Executive Committee to the potential crystallisation of a key risk.

We consider that this stress-testing based assessment of the Group's prospects is reasonable in the circumstances of the inherent uncertainty involved.

The period over which we confirm longer-term viability

The period over which the Directors consider it possible to form a reasonable expectation as to the Group's longer-term viability is the three-year period to 31 March 2021. This is within the period covered by our strategic planning process and is subject to stress-testing and scenario planning around potential risks. It has been selected because it presents the Board and readers of the Annual Report with a reasonable degree of confidence whilst still providing an appropriate longer-term outlook.

Confirmation of longer-term viability

As noted on page 53, the Directors confirm that their assessment of the principal risks facing the Group was robust. Based upon the robust assessment of the principal risks facing the Group and their stress-testing based assessment of the Group's prospects, all of which are described in this statement, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to 31 March 2021.

OPERATING REVIEW

EMEA Services

Financial performance

	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 ²	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 12 months beginning 1 April 2018

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 base line profit rate set annually, and the methodology used by the Single Source Regulations Office, as well as securing longer-term revenue visibility.

* Definitions of the Group's 'alternative performance measures' can be found in the glossary on page 139.

The base line 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 ~£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

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.

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 Managing 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 Armasuiss, 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.

Supporting our customers' enduring need for capability assurance

QinetiQ has skills and facilities that are vital to both maintaining and enhancing the UK's defence capability. We occupy a unique position in UK defence as many of these only exist within QinetiQ.

QinetiQ operates across the lifecycle of platforms, from initial early stage research, to development and testing to upgrades and enhancements. Throughout the lifecycle, we ensure that systems and platforms deliver what they are intended to do.

An example of this is the work we do in integrating and testing complex combat and communications equipment and software systems for all Royal Navy warships, guaranteeing their safety and effectiveness. As ships are brought into service, upgraded or maintained over their service life, QinetiQ ensures new or adapted systems integrate and work effectively in their own right and with pre-existing systems.

Conducted under the 10-year NCSISS contract, and operating in the Portsmouth area, we have established a centre of excellence for maritime mission systems integration. During FY18 we were pleased to add the new Type 26 frigate to the contract. QinetiQ will play an intrinsic role supporting the Type 26 both into active service and throughout its service life.

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 (CSIS).
- 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.

OPERATING REVIEW CONTINUED

EMEA Services continued

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. Revenues derived from outside of the UK are 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

Financial performance

	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

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

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.

* Definitions of the Group's 'alternative performance measures' can be found in the glossary on page 139.

Delivering innovation to our customers

QinetiQ North America (QNA) has a strong track record of delivering leading edge innovation to customers.

The business was selected by General Atomics as the provider of the Electromagnetic Aircraft Launch System (EMALS) and the Advanced Arresting Gear (AAG) for the USS Gerald R. Ford (CVN 78), the future John F. Kennedy (CVN 79) and the future Enterprise (CVN 80) aircraft carriers.

EMALS is designed to replace the steam catapult system currently used on US Navy aircraft carriers. EMALS provides significant benefits over current launch systems, including reduced maintenance and installed volume.

The electric motor-based AAG system provides for aircraft deceleration during aircraft carrier recovery operations. AAG allows for arrestment of a broad range of aircraft, reducing manning and maintenance, and higher reliability and safety margins. AAG's design uses simple, proven energy-absorbing water turbines coupled to a large induction motor for fine control of the arresting forces.

QinetiQ North America (40% of Global Products revenue)

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 US Department of Defence's (DoD) Man-Transportable Robotic System (MTRS Inc II) programs 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 the 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.

OptaSense (14% of Global Products revenue)

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.

OUR PEOPLE

ENGAGED IN HIGH-PERFORMING TEAMS



Safe for Life

The Safe for Life Champion role is a key catalyst for improving safety awareness and action. Champions receive behavioural observation and intervention training and are empowered to make improvements. For example at the BUTEC range site, our champion has identified new ways to ensure safe operations – from how boats are refuelled, to improving signage. His engagement is not just with our people but also with our customers to ensure everyone is able to contribute to a safe working environment.

Health and safety

	FY18	FY17	FY16
Lost Time Incident rate	4.0	5.7	5.0

The LTI rate is calculated as the number of lost time incidents, where the employee is away from work for one or more days, times 1,000, divided by the total number of employees.



Where to find more information

Page 18
Non-financial KPIs: employee engagement, apprentices and graduates, health and safety

Page 22

Principal risks and uncertainties: recruitment and retention

For more information on ED&I and our Gender Pay Gap Report www.QinetiQ.com/about-us/corporate-responsibility

We are committed to a safe, modern working environment where everybody has the opportunity to contribute to our success. Our culture, inclusive approach to engagement, recognition and development, enable people to deliver outstanding solutions for our customers around the world.

Focused on safety, health and wellbeing for our people

In 2017, we launched a three-year Health, Safety and Environment strategy. Our aim is to create a safety first culture, where everyone is involved in continuously improving health, safety and the environment. A 'Safe for Life' programme has been introduced across the Company, to ensure that we keep ourselves and each other safe at all times. In FY18, our leaders committed to a collective objective to drive and support the success of this programme. Safety awareness is increasing through a focus on communication and on behavioural safety. Following the launch of the programme we are observing an improvement in safety performance. The FY18 Lost Time Incident (LTI) rate for QinetiQ Group was 4.0 compared with 5.7 in FY17. There were no prosecutions, prohibition notices or improvement notices issued by regulators in the UK during the last financial year, two indicators that our approach to safety is creating real results. We are encouraging our people to manage their own health and wellbeing, enabling them to perform to the best of their ability, with energy and creativity. Plans for FY19 include greater emphasis on raising awareness on wellbeing issues – the importance of health, and how to get help and support, and we have recently created a wellbeing group to create momentum.

Creating the culture to engage our people for business performance and growth

We have introduced a cultural development strategy and plan, centred on three strands: defining our culture, managing performance and employee engagement. Our top 100 leaders and employee groups will continue to play a key role in shaping our 'One QinetiQ' culture. Improving the way in which we enable our people to own and drive their performance continues through our performance and development framework. We are ensuring consistency of approach, based on the 'what' (objectives) and on the 'how' (values and behaviours), as well as emphasis on continuous professional development, through our career pathways as our people are deployed to different business units within the Company.

Engaging our people is vital to our success and the delivery of our strategy. This starts from our first interaction with our future employees through our outreach programmes (see page 35), early careers pipelines, at interview, recruitment, onboarding and throughout people's careers including our Friends of QinetiQ employee partnership programme. We have developed a new approach to onboarding and induction, celebrating this new connection with QinetiQ. We communicate and listen to our people through many channels such as roadshows and monthly business reviews. We introduced the 'Global Portal' intranet platform in FY18, enabling greater digital connectivity across the Group. We value this continuous dialogue and feedback to shape our business focus which enables our people to understand QinetiQ's strategy, performance and priorities and how their contribution forms part of our overall success. We obtain regular feedback through a range of channels, including engagement surveys. At the end of FY18 we had a 72% response rate to the engagement survey and a score of 592 which is slightly lower than last year (596). At both local and organisational levels we are developing action plans with our people to improve engagement. We will introduce a new digital engagement tool in FY19 which will capture real time feedback more regularly throughout the year so that we can understand the impact of decisions made and actions taken in the moment. The UK Employee Engagement Group (EEG) is an independent consultative forum which acts as an employee voice. This year the EEG have been instrumental in developing our Rewarding for Performance framework and ensuring effective and fair implementation of organisational change. During FY18 there was engagement



QinetiQ Early Careers Live!
Over two days we challenged 130 apprentices and graduates with a range of creative exercises culminating in presenting to a key customer. The event provided an innovative and challenging environment and the level of stretch that our early careers population are demanding in a career with us and what we need from them.

Early careers

	FY18	FY17	FY16
Apprentices ¹	129	146	150
Graduates	109	106	135
Sponsored students	11	10	25
% UK workforce	4.8%	4.9%	5.7%

¹ This number does not include the 21 apprentices who are not part of the early careers community, 14 of whom are undertaking the Systems Engineering Masters Apprentices Programme.



Gender diversity

	Female	Male
Board Directors ¹	2 (22%)	7 (78%)
Senior Managers ²	44 (15%)	248 (85%)
All Employees ³	1,207 (21%)	4,564 (79%)

¹ For more information on Board diversity see page 59.

² Excluding senior managers who are also Board Directors (CEO and CFO).

³ Excluding senior managers.

between the Chair of the Remuneration Committee and the EEG Chair to ensure the Board are informed about employee views.

Creating a diverse and inclusive environment for innovation

We believe that creating diverse teams and an inclusive environment is fundamental to creating an innovative, collaborative and high-performing international company. In FY18, we revitalised our Equality, Diversity and Inclusion (ED&I) programme with a focus on training and we have worked with key groups (such as resourcing and project managers) to raise awareness of unconscious bias. We have reviewed and improved key policies and we continue to focus on attracting women into STEM careers (see page 35). In FY19 we will be building cultural awareness within regions to support our international growth agenda and expanding our training in ED&I. Our commitment to mentoring, 'fair treatment advisors' and progressive initiatives such as increased parental leave in Australia ensure that diversity of people and thought is central to our strategies. We continue to monitor our gender balance at senior leadership across the Group and the breakdown of employees by gender as at the end of March 2018 is shown in the table. We published our Gender Pay Gap in FY18 and the full report can be found on our website. Gender pay is entirely different to equal pay, as it does not show differences in rates of pay for comparable jobs. When we look at the salaries we pay men and women, the difference in mean and median pay is due primarily to our employee profile; more men being in senior, higher paid roles. Our mean gender pay gap at April 2017 was 17%. We are committed to reducing this gap; and will be focusing on this in our reward and talent processes. However we know gender is just one aspect of diversity and our programme goal is inclusion for all. For example through participation in the Social Mobility Index, Movement to Work (see page 35) and our membership of The 5% Club.

Rewarding and recognising our people

Creating transparency of our reward offering was delivered this year by total reward statements for all employees. FY19 will see the introduction of an all employee incentive scheme as the central part of our Rewarding for Performance framework, which recognises sustained contribution and performance. In July 2017, we held a gala dinner bringing together people across the Company to recognise and celebrate their exceptional achievements. There were individual and team awards that recognised the performance, values, capabilities and qualities shown by our people, that are central to our future success.

Developing our people

Underpinning our growth are the capabilities of our people; to deliver world-class solutions. Our Academy provides technical, business and leadership development training solutions to ensure our people are able to develop throughout their career. We have invested significantly in our leaders and managers, recognising the role they play and this will continue to be a priority in FY19. By March 2019, 800 managers will have completed the Management Development Programme. We are building a Group wide talent and succession plans for leaders and technical roles to ensure that capability and competencies for growth are specifically addressed within our strategy. These plans will be implemented by the end of FY19. The new Early Careers team was launched in December 2017, with a successful event for graduates and apprentices – QinetiQ Early Careers Live! In addition we are planning our future pipeline needs and exploring Degree Level apprenticeships (Level 6). We are a founding member of The 5% Club, which aims to increase employment and career prospects and equip the UK with the skilled workforce it needs. Members of the campaign commit to publishing the number of employees on apprenticeships, graduate programmes and sponsored students (see table and also page 19).

CORPORATE RESPONSIBILITY

OUR VALUES SUPPORT OUR STRATEGY FOR GROWTH

How we do business, in line with our values of integrity, collaboration and performance, underpins our business strategy and ensures we maintain trust with our stakeholders

Business ethics – doing business the right way

We strive to create an environment in which people feel able to 'speak up' and so we provide a number of routes for employees to seek help or raise concerns. Our people are encouraged to talk to a manager, use our ethics email advice service and our independently-run 24/7 confidential reporting line. We have provided prompt help and advice in response to all queries received via our ethics email services and all communication through the confidential reporting line is appropriately investigated. We provide advice and guidance on our ethical standards for employees via our Code of Conduct and our annual business ethics training, which is required for all employees, managers, leaders and our Board. We have introduced a new Supplier Code of Conduct, which clearly articulates our expectations. Our Ethics programme is overseen by our Business Ethics Committee, chaired by our Chief Ethics Officer (the Company Secretary and Group General Counsel). We are active participants in the ethics forum hosted by our trade association ADS, where members can share best practice on ethics, human rights and anti-bribery.

Anti-bribery and corruption

In line with our zero-tolerance approach to bribery and corruption we have robust anti-bribery policy and procedures in place, overseen by our Chief Ethics Officer, which are regularly reviewed against changing regulations and industry guidance. Anti-bribery risks are assessed in our business relationships and we use both in-house expertise and third party due diligence providers as part of this process. Anti-bribery training forms part of our mandatory business ethics training for all employees, and, additionally, we provide face-to-face training for higher risk roles.

Human rights

We seek to anticipate, prevent and mitigate potential negative human rights impacts through our policy and processes, which underpin our commitment to responsible business practices. For example, we address salient human rights issues through our Code of Conduct, trading policy, international business risk management process and export controls process. We monitor the application of these policies and procedures through our business assurance processes. We believe that this integrated approach is effective. As part of our ongoing programme to address modern slavery, we continue to provide training, and review our approach to risk in the supply chain and our new supplier code of conduct will help ensure clarity of requirements on human rights. Our modern slavery and human trafficking statement is published on our website.

Environmental stewardship and use of resources

As part of the overall Health, Safety and Environment Strategy we are working together to deliver for our customers while protecting and sustaining our environment. By engaging with others, including our customers, we will continue to embed our commitment to stewardship across our Company. Underpinning our approach is our ISO 14001 certification and in the UK we completed our transition to the new standard in June 2017. Our Environmental Working Group meets quarterly to discuss progress on waste management, energy use, conservation and any environmental incidents. We have recently reviewed our Integrated Rural Management Plans on four key sites which we manage on behalf of the MOD, to ensure that we are able to manage complex trials on sites which have conservation designations. We share progress with employees using our Global Portal, for example during 'Environment Week' in 2017. We continue to be active members of the MOD-Industry Sustainable Procurement Working Group, ensuring we are actively contributing to the sustainability agenda.



Adding diversity to Dorset's heathland

We have been participating in 'Back from the Brink', a Heritage Lottery Funded Conservation project, aiming to save 20 species from extinction. The Site of Special Scientific Interest (SSSI) at our Hurn site (used as a vehicle test track) is benefitting from mowing, scrub clearance and scrapes, to reverse the process of invading grass, scrub and bracken, as well as expanding habitat for species requiring open ground.

Greenhouse gas emissions and energy management

Building upon last year's success of achieving certification against ISO 50001 for our Energy Management System, the Energy Matters programme continues to deliver value across the Company. We have transitioned to a flexible procurement strategy to ensure the UK business obtains the greatest value from its electricity and gas procurement. We meet regulatory reporting requirements under the Carbon Reduction Commitment Energy Efficiency Scheme in the UK, and our greenhouse emissions are voluntarily reported under the Carbon Disclosure Project Climate Change Programme.

Our Scope 1 and Scope 2 emissions have been externally verified by an independent third party, against the ISO 14064-3 standard. The verification statement can be found on our website. The FY18 Scope 1 and 2 GHG emissions have reduced by 4% (2,126 tCO₂e) against the FY17 reported emissions, resulting in a 24% (15,632 tCO₂e) reduction to date against the FY14 baseline year (our first year of GHG reporting for the Group). Our emissions intensity ratio has also improved. Emissions arising from the use of electricity continue to account for the largest portion of our footprint (48%), with jet fuel (14%), natural gas (12%), and gas oil (5%) making up the majority of the remainder. This year we recorded a significant contribution to reported emissions from refrigerants (6%) which we believe is attributable to improved data collection and reporting processes as opposed to an increase in demand for refrigerant use.

Our target of a 17% reduction in GHG emissions by 2020 from a FY14 baseline has been surpassed having achieved a 24% reduction in FY18. In FY19 we will launch a new Energy Strategy which will include a new corporate target that will be established in accordance with the science-based targets methodology. Throughout FY19 our focus will be on cascading the new corporate target into site-specific targets, underpinned by improved internal performance reports and a renewal of the Energy Management Action Plans as part of the new Energy Strategy to ensure sites have a roadmap to achieve their targets.

The Task Force on Climate-related Financial Disclosures is a global initiative which has created a framework for companies to better articulate the potential impact of climate change on their business. Since 2017, we have undertaken climate change risk assessments on three sites which we manage on behalf of the MOD, to understand what the key issues might be and we are planning further assessments in FY19. The key findings of the assessments have helped us to ensure we understand any vulnerabilities to climate change and can prioritise mitigation.

Community investment

Our STEM (Science, Technology, Engineering and Maths) outreach programme recognises the value of inspiring the next generation of scientists and engineers and contributing to current and future skills shortages in these disciplines. There is clear evidence that giving young people the opportunity to engage with business has a positive impact on their future employability and our employee volunteering programme contributes towards this goal. Our people use their professional skills to make a positive difference and our approach is to grow sustainable long-term relationships with local schools and youth groups such as cadets, near to our sites. This year our volunteers engaged with over 90 schools and approximately 6,700 young people in the UK, through activities such as inspirational STEM projects with our STEM Ambassadors, visits to our sites, mentoring, support with extra-curricular STEM and coding clubs, and careers fairs. We have also engaged with young people at events such as The Skills Show with its focus on apprenticeships.

In addition to our engagement with cadet groups we supported over 140 armed forces 'wounded, injured and sick' leavers with their employability skills, working with the Career Transition Partnership as part of our commitment to the UK Armed Forces Corporate Covenant. We recognise that STEM subjects have traditionally been seen as male dominated and so as part of our ED&I strategy we continue to focus on attracting girls into STEM careers. We support International Women in Engineering Day and in 2017, we undertook a range of events. We engaged with 170 girls from 20 different schools and published blogs and videos featuring our female engineers from across the world, telling their stories. We also undertook other outreach activities focused on girls through the year (see case study). In FY19, we will enter the Social Mobility Employer Index for the first time, and we will welcome our first Movement to Work cohort in the UK, a programme which includes work placements for young people aged 16-24 who are not in employment, education or training (NEETs).

We introduced new corporate charities, nominated by our employees, in April 2017, with an emphasis on mental and physical health, and also rolled out a new programme of local charity partnerships at over 20 of our UK sites, to recognise locally important issues. In Australia, our people completed a 96 km trek, the Legacy Australia Kokoda Challenge, raising over A\$100,000 for Legacy, and they have offered in-kind project management and engineering services for the Australian War Memorial.

Greenhouse gas emissions

	FY18	FY17	FY16
Total Scope 1¹	24,651	21,245	23,691
Total Scope 2²	25,678	31,210	36,857
Total Scope 1 and 2³	50,329	52,455	60,548
Intensity ratio⁴	60	67	80

- ¹ Emissions (tCO₂e) from fuel combustion and operation of facilities
² Emissions (tCO₂e) from purchased electricity
³ Emissions (tCO₂e)
⁴ (tCO₂e per £m of revenue)

Our Group greenhouse gas (GHG) emissions are captured to meet the requirements of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. The table above provides a summary of the Group's GHG emissions from 1 April 2016 to 31 March 2018. We have adopted a financial control approach and have used the latest emissions factors from the UK Government and the International Energy Authority.



STEM outreach

In Australia our engineers hosted an industry visit for 120 Year 11 and 12 students attending the University of New South Wales Women in Engineering Camp. The camp gives young women who are interested in engineering the opportunity to spend a week learning about the exciting possibilities that a career in engineering has to offer. The students visited our Mine Warfare Maintenance Facility at HMAS Waterhen in Sydney and met with our engineers and technicians, including female role models, who shared their experiences and real world applications in electronics design and testing and safety relating to the use of explosive ordnance.



Where to find more information

For more on community investment, our Modern slavery statement and our greenhouse gas verification statement go to: www.QinetiQ.com/about-us/corporate-responsibility

CHIEF FINANCIAL OFFICER'S REVIEW

GOOD REVENUE VISIBILITY AND A STRONG BALANCE SHEET



David Smith
Chief Financial Officer

Financial highlights

- 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

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.

Orders bridge:

	£ million	
2017 Orders [†]	675.3	
FY17 NCSISS order	(109.0)	
FY17 Strategic Enterprise orders	(55.3)	
EMEA Services other performance	(12.7)	
Global Products other performance	56.3	
Acquisitions	32.0	
Foreign exchange	0.6	
2018 Orders [†]	587.2	

[†] Excludes the LTPA contract amendments.

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.

* Definitions of the Group's 'alternative performance measures' can be found in the glossary on page 139.

Total backlog

£2.0bn

2017: £2.2bn

Organic revenue growth

3%

2017: 1%

(£m)	Statutory results		Underlying* results	
	2018	2017	2018	2017
Revenue	833.0	783.1	833.0	783.1
Operating profit	141.0	132.7	122.5	116.3
Profit after tax	138.1	123.3	109.0	103.8
(p)				
Earnings per share	24.4	21.5	19.3	18.1
Full year dividend per share	6.3	6.0	6.3	6.0

(£m)	Underlying* results	
	2018	2017
Total orders ¹	687.4	1,676.7
Orders excluding LTPA amendments ²	587.2	675.3
Net cash inflow from operations	126.5	111.9
Cash conversion ratio	103%	96%
Free cash flow	56.3	76.4
Net cash	266.8	221.9

¹ FY18 includes value associated with work to be performed under the interim LTPA arrangement for 12 months beginning 1 April 2018

² Includes share of joint ventures

Revenue bridge:

	£ million
2017 Revenue	783.1
EMEA Services – organic	26.7
Global Products – organic	(6.4)
Acquisitions	30.7
Foreign exchange	(1.1)
2018 Revenue	833.0

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.

Underlying operating profit* bridge:

	£ million
2017 Underlying operating profit*	116.3
FY17 non-recurring trading items	(7.4)
EMEA Services – organic	(3.4)
Global Products – organic	2.7
FY18 non-recurring trading items	8.7
Acquisitions	6.6
Foreign exchange	(1.0)
2018 Underlying operating profit*	122.5

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*.

* Definitions of the Group's 'alternative performance measures' can be found in the glossary on page 139.

CHIEF FINANCIAL OFFICER'S REVIEW CONTINUED

"

We enter FY19 well positioned and with the resources to continue to invest."

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 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 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 and net cash

	31 March 2018	31 March 2017
Net cash flow from operations*	£126.5m	£111.9m
Cash conversion (pre-capex)	103%	96%
Free cash flow*	£56.3m	£76.4m
Net cash* (note 24)	£266.8m	£221.9m

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).

* Definitions of the Group's 'alternative performance measures' can be found in the glossary on page 139.

Total profit for the year

£138.1m

2017: £123.3m

Cash conversion (pre-capex)

103%

2017: 96%

Net cash

£266.8m

2017: £221.9m

Dividend

6.3p

2017: 6.0p

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
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) benefitting 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 its full year dividend at its 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 IAS 19 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 30, on page 125.

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



Test and evaluation enabling our customers to enhance their capabilities

As part of our crucial role in the Eurofighter Typhoon enhancement programme, we demonstrated the nature of our critical work to support UK defence capability.

Working in partnership with the MOD and MBDA, and using our facilities at MOD Aberporth, we provided the capability assurance required to ensure that the Brimstone 2 missile system can be effectively integrated onto Typhoon. In our role as independent technical evaluator we helped expand the overall capabilities of the Typhoon aircraft, allowing for the timely retirement of Tornado

Employees from across multiple QinetiQ sites worked together to ensure that safe and effective Typhoon capability will be delivered to the 'Front Line' on time and on budget.

Our work throughout the life of the project included Integrated Test Evaluation and Acceptance planning, the collection of valuable test evidence from trials, the independent technical evaluation of industry safety artefacts and support to the RAF's operational evaluation trials.

These tests are critical to ensure the Typhoon remains at the cutting edge of combat capability.



Photo credit, top left image:
Geoffrey Lee, Planefocus Ltd

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CORPORATE GOVERNANCE STATEMENT

AN INTRODUCTION FROM OUR CHAIRMAN



Mark Elliott
Non-executive
Chairman

Dear Shareholder,

This report focuses on how the Board has carried out its functions, its oversight of strategy and management activity, how it has applied good governance practices and how QinetiQ has complied with the requirements of the UK Corporate Governance Code, related regulations and guidance.

During the year under review, QinetiQ has progressed with delivery against the objectives of its vision-based strategy under the leadership of the Executive Committee. The Board has continued to enhance, as well as provide necessary challenge to, the development and implementation of the strategy, in particular through the annual strategy meeting in October.

During the year, the Company has focused on the modernisation of the UK Defence Test and Evaluation enterprise, growing its international business and innovation. Further details can be found on page 45 in relation to the Board decision-making around these topics.

As part of the process of implementing the strategy, the Board regularly reviews its own composition and size, to ensure it has the right balance of talent, skills and experience to support the Company's strategy. We believe that equality, diversity and inclusion are fundamental for our strategy to be successful. To achieve an optimal culture within the Group, and decision-making which is informed by a range of expertise, experience and cultural perspectives, we are striving for our workforce to be diverse in gender, background, age and ethnicity. Further details on the Board Diversity Policy can be found on page 59.

The Non-executive Directors continue to bring independent judgement on key issues affecting the Group, and the Board intends to continue to provide a solid foundation of robust corporate governance to underpin the work of the executive management team as QinetiQ proceeds with its strategic campaigns.

Mark Elliott
Non-executive Chairman
24 May 2018

“

The Board has continued to enhance, as well as provide necessary challenge to, the development and implementation of the strategy.”

CORPORATE GOVERNANCE STATEMENT

COMPLIANCE STATEMENT



Throughout the year of reporting QinetiQ has been compliant with the relevant provisions of the Financial Reporting Council's (FRC) UK Corporate Governance Code (the Code) as currently in effect. The Code and associated guidance are publicly available on the Corporate Governance page of the FRC's website, www.frc.org.uk.

The main principles of the Code focus on Leadership, Effectiveness, Accountability, Remuneration and Relations with shareholders. This statement provides an overview of how the Board has applied the main principles of the Code during the year of reporting.

A. Leadership

A.1 The Role of the Board

The Board of Directors represents the interests of QinetiQ and its shareholders. The Board has ensured that there is a framework of prudent and effective controls which enable risk to be assessed and managed, along with key policies and procedures and for the business to implement strategy and monitor operational performance through the Board's direction and advice.

Details of the Board and Committee membership and Directors' attendance at Board and Committee meetings are set out on pages 46 and 47.

A.2 Division of Responsibilities

The roles of the Chairman and Chief Executive Officer are separate, clearly established, set out in writing and agreed by the Board.

A.3 The Chairman

The Chairman, working with the Company Secretary, sets the agenda for the Board meetings and encourages an open and constructive debate. On appointment as Chairman in March 2010, Mark Elliott met the independence criteria as set out in the Code.

A.4 The Non-executive Directors

Non-executive Directors are appointed for a term of three years, subject to annual re-election in accordance with the Code. The Board undertakes an annual review of the independence of the Non-executive Directors.

The Non-executive Directors bring independent judgement on key issues affecting the Group and its business operations, including strategy, performance, resources and standards of conduct. They provide constructive challenge to management and help develop proposals on strategy. Their independence of character and integrity, together with the experience and skills that they bring to their duties, prevent any individual or small group from dominating the decision-making of the Board as a whole.

B. Effectiveness

B.1 Composition of the Board

The Board considers that, throughout the year, at least half of the Board, excluding the Chairman, comprised independent Non-executive Directors and that the composition of the Board had the requisite balance of skills, experience, challenge and judgement appropriate for the requirements of the business and

full Board effectiveness. The skills and experience of the Board's individual members, particularly in the areas of UK defence and security, the commercialisation of innovative technologies, corporate finance and governance, international markets and risk management, have brought both support and challenge to the Chief Executive Officer, Chief Financial Officer and management team during the year. Full biographical details of all the Directors appear on pages 48 and 49.

The Board has delegated responsibility for certain matters to four principal committees, namely the Audit, Nominations, Remuneration and Risk & CSR Committees. There is also a Security Committee and a Disclosure Committee. Details of the work of the Committees are set out on pages 55 to 77.

B.2 Board Appointments

The Nominations Committee oversees appointments to the Board. Further details of the role of the Nominations Committee and its activities during the year can be found on page 59.

B.3 Time Commitment

Each Non-executive Director must be able to devote sufficient time to their role as a member of the Board in order to discharge his or her responsibilities effectively. Prior to undertaking an additional external role or appointment, the Directors are asked to confirm that they will continue to have sufficient time to fulfil their commitments to the Company.

The Chairman is conscious that some shareholders have concerns regarding Directors taking on too many non-executive roles. Consequently, he has assessed the ability to meet the time commitments required by QinetiQ for those members of the Board who hold more than one other Board position, and he is satisfied that all Board members are able to meet the Company's time commitments going forward. In addition to their work on the QinetiQ Board and its Committees, the members of the Board also regularly make themselves available for Board calls, sub-committee meetings and executive leadership events.

B.4 Director Training and Development

Further details about a new Director's induction process and the Directors' ongoing training can be found on page 46.

B.5 Information and Support

The Chairman, working in conjunction with the Company Secretary, ensures that the Board receives accurate, timely and clear information. Board papers are made available electronically allowing sufficient time for review prior to each meeting.

All Directors have access to the advice of the Company Secretary. The Board has established a procedure whereby Directors may take independent professional advice at the Company's expense where they judge it necessary to do so in order to discharge their responsibilities as Directors.

B.6 Evaluation

The details of this year's Board evaluation, which was carried out internally, and an update on the recommendations from the 2017 evaluation can be found on page 50. The most recent external review was conducted by Oliver Ziehn of Lintstock in 2016. Oliver has no other connection with the Company. The next external review is scheduled for 2019.

CORPORATE GOVERNANCE STATEMENT

COMPLIANCE STATEMENT CONTINUED

B.7 Re-election

The Company requires each serving member of the Board to be put forward for election or re-election at each General Meeting.

C. Accountability

C.1 Financial and Business Reporting

A summary of the statements of Directors' responsibilities in respect of the Annual Report and the financial statements is set out on page 80. The going concern statement and viability statement are included on pages 54 and 27 respectively, and details of the process for ensuring that the Annual Report is fair, balanced and understandable are set out on page 56.

C.2 Risk Management and Internal Control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness in safeguarding shareholders' interests and the Company's assets. The risk management process and the system of internal control necessary to manage risks are assessed and monitored by the Audit Committee (financial risks) and the Risk & CSR Committee (non-financial risks). The report of the Audit Committee can be found on pages 55 to 58 and the report of the Risk & CSR Committee can be found on pages 60 to 61.

Details of risk management and internal control processes can be found on pages 52 to 54. The Strategic report, which can be found on pages 23 to 27, contains details of the Company's principal risks and uncertainties, their impact on the Company and how they are managed.

C.3 Audit Committee and Auditors

The Board has established an Audit Committee comprising at least three independent Non-executive Directors. The Committee's formal terms of reference can be found on the corporate governance section at the Company's website: <https://www.QinetiQ.com/en-gb/about-us/corporate-governance/terms-of-reference-for-the-audit-committee>.

A full report from the Audit Committee is set out on pages 55 to 58.

D. Remuneration

D.1 The level of components of remuneration

The Board has established a Remuneration Committee with formal terms of reference. The report of the Remuneration Committee appears on pages 62 to 63. The terms of reference can be found on the corporate governance section of the Company's website at <https://www.QinetiQ.com/en-gb/about-us/corporate-governance/terms-of-reference-for-the-remuneration-committee>.

D.2 Procedure

The Remuneration Committee is responsible for developing policy on Executive remuneration and fixing remuneration packages of Directors. Further details are set out on pages 62 to 77. The Committee also recommends and monitors the level and structure of remuneration for senior management.

The Committee's formal terms of reference can be found on the corporate governance section on the Company's website.

E. Relations with Shareholders

E.1 Dialogue with Shareholders

The Board fully supports the principles of the Code and also welcomes and acknowledges the Stewardship Code, both of which aim to foster a more proactive governance role by major shareholders. In addition, the Board also welcomes the joint guidance issued by the Institute of the Chartered Secretaries and Administrators (the ICSA) and the Investment Association (the IA) on the Stakeholder Voice in Board Decision Making.

The Company attaches significant importance to maintaining an effective engagement with shareholders to ensure a mutual understanding of objectives and to deal with issues of concern. Responsibility for communications with shareholders rests with the Executive Directors, assisted by the Group Director, Investor Relations and Communications. The Company Secretary oversees the communications with private individual shareholders. See page 51 for further details on the Board's engagement with shareholders.

An analysis of the shareholder register, by type of holder and by size of holding, can be found on page 79.

E.2 Constructive Use of the Annual General Meeting

The Board encourages all shareholders to participate in the Annual General Meeting (AGM) and to ask questions. All Directors attend the AGM, including the Committee Chairs, and are available to answer any questions on the work of the Committees.

The 2018 AGM is scheduled to be held on 25 July. The Notice of AGM and related papers will, unless otherwise noted, be sent to shareholders at least 20 working days before the meeting. For those shareholders who have elected to receive communications electronically, notice is given of the availability of the documents in the 'Investors' section of the Group's website. See page 80 for further information.

Operation of the Board

The Board has seven face-to-face meetings planned throughout the year, which are specified in an annual calendar of meetings, and operates through a comprehensive set of governance activities, which are considered by the Board and its Committees during the annual business cycle. In addition, when necessary, the Board conducts meetings via telephone between scheduled meetings, and the members of the Board are regularly communicating to progress the Group's business as required.

The Board has adopted procedures relating to the conduct of its business including the timely provision of information, and the Company Secretary is responsible for ensuring that these are observed.

The Chairman meets with the Non-executive Directors, without executives present, after each Board meeting. The Non-executive Directors, led by the Senior Independent Director meets with the Directors at least once a year without the Chairman being present, to evaluate the Chairman's performance during the year, taking into account the views of the Executive Directors.

Board and Committee meetings are generally held in London and spread over a two-day period, to allow sufficient time for the Board to deal with the various items of business. Whenever possible, the Board visits different business units and in March 2018 the Board held a two-day meeting at the Company's main facilities in Farnborough, UK.

KEY ISSUES CONSIDERED BY THE BOARD DURING THE YEAR

1. Group Strategy – the implementation phase

The Board continued to focus on matters of strategic and operational importance during the year, with regular strategy updates and discussions. In addition, the Board devotes one meeting a year to review the Group's strategy as a whole. At the March Board meeting, the Group Director, Strategy and Planning, presented the FY19 component of our five-year Integrated Strategic Business Plan. The plan incorporated feedback from the strategy meeting held earlier in the financial year.

The following items of the Group's strategy were noted in particular by the Board during the year:

- **Focus on modernisation of the UK Defence Test and Evaluation enterprise**
The CEO has provided the Board with regular briefings in connection with the modernisation of the UK Defence and Test Evaluation (T&E) enterprise, as this is a key element of the Company's T&E strategy. The Board and the Executive Committee will continue to focus on the T&E strategy in FY19
- **Focus on international business**
Items in connection with the Company's international expansion were included on the agenda throughout the year and will be one of the deep-dive items for the Board in FY19. In addition, the Group's international strategy was discussed in detail at the annual Board strategy meeting
- **Focus on innovation**
Innovation continues to be part of the Company's strategy, and included in the CEO's updates to the Board on strategy implementation. It was also discussed at the annual Board strategy meeting
- **Transformation programme**
The Board has had full oversight over the transformation programme during the year, discussing the conclusion of the programme and its replacement with a continuous improvement programme for FY19.

2. People Strategy and Culture

The Group HR Director has provided the Board with updates on people strategy and people culture. In FY19, the Board will continue to work with the CEO and Group HR Director to focus on a strategy to engage and retain talent that delivers exceptional operational performance and growth for both the business and its people.

3. Corporate Governance

The Board receives regular updates from the Company Secretary on legislation and proposed consultations which may affect the Company's legal and regulatory obligations, including proposals to reform corporate governance. It ensured that governance structures remained appropriate, or where necessary, updated, to reflect the business and global market in which QinetiQ operates.

CORPORATE GOVERNANCE STATEMENT



The induction that I received when joining QinetiQ enabled me to quickly gain a deep understanding of the Company, its key businesses and facilities, the work of the Board and the challenges ahead of me."

David Smith, Group CFO

Matters reserved to the Board

The Board has a clearly articulated set of reserved matters. Following the strategic review two years ago, the Board has reviewed and updated the schedule of matters reserved and limitations of authority to ensure they remain appropriate. The matters reserved can be found in full at <https://www.QinetiQ.com/en-gb/about-us/corporate-governance>.

Director development and training

New Directors receive a comprehensive induction on joining the Board, which is tailored to their experience and background. During the year David Smith, who was appointed as CFO in March 2017, has continued his induction process, with, among others, visits to Pendine, Aberporth, Boscombe Down and Haslar sites in the UK.

The Company Secretary organises site visits and training to suit Directors' individual requirements. This year Non-executive Director visits included the Malvern site in England and the British Underwater Test & Evaluation Centre in Scotland. The Company Secretary briefings to the Board on corporate governance matters, noted in particular the fundamental review of the FRC's Corporate Governance Code, the updated guidance on Board diversity and the new rules under the General Data Protection Regulation.

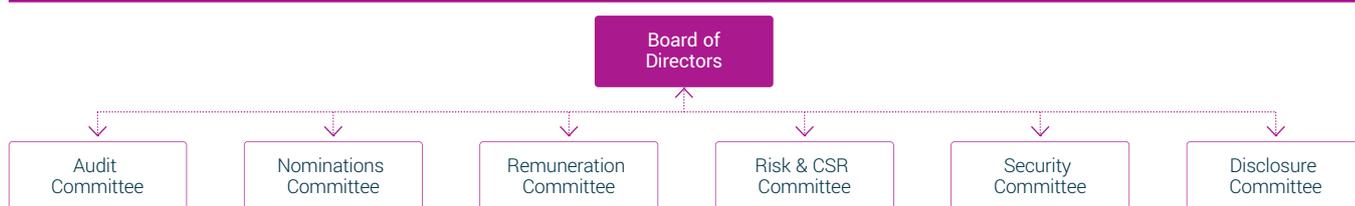
All Directors are expected to commit and take responsibility for their own development during their tenure. During the year of reporting, individual Non-executive Directors attended various seminars and workshops covering matters such as cyber risks, diversity, remuneration trends and strategy development. In addition, the Directors are required to complete the annual business ethics training, as noted on page 34.

The Board and its Committees

Details of attendance at meetings of the Board and its Committees: 1 April 2017 to 31 March 2018

Members	Board	Audit Committee	Nominations Committee	Remuneration Committee	Risk & CSR Committee
Mark Elliott	7/7	–	3/3	5/5	4/4
Steve Wadey	7/7	–	3/3	–	4/4
David Smith	7/7	–	–	–	–
Lynn Brubaker	7/7	4/4	3/3	5/5	4/4
Admiral Sir James Burnell-Nugent	7/7	4/4	3/3	5/5	4/4
Michael Harper	7/7	4/4	3/3	5/5	4/4
Ian Mason	7/7	4/4	3/3	5/5	4/4
Paul Murray	7/7	4/4	3/3	5/5	4/4
Susan Searle	7/7	4/4	3/3	5/5	4/4

Board and Committee structure



QinetiQ operates by way of six principal Board Committees and the Executive Committee, with all Non-executive Directors being members of all the Board Committees, except for the Security Committee and others where prohibited by the Code, statutory or Security Committee requirements. Key issues discussed and decisions taken at Committee meetings are circulated to all members of the Board after each Committee meeting. The Committees operate within written terms of reference approved by the Board, which can be viewed in full at <https://www.QinetiQ.com/en-gb/about-us/corporate-governance>.

The Disclosure Committee was established in 2016 following the requirements of the Market Abuse Regulations (MAR). The Committee comprises all Board members, except for when called at short notice, when it comprises the Chairman, the CEO, the CFO and any one of the Non-executive Directors who chair the Audit Committee, Remuneration Committee or Risk & CSR Committee.

Reports of the Audit Committee, Nominations Committee and Risk & CSR Committee are set out in this report as noted in the index on page 1. The relevant Code disclosures in respect of the Remuneration Committee are set out in the Directors' Remuneration Report on pages 62 to 77.

The Executive Committee

The interaction between the Board and the Executive Committee enables the Board to receive information first-hand about the Company and its operations and to give guidance on strategy and oversight of the business direct to senior management. The Executive Committee comprises the CEO, CFO, the Company Secretary and Group General Counsel, the Managing Directors of the business groups and the functional Directors. Executive Committee members and members of the senior management team present to the Board and its Committees on key matters. The full list of the members can be found at www.QinetiQ.com/about-us/corporate-governance.

The Executive Committee meets on a two-weekly basis. Its focus is on the achievement of the Group's strategic goals in respect of growth and operational excellence, with an ongoing consideration of governance issues. The Committee is responsible for the day-to-day management of the Group's activities, with the exception of QinetiQ North America (which is managed through a Proxy Board), and the oversight of the risk management process and its implementation by the businesses and the functions.

BOARD OF DIRECTORS

THE BOARD REPRESENTS THE INTERESTS OF QINETIQ AND ITS SHAREHOLDERS

Committee membership key

A Audit **N** Nominations **R** Remuneration **RC** Risk & CSR
S Security **■** Committee Chairman



Mark Elliott, Non-executive Chairman
 Appointed Non-executive Chairman in March 2010; Non-executive Director between June 2009 and February 2010.

N R RC

Board contribution: In addition to his long business experience, Mark brings to the Board 15 years of experience from board positions on FTSE listed companies. Mark's extensive international Board and management experience is essential to his work as the Chairman of the Board of QinetiQ, where he is responsible for leading the Board and ensuring that it operates effectively in order to promote the long-term success of the Company.

Skills and experience: Mark was a Non-executive Director of G4S plc, where he was also appointed the Senior Independent Director and Chairman of the Remuneration Committee. He was a Non-executive Director of Reed Elsevier NV, and Reed Elsevier Group plc, where he also became Chairman of the Remuneration Committee. Mark worked for IBM for over 30 years, occupying a number of senior management positions, including General Manager of IBM EMEA, and a member of IBM's worldwide Management Council.

Other appointments: Mark is Chairman of Kodak Alaris Holdings Limited.



Admiral Sir James Burnell-Nugent, Non-executive Director
 Appointed Non-executive Director in April 2010.

A N R RC S

Board contribution: Sir James brings to the Board unique experience from the defence industry, and of contracting with government departments. As a result of his experience he serves as Chair of the Risk & CSR Committee and of the Security Committee.

Skills and experience: During a 37 year career in the Royal Navy, which culminated in his appointment as Commander-in-Chief Fleet, he commanded the aircraft carrier HMS Invincible and three other ships and submarines. Between operational duties, Sir James held several positions at the MOD and gained cross-Whitehall experience while on secondment to HM Treasury.

Other appointments: Non-executive Chairman of Witt Limited.



Steve Wadey, Chief Executive Officer
 Appointed Chief Executive Officer in April 2015.

N RC S

Board contribution: Steve has a proven track record of driving growth, and in-depth experience of the defence and technology industries. He also has extensive operational and corporate experience. Steve is responsible for the Group's executive management, and implementation of the strategy.

Skills and experience: Steve is a Fellow of the Institution of Engineering and Technology, the Royal Aeronautical Society, and the Royal Academy of Engineering. He was previously Co-Chair of the UK Defence Growth Partnership, a member of the Prime Minister's Business Advisory Group, Co-Chair of the National Defence Industries Council Research and Development Group, and a Non-executive Director of the UK MOD Research and Development Board. Steve has held various roles with MBDA, most recently as Managing Director, MBDA UK, and Technical Director for the MBDA Group. Before that, he held various roles with Matra BAe Dynamics and British Aerospace.

Other appointments: Chair of the Defence Industry Liaison Board of the UK Department for International Trade, Defence & Security Organisation.



Ian Mason, Non-executive Director
 Appointed Non-executive Director in June 2014.

A N R RC S

Board contribution: Ian has extensive experience in strategy, business transformation, eCommerce and international business development. His current and previous experience as a CEO and Non-executive Director enable him to provide the Board with highly relevant business and Board experience. His advice has been, and continues to be, particularly valuable for the Board and leadership team in the work of implementing the strategy and effecting the transformation of the Company.

Skills and experience: Previously Ian was Group Chief Executive of Electrocomponents plc. He has also worked for the Boston Consulting Group and served as a Non-executive Director of the Sage Group plc.

Other appointments: Chief Executive Officer of Domestic & General Group.



**David Smith,
Chief Financial Officer**
Appointed Chief
Financial Officer
in March 2017.

RC S

Board contribution: David provides significant expertise to the Group from his extensive executive experience in blue-chip companies and work in the aerospace and defence, technology, and automotive sectors.

Skills and experience: David is an Associate of the Chartered Institute of Management Accountants and a member of its Advisory Panel. David was previously the CFO of Rolls-Royce Holdings plc, having joined as CFO of its Aerospace Division. Prior to that, David was CFO of Edwards Group and CEO of Jaguar Land Rover, having previously been its CFO. He has also held a variety of roles with the Ford Motor Company.

Other appointments: Non-executive Director of Motability Operations Group plc.



**Susan Searle,
Non-executive Director**
Appointed Non-
executive Director
in March 2014.

A N R RC S

Board contribution: Susan brings to the Board extensive experience of investing in growing technology businesses, acquisitions, intellectual property and exploitation of new technologies. Susan's experience from a variety of commercial, business development and operational roles, and from serving on a variety of private company Boards, enables her to provide both challenge and beneficial advice.

Skills and experience: Susan was a founder of Touchstone Innovations plc, leading it as CEO to 2013. She has served on a variety of private company boards in engineering, healthcare and materials. Susan was a Trustee of Fight for Sight, and a member of the international advisory Board of PTT. Previously, she held a variety of commercial and business development roles with Shell Chemicals, the Bank of Nova Scotia, Montech (Australia), and Signet Group plc.

Other appointments: Senior Independent Non-executive Director and Chair of the Remuneration Committee of both Benchmark Holdings plc and Horizon Discovery Group plc. Chair of Woodford Patient Capital Trust plc and Mercia Technologies plc (and Chair of its Nominations Committee).



**Paul Murray,
Non-executive Director**
Appointed Non-
executive Director
in October 2010.

A N R RC S

Board contribution: Paul has a broad range of experience in finance and corporate governance from many industries, all of which leverage technology. Having previously been a Group Finance Director of plc businesses and the current Chair of the Audit & Risk Committee of Royal Mail Group plc, Paul has a deep understanding of governance, accounting, and regulatory issues. Given his financial background at Board level, he serves as the Chair of the Audit Committee.

Skills and experience: Paul has held positions as Director of Knowledge Peers plc, and Independent Oil and Gas plc, Senior Independent Director of Taylor Nelson Sofres plc, and Non-executive Director of Thomson SA and Tangent Communications plc. He has also been Group Finance Director of Carlton Communications plc and LASMO plc, and a Trustee of Pilotlight.

Other appointments: Non-executive Director and Chair of the Audit & Risk Committee at Royal Mail Group plc. Director of Ventive Ltd and Naked Energy Ltd.



**Lynn Brubaker,
Non-executive Director**
Appointed Non-
executive Director
in January 2016.

A N R RC

Board contribution: Lynn's experience from senior Board positions from various US-based businesses, in particular the aerospace sector, makes her a valuable member of the Board to support the Company's strategic goals, management of customer relations, and sales and marketing.

Skills and experience: Lynn has held positions as Non-executive Director of Force Protection, Inc., Seabury Group, Graham Partners, Cordiem, the Flight Safety Foundation (as Chair), and as a member of the Management Advisory Council of the Federal Aviation Administration. Lynn was Vice President and General Manager of Commercial Aerospace at Honeywell International, and prior to that, she held a variety of roles in the commercial aerospace sector working for Allied Signal, the McDonnell Douglas Corporation, Republic Airlines and ComAir Airlines.

Other appointments: Non-executive Director of FARO Technologies Inc., Hexcel Corp., and the Nordam Group.



**Michael Harper,
Deputy Chairman and
Senior Independent
Non-executive Director**
Appointed Non-executive
Director in November
2011. Appointed Deputy
Chairman and Senior
Independent Non-
executive Director
in February 2012.

A N R RC S

Board contribution: Michael has a wealth of operational and corporate experience. Michael's extensive career as a business leader and Board member within, amongst others, engineering and aviation businesses, brings highly valuable insight to the Board and its discussions, and in particular to his role as the Chair of the Remuneration Committee.

Skills and experience: Michael has served as Chairman of Ricardo plc, Vitec Group plc, and BBA Aviation plc, having previously been its CEO. He was Senior Independent Director of Catlin Group Limited. In addition, he was a Director of Williams plc and, at the time of its demerger, he became CEO of Kidde plc.

Other appointments: Michael is a Non-executive Director of the Aerospace Technology Institute.



**Jon Messert,
Company Secretary
and Group General
Counsel**
Appointed as Company
Secretary and Group
General Counsel in
January 2011.

Skills and experience: Jon joined QinetiQ from Chloride Group plc where he held a similar role. He has a background in legal private practice as well as general counsel and company secretarial experience in other FTSE 250 companies.

CORPORATE GOVERNANCE STATEMENT

Board performance evaluation

The Board has a rigorous evaluation process each year to assess how it, its Committees and individuals, including the Chairman, are performing. The 2018 review was conducted internally, following the steps outlined as below:

- Completion by all members of tailored questionnaires which took into account the output from the 2017 performance evaluation process, the current dynamic of the Board and its current priorities
- Report produced summarising the results of the questionnaire and presented to the Chairman
- Report circulated to the Board, with a full discussion on the results and comments, and an action plan was agreed.

Progress against prior year review

The key findings of the prior year review and progress against them were as follows:

Key findings	Action taken
1 Succession planning, and ensuring the appropriate mix on the Board to support implementation of strategic goals over the next 3 – 5 years.	The Nominations Committee has continued to focus on succession planning during FY18 and will continue to do so in FY19. The revised Skills Matrix and the recently updated Board Diversity Policy will be instrumental when ensuring the continued appropriate mix of Directors on the Board.
2 A continued focus on strategy, and its implementation.	Strategy regularly discussed at the Board's meetings, and one meeting a year is devoted entirely to strategy.
3 Monitoring the effectiveness of the executive management team.	The Board receives updates on the activity and progress of the executive management team. In particular the transformation programme has supported the team's improvements in focus and delivery to the Board and the business. The Group HR Director reports on the executive management team's development programme.
4 Board materials – further standardisation of Board paper presentation format.	This activity has been undertaken and is continuing.
5 Appropriate attention to governance matters, while ensuring focus principally on the business operations and strategic development.	The Secretary continuously updates the Board on governance. During the year, the Board focused on the numerous initiatives stemming from the Corporate Governance Reform issued by BEIS in August 2017. Examples of this being the relationship with investors and other stakeholders, and board diversity.
6 Defining, monitoring, and measuring cultural development.	The Group HR Director reported to the Board on defining, monitoring and measuring cultural development, and on the progress made during the year. Ways of measuring progress with the Company's cultural development strategy, interventions, and appropriate actions going forward, were agreed.



The effectiveness of the Board is vital to the success of the Group.”

PRIORITIES FOR THE COMING YEAR:

- 1 Succession planning – focus on skills necessary for implementing the strategy.
- 2 Continuing to raise the bar on operational effectiveness and supporting management's implementation of the strategy. Emphasis on ensuring there is a balance between the achievement of operational performance and growth plans.
- 3 Focusing on a balance between advising, challenging and supporting management. Continued support for management's execution of strategy.
- 4 Leverage the Board's collective experience to help further enhance the strategy.
- 5 People and culture – focus on challenging, supporting and evolving this area.

Relations with shareholders and other stakeholders

The Company places considerable importance on communications with shareholders. The Chairman proactively offers to attend meetings with key shareholders and their corporate governance teams and he met with a number of the Company's major shareholders during the year of reporting.

The Executive Directors have an ongoing dialogue and a programme of meetings with institutional investors, fund managers and analysts. The Board is informed on a regular basis about the views of key shareholders including their concerns.

During the course of the year, the Chairman met with shareholders to discuss corporate governance and Directors' remuneration. Further details of the shareholder engagement regarding the Remuneration Policy, adopted at the 2017 AGM, can be found in the Directors' Remuneration Report and on QinetiQ's website, www.QinetiQ.com/about-us/corporate-governance.

Investor roadshows were held in London and Edinburgh in the UK and Boston in the US. The Board members make themselves available to meet shareholders as required, and routinely attend results presentations. Telephone briefings for analysts and investors took place in conjunction with these presentations, of which live and post-event webcasts of key presentations were provided. All shareholders were invited to attend the Company's AGM on 19 July 2017 in London, at which the full Board was in attendance.

The Company sets itself the target of providing information that is timely, clear and concise.

All shareholders and potential shareholders are encouraged to visit the 'Investors' section on the Company's website, www.QinetiQ.com, where all types of communication with shareholders can be found. The site also provides contact details for any investor-related queries, by telephone and by email.

The Company continues to look at ways of improving the quality of its engagement with shareholders and to explore with investors any additional practical means by which it can communicate effectively with shareholders and other stakeholders. As part of this, the Board welcomes recent initiatives on increased scrutiny on how companies are run and the emphasis on the importance of considering the interests of a broad stakeholder group in making business decisions.

The Board's engagement with the Group's employees is further described in the section on Engaging Our People, which can be found on pages 32 to 33.

Board oversight of risk management

The Board oversees the system of risk management and internal control by means of the Audit Committee and the Risk & CSR Committee in conjunction with the risk management and assurance processes detailed in this section. Matters of particular concern are escalated for presentation at Board meetings. Examples of such escalation are consideration of the risk register, expression of risk, and risk reporting. The Board routinely challenges management to ensure that the systems of internal control are constantly improving, to maintain their effectiveness. The CEO presents to the Board on the system of internal control in operation during the year.

At its meeting in March 2018, the Board reviewed the effectiveness of the system of internal control that was in operation during the year. Details of specific risk review activity undertaken by the Executive Committee, the Audit Committee and the Risk & CSR Committee, together with the current risk registers, were presented by the CEO.

The following activity was noted at that review:

Executive risk review

- Risk owners reviewed and updated their risks prior to review by the Executive Committee
- The Executive Committee formal risk register reviews were conducted at four meetings during the year.

Board Committee risk review

- The Audit Committee reviewed in detail the financial risk register at two meetings during the year
- The Risk & CSR Committee reviewed the non-financial risk register at four meetings during the year, which included deep-dive reviews of specific risks.

As a result of the presentation to the Board, the Board considered that the risk review activity undertaken during the year was effective.

Committee oversight of risk management

The risk management process and the system of internal control necessary to manage risks are managed by the Audit Committee (financial risks) and the Risk & CSR Committee (non-financial risks). The full Board attends these Committee meetings, either as a Committee member or as a guest, so as to receive at first-hand the findings of the Committees. The internal audit function independently reviews the risk identification and control processes implemented by management, and reports to the respective Committee.

The Audit Committee and the Risk & CSR Committee also review the assurance process, ensuring that an appropriate mix of techniques is used to obtain the level of assurance required by the Board. The reports of both Committees can be found on pages 55 to 58 and 60 to 61 respectively.

Risk reporting is embedded in the management of the business through the Executive Committee and monthly Business Performance Reviews and feeds into Group strategy at the executive and Board level.

Internal audit function

The internal audit function, which is independent of the business and has a direct reporting line to the Audit Committee, provides assurance to the Board and its Committees over the effectiveness of the internal control environment. The programme of work undertaken by the internal audit function is approved in advance by the Audit Committee. It is prioritised according to risk, including those risks identified by the Group through its risk management processes. Additionally, regular discussions are held between the internal audit function and the external auditor regarding internal audit reports, risks, internal audit plans and the wider control environment.

Board statements relating to risk management

Board statements relating to the 'fair, balanced and understandable assessment', principal risks, the effectiveness of the risk management and internal control process, and going concern statement, can be found on pages 53 and 54. The longer-term viability assessment can be found in the Strategic report on page 27.

Risk management and assurance activity

– Three lines of defence model

Risk management and assurance activity conforms to the three lines of defence model as detailed on page 52. The first line of defence is performed by the businesses, through managing activities in accordance with established operating principles; the second line of defence is performed by the oversight functions, including the safety and governance team; and the third line of defence is performed by the internal audit team, reporting to the Executive Committee, to the Board's Audit Committee in respect of financial risks, and to the Board's Risk & CSR Committee in respect of non-financial risks.

CORPORATE GOVERNANCE STATEMENT CONTINUED

Three lines of defence model

**Risk assurance activity during the year**

Risk assurance activity was ongoing during the year under review. The following areas were covered by the Executive Committee and key issues were reported to the Risk & CSR Committee:

- Updates in respect of general risk governance from the Group Director, Safety and Governance
- Reviews of business risk registers and moderation to form the Group Risk Register
- Quarterly reports from the internal audit function in respect of the effective management of Group risks and the risk management process
- Review of the risk identification process
- The output from the self-certification process and a review of the effectiveness of internal controls
- Regularly requiring risk owners to report their activity to the Risk & CSR Committee.

Self-certification process

An annual process of hierarchical self-certification on the effectiveness of internal controls, which provides a documented and auditable trail of accountability for the operation of the system of internal control, is in operation. This process is informed by a rigorous and structured self-assessment that addresses compliance with Group policy. It provides for successive assurances to be given at increasingly higher levels of management and, finally, to the Board. The self-certification process is carried out at the full year and the half year.

Risk management and internal control: Financial reporting process

The following elements provide assurance in respect of the financial reporting process and preparation of consolidated accounts:

- The financial management and control framework
- The Company's finance function
- The internal control and risk management systems
- The internal audit function
- The external audit function
- Oversight by the Audit Committee and the Board.

The Company operates a financial management and control framework, comprising a system of targets, reporting (external and internal) and controls, that is embedded throughout the businesses and on which progress is reported to the Audit Committee and to the Board. The finance function consists of different financial reporting teams who report to the CFO. The Group Finance team comprises suitably qualified and experienced professionals, including accountants. It is responsible for the preparation of the half-year and annual reports and for internal financial reporting to senior management and the Board. To ensure a consistency of approach and accuracy in financial reporting, the team provides advice on accounting and financial reporting issues to QinetiQ's businesses and sets the Group's accounting policies which are contained in the Finance Accounting Manual. The team liaises with the external auditor.

The internal control and risk management systems described on pages 51 to 54 apply to the Company's process of financial reporting and the preparation of consolidated accounts. The internal audit and external audit functions, and the reviews by the Audit Committee and the Board, provide a structured approach to the review and challenge of financial information and financial reporting.

Employee reporting and guidance: Confidential reporting process

QinetiQ has in place a confidential reporting process which is detailed on the Company's intranet. If an individual does not feel that they can resolve any concerns with the Company directly, either through discussions with their line manager or directly with the Company Secretary or Group Internal Audit Manager, they can use an externally provided confidential internet and telephone reporting system, as noted in the Corporate responsibility section on page 34. All concerns are passed by the external third party to the Group Internal Audit Manager who ensures that they are held in strict confidence and are properly investigated. Reports on confidential reporting activity and the outcome of investigations are regularly reported to the Audit Committee. The Audit Committee reviewed the effectiveness of the Group's confidential reporting process during the year, as noted on page 57.

Anti-bribery and the prevention of corruption

QinetiQ has internal procedures in place that are designed to ensure compliance with the UK Bribery Act 2010, and other international regulations and best practice relating to the prevention of corruption, which are applicable to its business.

Ethics

The Company provides employees with guidance to assist them in making informed ethical decisions on a day-to-day basis; further details can be found in the Corporate responsibility section on page 34.

Management and control of US subsidiaries

The US Global Products division, trading as QinetiQ North America, which contributed approximately £70m to the Group's revenue in 2018, operates under a Proxy arrangement, as detailed below, with the remainder of the US business operating outside the Proxy regime and therefore following the same reporting lines and processes as the Group's other, non-regulated businesses.

US Global Products division and the Proxy arrangement

QinetiQ North America is managed via Foster-Miller, Inc. (FMI), a wholly-owned subsidiary of QinetiQ in the US. It has been placed under a Proxy arrangement as it is required by the US National Industrial Security Program to maintain facility security clearances and to be insulated from foreign ownership, control or influence. Under the Proxy arrangement, FMI and the US Department of Defence (DoD) are parties to a Proxy agreement that regulates the management and operation of FMI. Pursuant to this Proxy agreement, QinetiQ has appointed three US citizens who hold the requisite US security clearances as Proxy holders to exercise the voting rights in FMI.

In addition to their powers as Directors, the Proxy holders have power under the Proxy arrangements to exercise all prerogatives of share ownership of FMI. The Proxy holders have a fiduciary duty, and agree, to perform their role in the best interests of QinetiQ as shareholder (including the legitimate economic interest), and in a manner consistent with the national security interests of the USA. QinetiQ Group plc does not have any representation on the Board of FMI. QinetiQ Group plc may not remove the Proxy holders other than for acts of gross negligence or wilful misconduct or for breach of the Proxy agreement (and always only with the consent of the US Defence Security Service).

In terms of the power to govern, the Proxy agreement vests certain powers solely with the Proxy holders and certain powers solely with QinetiQ. For example, the Proxy holders cannot carry out any of the below without QinetiQ's express approval:

- Sell or dispose of, in any manner, capital assets or the business of FMI
- Pledge, mortgage or encumber assets of FMI for purposes other than obtaining working capital or funds for capital improvements
- Merge, consolidate, reorganise or dissolve FMI
- File or make any petition under the federal bankruptcy laws or similar law or statute of any state or any foreign country.

Unlike minority interest holders with protective veto rights, QinetiQ can unilaterally require the above to be carried out and these are, therefore, considered to be significant participative features. In addition, QinetiQ can require the payment of dividends, and the pay-down of parent company loans, from FMI.

The Company maintains its involvement in FMI's activities through normal business interaction and liaison with the Chair of the Proxy Board. QinetiQ's CEO and/or CFO attended four meetings of the Proxy Board during the year under review. On occasion, the Proxy holders are invited to attend Board meetings of the Company.

The President of FMI is a member of the Executive Committee. FMI commercial and governance activity is included in the business update provided in the regular executive report to the Board. This activity is subject always to the confines of the Proxy regime to ensure that it meets the requirement that FMI must conduct its business affairs without external control or influence, and the requirements necessary to protect the US national security interest.

Directors' statement in respect of 'fair, balanced and understandable' assessment

All of the Directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy. In this context, the coordination and review of the Group-wide input into the Annual Report is a vital part of the control process upon which the Directors rely and is an exercise which spans a period wider than the timetable for compiling the Annual Report itself. Critically, these processes include the controls the business operates throughout the year to identify key financial and operational issues. Further details can be found in the report of the Audit Committee on page 56.

Board assessment of principal risks

The Board confirms that it has carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. The way in which the Board understands and manages risk is set out on pages 51 to 61 and details of principal risks and their management and mitigation can be found on pages 22 to 27. Board level oversight is carried out by the Audit Committee and the Risk & CSR Committee. At its meeting in March 2018, the CEO presented details of the risk review activities that had taken place during the year.

Board review of the effectiveness of risk management and internal control processes

The Board confirms that it has conducted a review of the effectiveness of the Company's risk management and internal control systems in operation during the year, as required by the Code. The Board considers that the risk review activities undertaken during the year under review, as presented by the CEO at the Board's March meeting, amounted to an effective system being in place to ensure that all aspects of risk management and internal control had been considered for

CORPORATE GOVERNANCE STATEMENT CONTINUED

the year under review. Details of the Company's principal risks and uncertainties and how they are managed and mitigated can be found in the Strategic report on pages 22 to 27. Details of the Company's risk management and internal control systems are set out in this Corporate governance statement on pages 42 to 61, where the reports of the Audit Committee and Risk & CSR Committee in respect of the oversight of risk management can also be found.

Going concern

The Group's activities, combined with the factors that are likely to affect its future development and performance, are set out on pages 20 to 31. The CFO's review on pages 36 to 39 sets out details of the financial position of the Group, the cash flows, committed borrowing facilities, liquidity, and the Group's policies and processes for managing its capital and financial risks. Note 26 on page 115 to the financial statements also provides details of the Group's hedging activities, financial instruments, and its exposure to liquidity and credit risk.

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 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' section on pages 22 to 26.

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 the next 12 months.

REPORT OF THE AUDIT COMMITTEE



Paul Murray
Audit Committee
Chairman



The Committee operates to assure integrity in financial reporting and controls, the effectiveness of its internal audit function, the relationship with the external auditors and that appropriate whistleblowing arrangements are in place.”

Dear Shareholder,

I am pleased to present the report of the Audit Committee on the work carried out during the last financial year. The Committee continues to operate on the basis of an open but challenging dialogue with management and with the internal and external auditors’ and the application of an appropriate level of scrutiny.

The main responsibilities of the Committee are set out in this report. It details the activities, discussions and decisions which enabled the Audit Committee to fulfil its objectives effectively during the year of reporting.

Paul Murray

Audit Committee Chairman

The Audit Committee is chaired by Paul Murray, who continues to have recent and relevant financial experience. The Board considers the members of the Committee to be independent, and in accordance with the Code, the Board concludes that the Committee as a whole possesses competence relevant to the Company’s sector, having a range of financial and commercial experience in the industry and commercial environment in which QinetiQ operates. The CEO, CFO, Group Financial Controller, Group Internal Audit Manager and representatives of PwC attended all Committee meetings during the year. Two meetings were also held with the Committee and PwC, without management being present.

Main responsibilities

The Audit Committee monitors the Group’s integrity in financial reporting and reviews the effectiveness of the financial risk management framework.

The Audit Committee meets as necessary and at least four times a year. During the year of reporting, the Committee met on four occasions.

The Committee met PwC and the Group Internal Audit Manager on two separate occasions during the year, without Executive Directors present, to discuss the audit process and assure itself regarding resourcing, auditor independence and objectivity.

REPORT OF THE AUDIT COMMITTEE CONTINUED

Activities during the year

The Committee has an annual calendar of activities, and in addition it identifies particular areas of which the Committee wishes to focus on.

The significant issues that the Committee considered during the year are set out in the table below:

Areas of focus	Action taken by the Committee
Longer Term Viability Statement	The Committee scrutinised and challenged the principle underpinning the Statement for FY18, and concluded that the Group will be able to continue in operation and meet its liabilities as they become due. The Committee therefore continues to consider it appropriate that the Statement covers a three-year period. The Statement can be found in full on page 27.
Financial reporting	<p>As a standing agenda item, the Committee focused on understanding the reasonableness of provisions and liabilities, both in terms of consistency of policy application for repeating items, and judgements around discrete events and projects. Considering the nature of the business and global market in which QinetiQ operates, comprehensive discussions were held by the Committee throughout the year where the Committee reviewed whether suitable accounting policies had been adopted, and whether management had made the appropriate estimates and judgements. In addition, support and assessment were sought from the external auditor. To facilitate this process, the Committee received presentations from the CFO and the Group Financial Controller and also received a report from the external auditor covering the key risk areas addressed during the audit, and the auditors' view of the key judgements made by management.</p> <p>Specific issues addressed by the Committee for the periods ended 30 September 2017 and 31 March 2018 include the following:</p> <ul style="list-style-type: none"> - The basis for, and judgements made by management in determining, the liabilities recorded for litigation, onerous contracts, potential claims and other disputes - The carrying values of the Group's cash-generating units (CGUs), specifically goodwill associated with the US Global Products CGU which had been impaired in 2016. The major assumptions impacting on the net present value of future expected cash flows were also discussed. Certain discount rate assumptions and market growth forecasts are advised by external consultants - Assumptions used to value the net pension asset of £316.2m (as advised by the Company's external actuaries) - The basis for recognition of US tax losses and judgements in respect of the Group's tax reserves, including R&D expenditure credits - The disclosures in the interim statement, the preliminary announcement and Annual Report and Accounts, in particular those relating to non-recurring items (specifically, the £5.3m relating to the release of engine servicing obligations), risk, goodwill and tax - The implications of the experienced delays and any potential incremental delays to the BEPIColombo Mission to Mercury programme. <p>Based upon the business assurance process and discussions with management and the external auditor, the Committee was satisfied that the accounting disclosures and assumptions were reasonable and appropriate for a business of the Group's size and complexity, that the external auditor had fulfilled its responsibilities in scrutinising the financial statements for any material misstatements and that the disclosures were satisfactory.</p>
Fair, balanced and understandable	The Committee was required to provide advice to the Board on whether the Annual Report and Accounts, taken as a whole, provide a fair, balanced and understandable assessment of the Company's financial position and future prospects and provide all information necessary to a shareholder to assess the Group's performance, business model and strategy. Following the process established and reported on in previous years, and in forming its opinion, the Committee reflected on the information it had received and its discussions throughout the year. The assessment was assisted by an internal verification of the factual content by management, a review at different levels of the Group to ensure consistency and overall balance, and a comprehensive review by the senior management team and the external auditors. Following its review, the Committee was of the opinion that the FY18 Annual Report and Accounts were representative of the year and present a fair, balanced and understandable overview, providing the necessary information for shareholders to assess the Group's position and performance, business model and strategy. The external auditor confirmed their satisfaction with the standard achieved. The Board's statement in this respect can be found on page 27.
IFRS 15	During the year the Committee received reports and discussed the implications of the new key accounting standard, IFRS 15, on revenue recognition. A detailed assessment has been undertaken by management and the impact on the Group's most significant contracts has also been considered by both the retiring auditors (KPMG) and the incoming auditors (PwC). The Committee's review of the work undertaken and the overall impact assessment concluded that the implementation of IFRS 15 does not have a material impact on the Group.

Internal controls

During the year under review, the Committee monitored the effectiveness of the systems of internal control to gain assurance that an effective control framework was maintained. Reports on the effective operation of the control framework were received from management and reviewed by the Committee along with key policies and processes.

As in previous years, particular attention was given to the timely and effective implementation of remedial actions, either identified by the business directly, or by the internal audit function, with updates on improvement actions being scheduled for follow up at a later meeting during the year. The internal auditor reported on four occasions to the Committee on the operation of internal control and risk management processes.

The internal audit function's risk-based strategic and annual plan was presented, and scrutinised twice during the year by the Committee, to provide assurance that resources were adequate and directed towards key risk areas.

The annual plan is structured to ensure that all significant financial and non-financial risks are reviewed within a rolling three-year strategic plan. The audits include the review of financial systems, programmes and projects, as well as the management of specific risks identified through the Group's risk management processes. During the year under review, the internal audit function audited constituent parts of the Group's transformation programme, in line with a programme to support adherence to plans and achievement of outcomes. Other areas of focus during the year were anti-bribery and corruption processes and IT risk and control.

Internal audit activity in the year continued to indicate that, overall, an effective control environment was in place, with an open culture of continuous improvement being demonstrated by regular management requests for internal audits to be undertaken.

The Committee also regularly reviews the effectiveness of the financial risk management framework, including reviewing key financial risks and assessing the effectiveness of management's remedial action plans.

The process in respect of QinetiQ North America is adjusted to take into account the Proxy arrangements referred to on page 53. The executive management function has regular contact with the Chair of the Proxy Board and with US executive management, and the Group's internal controls have been applied as far as possible within the requirements of the Proxy regime.

The internal audit function continues to work closely with US management to gain assurance that an effective control environment is in place. In addition, the Executive Directors attended meetings of the US Board during the year.

The Committee confirms its view that it has received sufficient, reliable and timely information from management in the last financial year to enable it to fulfil its responsibilities.

Audit Committee effectiveness review

The evaluation of the effectiveness of the Committee was conducted alongside the Board effectiveness review, and carried out by way of an externally provided questionnaire-based process.

The following actions had been noted from the 2017 effectiveness review:

- Developing an effective and transparent relationship with the newly appointed CFO
- Ensuring a successful transition to the new Audit Partner, PwC.

These items were covered during the year under review. Details of the risk review can be found in the Report of the Risk & CSR Committee on page 61. The processes for risk management and control of the US business were covered in reports from the internal audit function, and the Committee received updates from the external auditor in respect of financial matters.

The effectiveness of the Committee continued to be rated highly. It was agreed that the Committee should focus on the following areas over the coming year:

- Value gained from PwC's first year as auditors
- Gaining an improved understanding of the control environment at QNA
- Focus on ensuring that the internal audit function continues to have the appropriate resources, processes and systems.

External audit

Policy on the regulation of non-audit work and safeguarding auditor independence

The Company views it as essential that the external auditor is both independent of any conflict of interest and perceived to be so. To safeguard auditor independence and objectivity, the following process is operated by the Company:

The Company has a Code of Practice applicable to all employees which sets out the principles for regulating the award of non-audit work to the external auditor. The Code of Practice clearly articulates the non-audit services which are prohibited, the non-audit services which can be purchased and the key approvals that are necessary prior to the provision of non-audit work.

Pursuant to the Code of Practice, any non-audit services conducted by the external auditor require the prior consent of the CFO or the Chairman of the Audit Committee; any services exceeding £50,000 in value require the prior consent of the Audit Committee as a whole.

The Committee ensures that any advisory and/or consulting services provided by the external auditor do not conflict with its statutory audit responsibilities and are conducted through entirely separate working teams; such advisory and/or consulting services generally only cover regulatory reporting, tax, and mergers and acquisitions work.

The Code of Practice enables the Committee to take corrective action if it believes that there is a risk of the external auditor's independence being undermined through the award of such work.

It is also QinetiQ's policy that no PwC employee may be appointed to a senior position within the QinetiQ Group without the prior approval of the CFO.

Review of non-audit work during the year

The Committee reviews the cost and nature of non-audit work undertaken by the external auditor at three meetings as a standing item, with a fourth meeting considering the auditor's fees as part of the year-end review.

The Committee had concluded, prior to engaging PwC for the provision of these services, that there had not been any conflict of interest that might compromise the independence of PwC's audit work. Details of the external auditor's remuneration can be found in note 5 on page 103.

REPORT OF THE AUDIT COMMITTEE CONTINUED

	2018		2017	
	£m	% of audit fee	£m	% of audit fee
Audit fees	0.6		0.5	
Non-audit:				
Audit-related assurance services	0.1	12%	0.1	22%
All other non-audit services	0.0	1%	0.0	2%
Total non-audit fees	0.1	13%	0.1	24%

Fees related to non-audit work services amounted to £75k, including £72k for audit related services (2017: £129k including £120k for audit related services).

Review of the effectiveness and the independence of the external auditor

At its September meeting the Committee reviewed the results of an effectiveness survey of the previous year's audit process, which allowed the learnings to be fed into the current year's planning process. At its May meeting, the Committee again reviewed the effectiveness and the independence of the external auditor during the year. The members of the Committee have declared themselves satisfied with the performance of PwC as the Company's auditor in the last financial year.

Appointment of auditor

Following a robust tender process in 2017, which was managed by the Audit Committee and a sub-committee appointed, comprising the Audit Committee Chairman, two Non-executive Directors, the CFO and the Group Financial Controller, it was concluded that PwC was the preferred firm to conduct the audit engagement. The sub-committee recommended to the Board that PwC be selected as the Group's external auditor for the year ending 31 March 2018 and PwC were appointed as the Company's auditor at its Annual General Meeting on 19 July 2017.

The Committee and the Board will be recommending PwC's re-appointment at the 2018 AGM.

Statutory audit services compliance

The Company confirms that, during the year under review, it has complied with the provisions of the Competition and Market's Authority's Order on statutory audit and services, which relates to the frequency and governance of external audit tenders and the setting of a policy on the provision of non-audit services.

REPORT OF THE NOMINATIONS COMMITTEE



Mark Elliott
Non-executive
Chairman



QinetiQ's Gender Pay Gap data can be found on our website – www.QinetiQ.com.



Board appointments are made on merit, experience and performance and the Company is progressively committed to increasing diversity in its widest sense, at Board level, senior management, and for the Company as a whole. Two out of the last three appointments to the Board were women.”

Dear Shareholder,

During the year under review, the Nominations Committee focused on diversity and succession planning. The Committee has adopted a new Board Diversity Policy, of which further details are outlined in this report. The key focus for the upcoming year will be succession planning and working towards reaching our diversity targets.

Mark Elliott

Nominations Committee Chairman

Main responsibilities

The role of the Committee is to ensure that the composition of the Board and Committees comprise the optimum balance of skills, knowledge and experience, and to oversee succession planning for the Board and senior management. It considers diversity, including skills mix, international industry experience, gender and ethnic background, when seeking to appoint a new Director to the Board.

The Committee meets at least twice a year and when called by its Chair. During the year under review, the Committee met on three occasions.

Effectiveness of the Committee

The effectiveness of the Committee is monitored and assessed regularly by Mark Elliott, as the Chairman of the Committee and Chairman of the Board, and as part of the Board performance evaluation. The overall outcome of the FY18 review of the Committee was positive, and in particular it was noted that the Committee benefitted during the year from the setting up of two formal meetings, and conducting ad hoc meetings as necessary.

Focus areas and activities

Board Diversity Policy

QinetiQ recognises the value of and welcomes the current discussions around diversity in the boardrooms of UK companies. The Nominations Committee has this year adopted a new Board Diversity Policy, which can be found on <https://www.QinetiQ.com/About-us/Corporate-Governance>.

The Board continues to have regard to the Hampton-Alexander Review recommendations to improve gender diversity among FTSE Boards and leadership teams and the Parker Review on ethnic diversity on UK Boards. The Board aspires to meet the voluntary targets as set out in those reports.

Progress against the Policy and future steps

The Board currently comprises 22% women, which is a smaller number than the Board aspires towards. The Board is committed to progress against the target set in the Board Diversity Policy. The Committee only engages executive search firms that adhere to the Voluntary Code of Conduct for Executive Search Firms, which promotes best practice for corporate board searches, including diversity. Such search firms are expected to identify and present to the Committee an appropriately diverse range of candidates, with relevant experience and knowledge, who can demonstrate independence of approach and thought.

Succession planning

The Committee places high emphasis on ensuring that the Company has got appropriate plans in place for orderly succession of appointments to the Board and to senior management. The composition of the Board remains under review and succession planning continues to be of the utmost importance for the Committee for the upcoming year.

REPORT OF THE RISK & CSR COMMITTEE



Admiral Sir James Burnell-Nugent
Risk & CSR
Committee Chairman

Dear Shareholder,

I am pleased to report that, during the year, the Committee continued to carry out its core functions, with the support of the Executive Committee, in respect of non-financial risk management and oversight. The annual calendar of activities, together with the in-depth review of 'red' risks and deep-dives into key risk areas, has continued to provide a firm basis on which the Committee is able to oversee the operation of the non-financial risk management processes within the Group. Regular updates, including corporate responsibility issues from management responsible for specific areas, continued to further the Committee's understanding of risks and how they are mitigated.

Admiral Sir James Burnell-Nugent

Risk & CSR Committee Chairman

Main responsibilities

The Committee has three primary functions:

- To oversee the sound operation of the Company's risk management systems
- To monitor non-financial risk exposures, including security, trade controls, ethics, corporate responsibility and health, safety and environment
- To monitor adherence to the generic MOD compliance system.

The Committee meets as necessary, although normally not less than four times a year. During the financial year ended 31 March 2018, the Committee met on four occasions.

Activities during the year

Details of key activities in respect of health, safety and environment and business ethics are set out in the Our People section on pages 32 to 33.

The key activities of the Committee during the year, which are described in further detail on page 61, were as follows:

- a) A review of the Group's risk management activities
- b) A review of the generic MOD compliance system
- c) The outcome of the Committee's effectiveness review.

//

The Committee is responsible for ensuring that the business operates within agreed risk appetite while taking account of emerging risks."

a) A review of the Group's risk management activities:

During the year the Committee received regular reports from the Group Director, Safety and Governance; the Group Director, Corporate Responsibility; the Group Head of Enterprise Risk Management; and the Group Head of Internal Audit.

The reports from the Group Director, Safety and Governance and Group Head of Risk covered key areas of risk management activity, including health and safety and international trade controls. These reports also included a high level summary of changes to non-financial risks, an overview of assurance activity, anti-bribery and corruption. The reports from the Group Director, Corporate Responsibility covered areas such as business ethics and code of conduct, emerging reputational risks, diversity and inclusion, stakeholder engagement, environment, trading policy and Modern Slavery Act reporting. The reports from the Group Head of Internal Audit provided an update on internal audit activity since the Committee's last meeting, details of progress with audit recommendations and details of any overdue recommended actions from internal audits.

Details of the principal risks and uncertainties can be found in the Strategic report on pages 22 to 26. 'Red' risks are made the subject of a report to the Committee or become the subject of a deep-dive review as part of the Company's risk management processes.

b) Generic MOD compliance system:

A key aspect of the Committee's work is the oversight of the MOD's generic compliance system. This is integral to the work of QinetiQ in its relationship with the UK Government.

The generic compliance system is designed to give the MOD customer confidence that QinetiQ is able to provide impartial advice during any competitive evaluation of a procurement opportunity where the Group wishes to operate on both the 'buy' and the 'supply' sides. The aim is to achieve a balance between meeting the needs of the procurement customers in the MOD (principally Defence Equipment & Support) and the need to allow QinetiQ the flexibility to commercialise research into the supply chain and pursue its planned business activities, without compromising the defence or security interests of the UK.

The Board nominates two senior executives to act as Compliance Implementation Director and Compliance Audit Director. During FY18 those roles were held by the Group Director, Safety and Governance and the Company Secretary and Group General Counsel respectively. In FY19 the Group Commercial Director will take over the role of Compliance Implementation Director.

Oversight of the operation of the compliance system is provided by the Committee. During the year under review, the Committee received an annual report from the Group Director, Safety and Governance and the internal audit function on the compliance areas that it monitored. A typical report includes a summary of the scope and an executive summary of the findings with an audit opinion, with agreed associated time-bound action plans.

The Committee addresses any issues that would arise if QinetiQ were to fail to comply with the requirements of the generic compliance system. No breaches were noted during the year.

Examples of deep-dive reviews into key risks carried out by the Committee during the year are as follows:

- International Business Governance
- Aviation Risk Management
- Recruitment and Retention.

For each deep-dive, Committee members were able to challenge the details provided and receive further details or give guidance as necessary.

c) Effectiveness review:

The evaluation of the effectiveness of the Committee was taken alongside the Board effectiveness review and carried out by way of an externally provided questionnaire-based process. The following actions had been noted from the 2017 effectiveness review:

- Devoting more time to deep-dives and less to reporting
- Improved quality of papers
- Continuing to simplify and further use the new risk reporting system
- Further training in risk management.

These items have been covered during the year under review by the specific project with regard to risk reporting and the ongoing Committee activities, as noted in this report.

The outcome of the 2018 review was considered at the Committee's May meeting. The performance of the Committee was rated highly overall, benefitting from good executive engagement. The following actions for the Committee were agreed for the upcoming year:

- Considering additional methods of reviewing risks
- Carrying out more work on emerging risks
- Improving internal audit's contribution in non-process areas
- Sustaining and developing recent improvements.

Report of the Security Committee

There was no requirement for the Committee to meet during the year.

Membership and attendance during the year

The Security Committee is chaired by Admiral Sir James Burnell-Nugent and the other Committee members during the year were Michael Harper, Ian Mason, Paul Murray, Susan Searle, David Smith and Steve Wadey.

Main responsibilities

The Committee was established in June 2009 to enable UK nationals on the Board to consider matters of a UK national security dimension that have an impact on QinetiQ's UK business. The Committee's full terms of reference can be found in the Governance section of the QinetiQ website at www.QinetiQ.com/about-us/corporate-governance.

DIRECTORS' REMUNERATION REPORT (DRR)

CHAIRMAN'S STATEMENT



Michael Harper,
Remuneration
Committee Chairman

Our Directors' Remuneration Report is organised into the following sections:

Chairman's statement	62-63
At a glance	64-65
Summary Remuneration Policy	66
Annual Report on Remuneration	67-77

This report complies with the Large and Medium-sized Companies and Groups (Accounting and Reports) (Amendment) Regulations 2013 as well as the Companies Act 2006.

During FY18 the Committee met five times with full attendance at each meeting (detailed summary of attendance is provided on page 46).

The full terms of reference of the Remuneration Committee can be found on the QinetiQ website (www.QinetiQ.com).



The Remuneration Committee has spent a great deal of time during the year considering financial performance as it relates to the incentive arrangements of the Executive Directors and QinetiQ's top 200 leaders with a view to ensuring alignment to the shareholder experience."

Dear Shareholder

As the Group Chairman has outlined in his statement on page 4, strong progress has been made by the CEO and the Executive Committee during the second year of the ambitious strategy to modernise and grow our business. This progress is evident from a second successive year of organic growth, the increasing contribution from our international businesses and overcoming the profit headwinds in the UK on single-sourced work.

Despite this, the annual contribution to the Bonus Banking Plan (BBP) pool for FY18 of 66.7% and 66.1% of the maximum for the CEO and CFO respectively is lower than for the CEO in FY17. The first award under the Deferred Share Plan (DSP) is 62.5% of the maximum opportunity for Executive Directors which reflects strong performance against the stretching targets set. The DSP award provides a contingent share award to our top 200 leaders thereby aligning their reward to the shareholder experience through the delivery of future profits and share price growth. The shares will vest in full only if the level of underlying operating profit in FY18 is maintained in FY21.

The business context in FY18

The essence of the business strategy is to grow sustainably over the next five years through a transformation of the Company. This continues at pace and we are partnering with our customers and investing in organic growth. This organic investment includes internal research and development, complemented by bolt-on acquisitions where there is a strong strategic fit. Progress against the strategy is reflected in the collective and personal objectives outturn for the Executive Directors.

Short-term operational excellence is critical and the Remuneration Committee has spent a great deal of time during the year considering financial performance as it relates to the incentive arrangements of the Executive Directors and QinetiQ's top 200 leaders with a view to ensuring alignment to the shareholder experience. A sharp focus on annual performance continues to be critical to delivering sustained, longer-term shareholder value.

The Directors' Remuneration Policy

Extensive consultations with shareholders and the voting guidance agencies resulted in the approval of the Directors' Remuneration Policy at the AGM in 2017 and we are grateful for your support. There was a significant vote against the Directors' Remuneration Policy with some shareholders expressing concern that incentives are too dependent on annual performance. We have improved the disclosure and transparency in this Annual Report on Remuneration to enable our shareholders to review decisions taken during the year as we implement the Policy. We have also made every effort to engage with major shareholders through the year on incentive performance measures and broader corporate governance issues.

We trust that improving communications in these ways will ensure both the successful implementation of the Policy and continued shareholder support.



We have also engaged with major shareholders through the year on incentive performance measures and broader corporate governance issues.”

Independent advisor to the Remuneration Committee

The appointment of PwC as Independent Auditor meant that they could no longer advise the Remuneration Committee. FIT Remuneration Consultants were appointed as advisors in April 2017 after a thorough review. We are working closely with FIT to implement the Directors' Remuneration Policy and receive advice on remuneration governance, executive pay market practice and related issues to assist our decision-making.

Incentive outturn for FY18

The FY18 BBP outturn for the Executive Directors was 66.7% and 66.1% of the maximum for the CEO and the CFO respectively. This is based on above-target profit and cash performance, with orders achieving the threshold level of performance, reflecting a good year for the Company. Performance against collective and personal objectives was also very strong reflecting the critical contribution which both Executive Directors have made. This outturn is below that for the previous year (86.4% of maximum for the CEO; the CFO did not participate in FY17 as he had just joined the Company), which reflects the targets set by the Remuneration Committee.

Of the FY18 BBP outturn noted above, 50% will be paid in cash and 50% deferred into Cycle 2 of the BBP, where it will remain at risk of forfeiture for three years (see page 70 for the details). FY18 is also Year 4 of Cycle 1 of the BBP and 314,971 QinetiQ shares will be released to the CEO in June 2018 as a result of deferring payments into the BBP in FY16 and FY17. These deferred amounts were already reported as remuneration in the year they were earned.

The first DSP award will be made in June 2018 at 62.5% of the maximum available, reflecting performance against the stretching annual underlying operating profit target. However, this DSP award will not vest in full unless the FY18 profit performance (£122.5m) is achieved in FY21. Even then the vested shares must be retained for a further two years. The 2018 DSP award is, therefore, an initial contingent share award in a six-year programme providing a clear link to the shareholder experience.

No shares awarded under the legacy Performance Share Plan (PSP) in 2015 vested in 2018 as the challenging threshold targets were not met.

Incentive targets for FY19

The Bonus Banking Plan for FY19 is based on the same financial metrics as in FY18 (profit, cash and orders) with stretch targets set against the delivery of the Integrated Strategic Business Plan (ISBP) and a 75% weighting. Non-financial targets have a 25% weighting based on the achievement of collective and personal objectives.

In support of the ISBP, the FY19 DSP performance measure is absolute growth in international revenue. We have also agreed strong underpins to ensure that margins are maintained on non-UK revenue and Group operating profitability must be at least equal to FY19 performance in FY22, as detailed on page 76. The Remuneration Committee carefully considered the performance measure for this award and we agreed that this is the right metric at this stage in the development of the Company. The targets have been set to be stretching.

Employee engagement and reward

All QinetiQ's employees are key to the delivery of the strategy. The CEO and the Group HR Director have held regular discussions with our Employee Engagement Group on reward matters including executive remuneration. The people section on page 32 details our employee engagement activity including the introduction of a new engagement tool in FY19.

I have met the Chair and the Deputy Chair of the Employee Engagement Group twice during the year and I have found the discussions very helpful in terms of understanding employee views, and I understand that they too have found the meetings helpful to better understand the Company's approach to executive remuneration. It is our intention to continue to meet at appropriate intervals.

Conclusion

The Directors' Remuneration Policy was approved at the 2017 AGM and is summarised on page 66. It is also available to view in full on the Company's website www.QinetiQ.com. Implementing this Policy in FY18 in the interests of shareholders has been the primary focus of the Remuneration Committee.

FY18 was a good year for QinetiQ as we deliver against our strategy and the Remuneration Committee considers that the rewards delivered appropriately reflect this.

I am very grateful for the time shareholders and their representative bodies have given us throughout the year and I hope that we can rely on your vote in favour of the Annual Report on Remuneration at the AGM on 25 July 2018.

Michael Harper

Remuneration Committee Chairman, 24 May 2018

DIRECTORS' REMUNERATION REPORT

AT A GLANCE

How to use this report

This 'At a Glance' section highlights the performance and remuneration outcomes for the year ended 31 March 2018 with greater detail provided in the Annual Report on Remuneration.



Audited information

Content contained within a grey box, accompanied by this 'Audited information' icon, indicates that the information has been audited.

Key

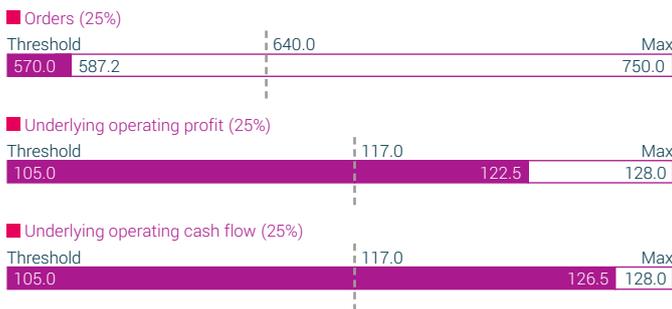
- Fixed pay
- Bonus Banking Plan (BBP)
- Deferred Share Plan (current policy, DSP)
- Performance Share Plan (old policy, PSP)
- Shareholding guidelines
- Denotes a KPI (see page 20)

Performance in 2018

The BBP measures annual performance against three financial KPIs (75% weighting) and other key strategic, operational and personal targets (25% weighting). Annual financial performance was strong and the Company achieved above target levels of performance on profit and cash, with orders exceeding the threshold level. Against non-financial measures, recognising the exceptional personal contribution to Company performance of both Executive Directors during the year, the CEO and the CFO received payments of 77.5% and 75.0% of the maximum respectively. The DSP award for FY18 reflects above-target underlying operating profit performance which must be maintained in FY21 for shares to vest in full.

Measures and targets used for BBP and performance outcome

Financial (75%)



Key

Target

Measure and initial target for DSP and performance outcome



FY18 DSP annual target level of performance was exceeded, but performance was below the maximum stretch level. The vesting of the award is subject to a performance underpin that the Company must meet or exceed the £122.5m operating profit performance for FY18 in FY21 for full vesting.

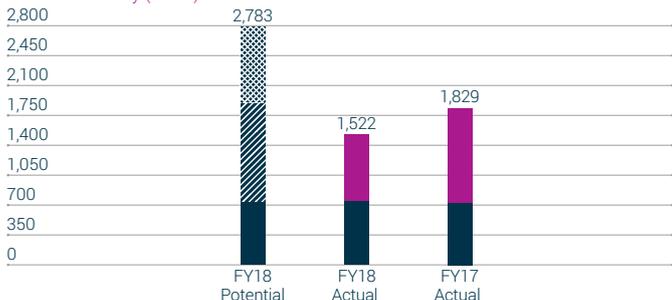
Strategic, operational, personal (25%)

CEO and CFO 77.5% and 75.0% achievement respectively as detailed on page 69.

What we paid our executives this year

The charts below illustrate FY18 potential opportunity against FY17 and FY18 actual pay for both Executive Directors. The actual pay for both Executive Directors reflects the above target BBP payment and no PSP vesting, as the 2015 PSP award to the CEO lapsed and the CFO was not with the Company at the time of grant.

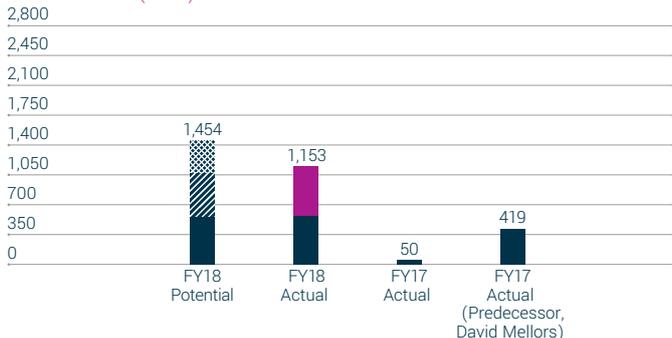
CEO: Steve Wadey (£'000)



Key

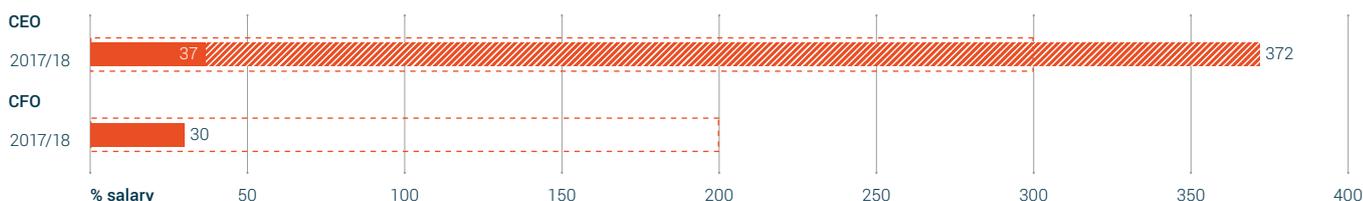
- Minimum = fixed pay
- ▨ Target = On-target award for the BBP and PSP performance
- Maximum = Maximum award under the BBP and PSP
- BBP award

CFO: David Smith (£'000)



Shareholding requirement

In line with the new Directors' Remuneration Policy, for FY18 the minimum shareholding requirement was increased to 300% of salary for the CEO and 200% of salary for the CFO (previously 200% for the CEO and 150% for the CFO). The relatively low current shareholding of the Executive Directors illustrated below reflects their short length of service. The Committee is confident that the implementation of the Policy through the operation of the BBP and DSP will increase the shareholdings given strong Company performance.

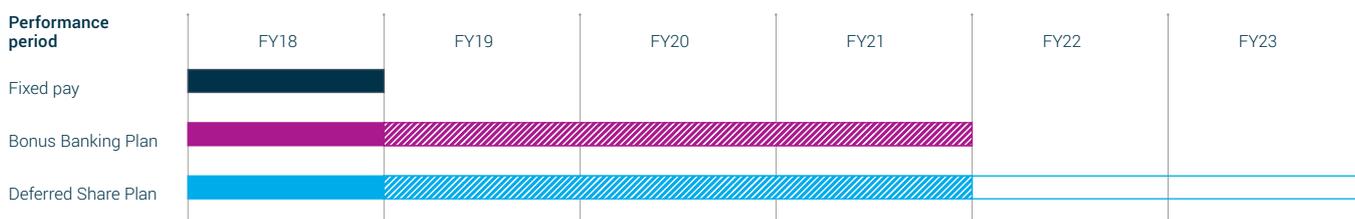


Key

Shareholding requirement ● Shares beneficially owned and deferred ▨ Shares subject to performance conditions

Components of remuneration – timing

To create strong alignment between executive remuneration and the long-term interests of our shareholders, the annual BBP awards remain, in part, subject to forfeiture based on performance for three years after the award was earned. Annual DSP awards also have a similar forfeiture period, after which any vested shares must be retained by the executive for a further two years.



Key

● Pay at risk, shares held, subject to certain performance conditions ○ Shares held, not subject to performance conditions

Our remuneration principles

Flexible

The Committee can select measures and set tough targets each year to ensure that executives are incentivised aligned to the delivery of each stage of our strategy.

Stretching

Targets are set by the Committee to ensure executives are incentivised to outperform, whilst delivering sustainable levels of performance.

Aligned

Whilst our incentive targets are initially assessed on an annual basis, the BBP has a deferred share-based element with the risk of forfeiture, and the DSP has a 'meet or exceed' performance underpin, whereby performance must be met or exceeded in year three, after which any vested shares must be retained for a further two years.

DIRECTORS' REMUNERATION REPORT

SUMMARY REMUNERATION POLICY

The Directors' Remuneration Policy was approved by shareholders at the AGM on 19 July 2017. The full Policy is provided in the Corporate Governance section on the Company's website, and it is expected to remain in effect until the 2020 AGM. A summary of the Policy is set out below:

Element	Policy summary description	Maximum opportunity
Base salary	<p>When determining an appropriate level of salary, the Committee considers:</p> <ul style="list-style-type: none"> – general salary rises to employees – remuneration practices within the Group – any change in scope, role and responsibilities – the general performance of the Group – the experience of the relevant Director – the economic environment – when the Committee determines a benchmarking exercise is appropriate, salaries within the ranges paid by the companies in the comparator groups used for remuneration benchmarking. 	<p>Typically, the base salaries of Executive Directors in post at the start of the Policy period and who remain in the same role throughout the Policy period will be increased by a similar percentage to the average annual percentage increase in salaries of all other employees in the Group. The exceptions to this rule may be where:</p> <ul style="list-style-type: none"> – an individual is below market level and a decision is taken to increase base pay to reflect proven competence in the role; or – there is a material increase in scope or responsibility to the Executive Director's role.
Pension	The Company provides a non-consolidated pension contribution allowance in line with practice relative to its comparators.	The maximum pension contribution allowance is 20% for existing Executive Directors. Any new Executive Directors will have a maximum contribution of 15%.
Benefits	Benefits include car allowance, health insurance, life assurance, income protection and membership of the Group's employee Share Incentive Plan which is open to all UK employees.	Benefit values can vary year-on-year depending on premiums and the maximum is the cost of providing the relevant benefits.
Incentive Plan	<p>The Incentive Plan supports the Company's objectives by:</p> <ul style="list-style-type: none"> – allowing the setting of annual targets based on the strategic objectives at that time; and – providing substantial deferral in shares and ongoing adjustment by requiring a threshold level of performance to be achieved during the deferral period. <p>The Incentive Plan consists of two elements:</p> <p>Bonus Banking Plan (BBP) Annual contributions are earned based on the satisfaction of the performance conditions. Contributions are made for three years with payments made over four years. Half the value of a participant's bonus account is paid out annually for three years with 100% of the residual value paid out at the end of year four. Half of the unpaid balance of a participant's bonus account is at risk of annual forfeiture.</p> <p>Deferred Share Plan (DSP) Deferred share-based element earned based on the satisfaction of pre-grant annual performance assessment, which is subject to a three-year vesting period and a further two-year holding period.</p> <p>A minimum 50% of the unvested award is at risk of forfeiture after three years based on a performance underpin.</p>	<p>Maximum 325% of salary (200% of salary under the Bonus Banking Plan and 125% of salary under the Deferred Share Plan).</p> <p>Bonus Banking Plan Maximum = 200% of salary. Target = 80%–120% of salary. Threshold = 0% of salary.</p> <p>Deferred Share Plan Maximum = 125% of salary. Target = 30%–75% of salary. Threshold = 0% of salary.</p>
Shareholding requirements	<p>Executives have five years to accumulate the required shareholding by retaining at least 50% of the post-tax vested shares from Company incentive plans.</p> <p>300% of base salary for the CEO. 200% of base salary for the CFO.</p>	n/a
Chairman and Non-executive Directors		
Fees	Fees are reviewed annually based on equivalent roles in the comparator group used to review salaries paid to the Executive Directors.	The fees for Non-executive Directors and the Group Chairman are broadly set at a competitive level against the comparator group.



Our full Remuneration Policy can be found on our website www.QinetiQ.com

DIRECTORS' REMUNERATION REPORT

ANNUAL REPORT ON REMUNERATION

The following section of this report details how the Directors' Remuneration Policy has been implemented for the year ended 31 March 2018.

✓ Audited information

Executive Directors' single total figure of remuneration

Executive Director	Year	Salary £'000	Benefits £'000	Pension £'000	Bonus Banking Plan £'000	Deferred Share Plan £'000	Performance Share Plan £'000	Total remuneration £'000
Steve Wadey (CEO) Restated	2018	582	48	116	776	–	–	1,522
	2017	568	43	113	1,105	–	–	1,829
David Smith (CFO) Restated. Appointed 1 Mar 17	2018	443	37	88	585	–	–	1,153
	2017	40	3	7	–	–	–	50
Previous Executive Director								
David Mellors (CFO) Restated. Left 31 Dec 16	2018	–	–	–	–	–	–	–
	2017	332	21	66	–	–	–	419

Benefits include travel and subsistence expenses incurred in relation to the execution of their duties with the Company that are considered by HMRC to be taxable. The 2017 figures have been restated to include these expenses in-line with emerging best practice. David Mellors' annual incentive and David Smith's pension have been restated as announced on 7 July 2017, having been reduced by £645,000 and £7,000 respectively.

Fixed pay

Salary

Salaries are normally reviewed each September, which is the same timing for the rest of the UK employee population. The Committee takes a number of factors into consideration when awarding salary increases including Company and individual performance, affordability and general market movements.

	Salary as at August 2017 £'000	Increase in the year	Salary as at September 2017 £'000	FY18 Pro-rated salary £'000
Steve Wadey	574	2.4%	588	582
David Smith	440	1.1%	445	443

Benefits

Benefits comprise a car allowance, travel allowance, private medical insurance, life assurance, income protection, and taxable expenses.

	Taxable expenses £'000	Car allowance £'000	Insured benefits £'000	Total benefits £'000
Steve Wadey	15	19	14	48
David Smith	4	13	20	37

Pensions

Neither of the Executive Directors participate in the QinetiQ pension scheme. The pension figure consists of cash in lieu of pension equating to 20% of base salary.

	Cash in lieu of pension £'000	Total in lieu of pension £'000
Steve Wadey	116	116
David Smith	88	88

Bonus Banking Plan Cycle 2

The Bonus Banking Plan was introduced in 2014 and operates on a four-year cycle mirroring the financial year, i.e. running from 1 April to 31 March. FY18 represents year 4 in Cycle 1, and year 1 in Cycle 2 as detailed on page 70.

	BBP balance brought forward £'000	Dividend equivalent payment £'000	BBP award in year £'000	Cash payment (50% value) £'000	BBP balance carried forward £'000
CEO	–	–	776	388	388
CFO	–	–	585	293	292

Each year the incentive award earned is added to the total plan balance, with 50% of the total plan balance being paid in cash, and the remaining 50% held in the plan in notional shares. In year 4, the total remaining plan balance is paid in shares.

Deferred Share Plan

The Deferred Share Plan contingent share award to be made in June 2018 is not included in the single figure as vesting remains subject to a stretching performance underpin in 2021. It will, to the extent it vests, appear in the single total figure in 2021.

Performance Share Plan

The Share Plan award made to the CEO in 2015 did not vest in 2018 as detailed on page 71.

DIRECTORS' REMUNERATION REPORT

ANNUAL REPORT ON REMUNERATION CONTINUED

Bonus Banking Plan

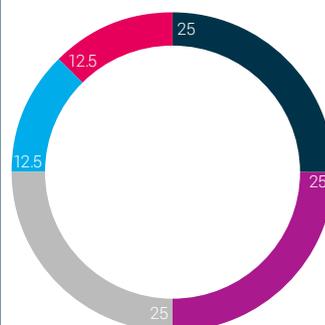
FY18 performance measures and operation

For the year ended 31 March 2018 achievement of on-target performance provides a payment equal to 115.0% of base salary, rising on a linear scale to 200% of base salary for achievement of stretch performance.

The scheme begins to pay out once threshold performance measures have been achieved. For the year ended 31 March 2018, the CEO and CFO were measured against the targets as shown in the chart to the right. The Target payment is 60% of maximum for financial objectives and 50% for non-financial objectives.

Setting performance targets – the Remuneration Committee takes into account the budget and the Company's strategy set in relation to the ISBP, shareholder expectations and the external environment. The aim is to set stretching targets which incentivise the Executive Directors to deliver annual results which will exceed the expectations of investors, but which are also sustainable and do not create undue risk.

% of base salary (%)



Key

- Orders
- Underlying operating profit
- Underlying net cash flow from operations
- Collective objectives
- Personal objectives

Audited information

2018 performance outcomes

	Weighting (%)	Threshold	Target	Stretch	Actual	% of maximum reward achieved	CEO contribution	CFO contribution
CEO/CFO financial performance measures:								
Orders	25	£570m	£640m	£750m	£587.2m	14.7%	£42,914	£32,649
Underlying operating profit ^(a)	25	£105m	£117m	£128m	£122.5m	80.0%	£232,867	£177,167
Underlying net cash flow from operations ^(a)	25	£105m	£117m	£128m	£126.5m	94.5%	£274,957	£209,189
CEO/CFO shared strategic and operational objectives (as detailed on page 69):								
Strategy:	12.5	40%	50%	100%	75%	75.0%	£109,156	£83,047
– Performance against key stretching objectives relating to the UK business, International and innovation								
Operational:		40%	50%	100%	75%			
– Performance against stretching objectives relating to culture change, process improvement and Health & Safety								
CEO individual personal objective:								
Stretching objectives measuring growth and leadership	12.5	40%	50%	100%	80%	80.0%	£116,433	
CFO individual personal objectives:								
Stretching objectives measuring delivery, transformation, growth and leadership	12.5	40%	50%	100%	75%	75.0%		£83,047
CEO overall results						66.7%	£776,327	
CFO overall results						66.1%		£585,099

^(a) Definition of underlying measures and performance can be found in the glossary on page 139.

Bonus Banking Plan (continued)

✓ Audited information

Financial performance measures (75% award)

The three key measures of orders, underlying operating profit and underlying net cash flow from operations are given an equal 25% weighting.

Underlying operating profit in FY18 included a number of non-recurring trading items totalling £8.7m. These comprised a £5.3m credit relating to the release of engine servicing obligations, £4.7m credit due to the settlement of a contractual dispute, a £2.7m charge relating to property liabilities and a number of other contract-related releases. The decision to include these items took into account a number of factors including a qualitative assessment of the nature of the items.

Reconciliation of measures used in determining remuneration to Group KPIs

There were none as BBP performance metrics and financial KPIs were aligned.

£m	Orders	Underlying operating profit	Underlying cash flow
Per KPIs on page 20	587.2	122.5	126.5
Metric used for BBP	587.2	122.5	126.5
Difference	0.0	0.0	0.0

Shared strategic and operational measures (12.5% award)

Measures	2018 Performance	Outcome (% maximum)
Strategic		
UK	– Secured contracts for the continued modernisation of Test and Evaluation facilities.	
International	– Secured significant contracts in export markets and with non-UK governments for the outsourcing of Test and Evaluation capabilities.	
Innovation	– Successful progress to resource key growth campaigns with approved capture plans. – Secured agreement for the transformation of Air Test and Evaluation Centre.	
Operational		
Transformation	– Embedded culture change to adopt new operating model. – Created a culture of listening and responding to customers and employees using an active feedback loop.	
Organisational development	– Each member of the Leadership Community personally engaged in leading monthly Rapid Improvement Events to drive cultural change. – Implemented 'Safe for Life' across the Group, including supply chain.	
Total		75.0%

Personal objectives (12.5% award)

Objectives	2018 Performance	Outcome (% maximum)
CEO		
Growth	– Implemented the approved five year ISBP to deliver sustainable profitable growth through organic and inorganic actions, with clear top down criteria for potential acquisitions aligned with delivery of the Group strategy. Developed a focused approach to international growth and pursued initial opportunities.	
Leadership	– Created a more customer focused, listening culture, demonstrating senior leadership behavioural change that delivers consistent operational performance and execution of the group strategy.	
Total		80.0%
CFO		
Growth & Transformation	– Resolved issues with systems, processes and tools such that the new operating model runs smoothly, in terms of capture management, programme management, workflow and resource demand/supply. Secured cultural shift in embedding and operating new business model. – Worked with the other leaders to mature the FY19 ISBP and pursued organic and inorganic growth actions to ensure sustainable revenue and profit growth.	
Leadership	– Developed the Finance and Performance Excellence organisations. – Ensured each team member was aligned with delivery of the overall business strategy and performance targets.	
Delivery	– Improved underlying processes and governance to drive consistent operational performance across the Group.	
Total		75.0%

DIRECTORS' REMUNERATION REPORT

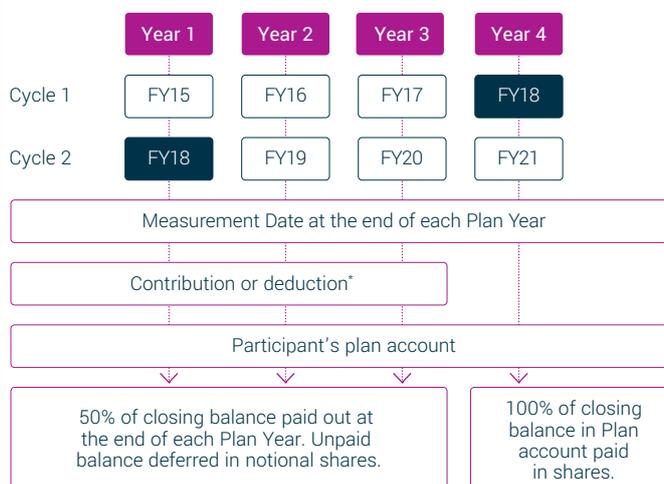
ANNUAL REPORT ON REMUNERATION CONTINUED

Bonus Banking Plan (continued)

How the plan operates

- The Plan operates on a fixed four-year cycle. FY18 represents year 1 of Cycle 2, and year 4 of Cycle 1. Plan years commence on 1 April.
- Performance targets are set at the beginning of each Plan year.
- At the end of each of the first three Plan years the performance against targets is assessed and the level of the incentive earned is determined and paid into the Plan account.
- Each year 50% of the account balance is subject to forfeiture.
- At the end of each of the first three Plan years, 50% of the account balance will be paid and the balance retained and held in the Plan as notional shares.
- At the end of the fourth year, any remaining balance in the Plan account is paid out in shares.

BBP payout mechanism



* Single figure BBP value for a Plan/financial year.

✓ Audited information

Operation during 2018

Cycle 1

	Notional shares on account at beginning of Plan year 4 (31 March 2017)	30-day average share price as at measurement date (£)	Share value as at measurement date (£)	Bonus plan contribution for Plan year 4 (£)	Dividend equivalent payment (£)	Bonus pool total value as at measurement date (£)	Gross cash payment for Plan year 4 (£)	Bonus pool total value following cash payment (£)	Notional shares at end of Plan (31 March 2018)
CEO	305,913	2.06	630,181	–	18,661	648,842	–	–	314,971
CFO	–	–	–	–	–	–	–	–	–

Cycle 2

	Notional shares on account at beginning of Plan year 1 (31 March 2017)	30-day average share price as at measurement date (£)	Share value as at measurement date (£)	Bonus plan contribution for Plan year 1 (£)	Dividend equivalent payment (£)	Bonus pool total value as at measurement date (£)	Gross cash payment for Plan year 1 (£)	Bonus pool total value following cash payment (£)	Notional shares on account at beginning of Plan year 1 (31 March 2018)
CEO	–	2.06	–	776,327	–	776,327	388,163	388,164	188,429
CFO	–	2.06	–	585,099	–	585,099	292,550	292,549	142,014

Forfeiture

For Cycle 1 the CEO retained notional shares in his Plan account of which 50% were subject to forfeiture. Forfeiture would have been enacted if Group underlying operating profit was less than £95.0m for FY18. FY18 Group underlying operating profit was £122.5m (excluding contribution from acquisitions) therefore no notional shares were forfeited. It is anticipated that the shares will be paid out in June 2018.

Discretion

For Cycle 2, for the year ended 31 March 2018, financial targets were exceeded providing a contribution of 133.4% of base salary for the CEO and 132.1% of base salary for the CFO. £776,327 and £585,099 has been reported in the single figure table which represents the cash and deferred notional share elements. No discretion was applied to these contributions.

Deferred Share Plan (DSP)

Scheme interests awarded during the financial year ended 31 March 2018

The Deferred Share Plan was approved by shareholders at the 2017 AGM. A maximum award of 125% of salary may be made to the CEO and CFO with the amount contingent on meeting a stretching annual performance target based on QinetiQ's strategic growth plan. Once the award has been made, it is deferred for three years and remains subject to a performance underpin; any vested shares are then subject to a further two-year holding period.

Setting performance targets FY18

The FY18 DSP performance measure was underlying operating profit but with more stretching performance targets than those set for the BBP. Calibration was set with a maximum of 125% of salary available for achieving Stretch and 35% of the maximum payable at Target performance. The performance targets were set by the Remuneration Committee so as to be stretching.

✓ Audited information

2018 performance outcome

The 2018 Deferred Share Plan award was measured against 2018 underlying operating profit with the following calibration.

Measure	Weighting	Threshold	Target	Stretch	Actual	% Max award achieved	% Salary awarded	Total £'000
Underlying operating profit	100%	£110.0m	£117.0m	£130.0m	£122.5m	62.5%	78.1%	
CEO								454,818
CFO								346,029

Underlying operating profit achievement at £122.5m is therefore 62.5% of maximum resulting in an award of 78.1% of salary for the CEO and CFO. The DSP award is also subject to a stretching performance underpin which must be achieved before shares vest to the benefit of the participant. The profit outturn for 2018 (£122.5m) must be maintained at the end of the year of vesting (2021) for the shares to vest. If this is not maintained then, at a minimum, 50% of the award will lapse. Any vested shares must be retained for a further two-year period.

The share value is based on the 30-day average share price ending on 31 March 2018; this is £2.06. It is anticipated that 2018 Deferred Share Plan awards will be made on or around 1 June 2018. The eventual number of contingent shares awarded will therefore be detailed in the 2019 Directors' Remuneration Report.

For details of the non-recurring trading items in the underlying operating profit figure, please refer to page 69.

Performance Share Plan (PSP)

2015 PSP

The 2015 PSP award was measured 50% based on EPS growth of 3% to 10% per annum (25% vesting at threshold, 100% at maximum, with linear vesting between these points), and 50% based on TSR performance against the FTSE 250 (30% vesting at median performance, 100% at upper quartile performance, with linear vesting between these points).

The 2015 PSP award measurement period was to 31 March 2018 and the Committee reviewed performance against the EPS and TSR performance measures at the May 2018 meeting.

Measures	Weighting	Performance conditions	Performance			% Max award achieved
			Threshold	Stretch	Actual	
EPS	50%	Between 3% and 10% per annum	16.6p	20.2p	16.4p	0%
TSR	50%	Between FTSE 250 median and upper quartile	24.8%	61.6%	17.1%	0%

Based on audited EPS performance and TSR performance analysis provided by the independent advisor to the Committee (FIT), it was determined that neither test was met and the 2015 PSP award to the CEO will lapse in full on the third anniversary of grant (28 July 2018).

Performance condition adjustments during 2018

As in prior years, the Committee adjusted the performance conditions for the Performance Share Plan to reflect continuing operations and share buyback so performance is measured on a like-for-like basis.

Reconciliation of measures used in determining remuneration to Group KPIs

	EPS p
Per KPIs on page 21	19.3
Metric used for PSP	16.4
Difference	2.9
Which relates to:	
– Constant number of shares	
– Excluding profit after tax of acquired businesses	

DIRECTORS' REMUNERATION REPORT

ANNUAL REPORT ON REMUNERATION CONTINUED

✓ Audited information

Statement of Directors' shareholding and share interests

In relation to the revised shareholding requirement adopted on 1 April 2017 the Company requires Executive Directors to hold shares equivalent to 300% (CEO) and 200% (CFO) of base salary. Executive Directors have five years to achieve the required level through, at a minimum, retaining 50% of the after-tax shares vesting from Company incentive plans.

The CEO does not currently meet the minimum shareholding requirement; with a current holding equivalent to 37% of base salary using a share price of £2.09 (three-month average to 31 March 2018). This reflects his appointment date as CEO and the lack of any opportunity for share-based awards to vest.

The CFO does not currently meet the minimum shareholding requirement; with a current holding equivalent to 30% of base salary using a share price of £2.09 (three-month average to 31 March 2018). This reflects his recent appointment as CFO and the lack of any opportunity for share-based awards to vest.

	Shares beneficially owned	Shares subject to performance conditions	Shares not subject to performance conditions	Total shares held at 24 May 2018
Steve Wadey	103,028	941,962	–	1,044,990
David Smith	64,556	–	–	64,556
Mark Elliott	145,000	–	–	145,000
Michael Harper	40,000	–	–	40,000
Admiral Sir James Burnell-Nugent	15,567	–	–	15,567
Paul Murray	83,214	–	–	83,214
Susan Searle	25,000	–	–	25,000
Ian Mason	10,000	–	–	10,000
Lynn Brubaker	12,000	–	–	12,000

Shares beneficially owned comprise shares held under the Share Incentive Plan (including matched shares) and shares owned by the Director and any connected persons.

Shares subject to performance conditions comprise awards made under the Performance Share Plan as detailed below. Notional shares held by the CEO in the BBP Cycle 1 do not appear in the table above as they are not actual shares at 24 May 2018.

Total scheme interests summary

Total scheme interests, including those awarded during the financial year ended 31 March 2018, are as follows.

Steve Wadey

Plan name	Date of grant	Number 1 April 2017	Granted in year (maximum potential of awards)	Exercised/ vested in year	Lapsed in year	Number 31 March 2018	Market price on date of grant	Vest date
PSP 2015	28 Jul 15	363,636	–	–	–	363,636 ¹	231.0	28 Jul 18
PSP 2016	1 Jul 16	476,190	–	–	–	476,190	224.4	1 Jul 19
PSP 2017	22 Jun 17	–	102,136	–	–	102,136	281.0	22 Jun 20
		839,826	102,136	–	–	941,962		

¹ As detailed on page 71, the performance conditions for the 2015 PSP were not met, and the 2015 PSP award to the CEO will lapse on 28 July 2018.

The 2017 PSP award will vest 50% based on EPS growth of 3% to 10% per annum (25% vesting at Threshold, 100% at maximum, with linear vesting between these points), and 50% based on TSR performance against the FTSE 250 (30% vesting at median performance, 100% at upper quartile performance, with linear vesting between these points).

The contingent share award in relation to the 2018 DSP will be granted on or around 1 June 2018. The Committee estimates that 220,785 contingent shares will be granted to Steve Wadey and 167,975 to David Smith. This is calculated based on awards of 78.1% salary, and a share price of £2.06 (based on 30 days to 31 March 2018).

The highest and lowest prices of a QinetiQ share during the year ended 31 March 2018 were 319.7p and 195.5p. There have been no other changes to the interests shown above between 31 March 2018 and 24 May 2018.

Payments to past Directors and payment for loss of office

No payments were made to past Directors during the year and no payments were made for loss of office during the year.

Performance review

The nine-year and three-year charts show the Company's Total Shareholder Return over the period from 31 March 2009 to 31 March 2018 and 31 March 2015 to 31 March 2018 compared with the FTSE 250 (excluding investment trusts) over the same period based on spot values. The Committee has chosen to demonstrate the Company's performance against this index as it is the index in which the Company is listed. This comparator group is also used to measure TSR performance in the PSP (under which no future awards will be made).

Nine-year comparator chart



Key

- QinetiQ
- FTSE 250 (excluding investment trusts)

Three-year comparator chart



CEO remuneration

The table below shows the CEO's remuneration over the same performance period as the Total Shareholder Return chart (31 March 2009 to 31 March 2018):

Year ended 31 March	CEO	Salary/fees	Single figure	Annual bonus (% of maximum)	Long-term incentives (% of maximum vesting)
2018	Steve Wadey	582,167	1,522,460	66.7%	–
2017 (restated)	Steve Wadey	568,166	1,829,470	86.4%	–
2016	Steve Wadey	520,219	1,654,546	85.4%	–
2016	David Mellors	455,885	1,423,382	82.9%	–
2015	David Mellors	501,227	1,725,960	88.6%	13.9%
2015	Leo Quinn	469,776	673,979	–	–
2014	Leo Quinn	610,844	2,177,742	77.0%	15.4%
2013	Leo Quinn	593,050	3,992,001	100.0%	40.3%
2012	Leo Quinn	580,000	1,495,284	100.0%	–
2011	Leo Quinn	580,000	1,327,156	100.0%	–
2010	Leo Quinn	217,872	886,564	–	–
2010	Graham Love	266,667	1,246,320	–	–

The Committee notes the encouragement for additional reporting in relation to CEO pay ratios. Until a common methodology is established the Committee will not publish a CEO pay ratio as this number is of little relevance on a stand-alone basis and external comparisons are invalid unless the disclosure is calculated on a consistent basis. The Committee considers pay relativities throughout the business as part of its deliberations and will continue to do so.

The 2017 single figure has been restated in respect of benefits as explained above.

Percentage change in CEO remuneration

The following table compares change in CEO remuneration with an employee comparator group (averaged per capita). The comparison group (4,000 employees) represents the employees in the UK principal businesses in service between 1 April 2017 and 31 March 2018.

	CEO			Comparison group		
	2018	2017	% change	2018	2017	% change
Base salary	£582,167	£568,132	2.5%	£41,283	£39,694	4.0%
Benefits	£47,533	£43,083	10.3%	£1,190	£1,138	4.6%
Annual bonus	£776,327	£1,104,687	-29.7%	£1,436	£1,506	-4.6%

DIRECTORS' REMUNERATION REPORT

ANNUAL REPORT ON REMUNERATION CONTINUED

Remuneration policy for all employees

All employees of QinetiQ are entitled to base salary, benefits and pension. UK and Australia-based employees are entitled to participate in the QinetiQ Share Incentive Plan. The maximum incentive opportunity available is based on the seniority and responsibility of the role. Participation in the DSP is available to Executive Directors, senior managers and selected employees throughout the organisation. For FY19, the Company has introduced an All Employee Incentive Scheme whereby every employee has the opportunity to earn a cash bonus based on Company and personal performance. The Committee is advised of the general reward policy for other employees and of any significant changes proposed.

Gender related pay

QinetiQ is subject to gender pay reporting for UK employees and a copy of our 2017 report is available on the Company's website.



Our Gender Pay Gap report can be found on our website www.QinetiQ.com

Relative importance of spend on pay

The graph below shows actual spend on all employee remuneration, shareholder dividends and buybacks and any other significant use of profit and cash within the previous two financial years.

	Total £m	Difference %
Total Employee remuneration	362.7	6.3
	341.1	
Share-based profit distribution	35.2	3.2
	34.1	
Other significant profit distribution	0.0	-100.0
	47.4	

Key

- FY17
- FY18

Audited information

Single figure remuneration for the Chairman and each Non-executive Director

Non-executive Directors' remuneration is shown as a single figure to provide an annual comparison between the remuneration awarded during the financial year ended 31 March 2018 and the preceding year.

Non-executive Director	Salary/fees £'000		Benefits £'000		Committee Chair fees £'000		US/UK attendance fee £'000		Single figure £'000	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Lynn Brubaker	48	46	16	6	–	–	21	15	85	67
Admiral Sir James Burnell-Nugent	48	46	2	4	9	9	–	2	59	61
Mark Elliott	242	238	76	76	–	–	–	–	318	314
Michael Harper	48	46	1	2	19	19	–	2	68	69
Ian Mason	48	46	1	3	–	–	–	–	49	49
Paul Murray	48	46	1	1	9	9	–	2	58	58
Susan Searle	48	46	1	2	–	–	–	2	49	50

Benefits include travel and subsistence expenses incurred in relation to the execution of their duties with the Company that are considered by HMRC to be taxable. The 2017 figures have been restated to include these expenses in-line with emerging best practice.

Mark Elliott, the Chairman, and Lynn Brubaker are US residents. Mark is entitled to an accommodation allowance of £75,000 and Lynn is entitled to receive a \$4,000 fee for attending UK meetings. UK-based Non-executive Directors are entitled to receive a £2,500 fee for attending US meetings.

The Committee Chair fees figure for Michael Harper includes a payment of £10,000 as Senior Independent Director.

Service contracts/letters of appointment

The Company's policy is that Executive Directors have rolling contracts which are terminable by either party giving 12 months' notice. Non-executive Directors do not have service contracts but are appointed under letters of appointment. All service contracts and letters of appointment are available for viewing at the Company's registered office and at the AGM. Non-executive Directors typically serve two three-year terms but may be invited by the Board to serve for an additional period (see table in the Nominations Committee report on page 59).

Director	Date appointed	Arrangement	Notice period
Lynn Brubaker	27 January 2016	Initial term of three years from date of appointment until the conclusion of the Annual General Meeting approximately three years from that date, subject to annual reappointment at the AGM.	1 month
Admiral Sir James Burnell-Nugent	10 April 2010	Initial term of three years from date of appointment, subject to annual reappointment at the AGM.	–
Mark Elliott	01 June 2009	Initial term of three years from date of appointment, subject to annual reappointment at the AGM.	–
Michael Harper	22 November 2011	Initial term of three years from date of appointment, subject to annual reappointment at the AGM.	–
Ian Mason	04 June 2014	Initial term of three years from date of appointment until the conclusion of the Annual General Meeting approximately three years from that date, subject to annual reappointment at the AGM.	1 month
Paul Murray	25 October 2010	Initial term of three years from date of appointment, subject to annual reappointment at the AGM.	–
Susan Searle	14 March 2014	Initial term of three years from date of appointment until the conclusion of the Annual General Meeting approximately three years from that date, subject to annual reappointment at the AGM.	–
David Smith	01 March 2017	Service contract	12 months
Steve Wadey	27 April 2015	Service contract	12 months

Implementation of Policy for the year ending 31 March 2018

Salary/fees

Non-executive Directors' fees were increased on 1 July 2017, resulting in an increase in base fees from £46,000 to £49,000 per annum. This was the first increase since 1 July 2015 and Non-executive Directors' fees will be reviewed again in July 2019. The Non-executive Group Chairman's fees were last increased on 1 December 2016 resulting in an increase to £242,000. Salaries and fees are reviewed in line with Policy.

Executive Directors are permitted to accept one external non-executive director position with the Board's approval. Any fees received in respect of these appointments may be retained by the Executive Director.

The CEO does not hold any non-executive directorships in other companies. David Smith was appointed non-executive director of Motability Operations Group plc on 1 July 2010. Non-executive director fees, as reported in the 2017 Motability Operations Group plc annual report, were £50,000 per annum which are retained.

Fees effective as at 1 April 2018 £

Group Chairman	242,000
Accommodation allowance for Group Chairman	75,000
Basic fee for UK Non-executive Director	49,000
Additional fee for chairing a Committee	9,000
Additional fee to Deputy Chairman/Senior Independent Non-executive Director	10,000
Additional fee for attendance at a Board meeting held in US by UK resident Non-executive Director	2,500
Additional fee for attendance at a Board meeting held in UK by US resident Non-executive Director	\$4,000

Implementation of Policy for the year ending 31 March 2019

Incentives for Executives

The table below shows the measures and relative weighting for the Bonus Banking Plan for the CEO and CFO:

	Performance measure (excluding 2018 acquisitions)	Relative weighting (%)
Bonus Banking Plan	Underlying operating profit	25.0%
Target performance 115% of base salary	Underlying net cash flow from operations	25.0%
Stretch performance 200% of base salary	Orders	25.0%
	Collective objectives	12.5%
	Personal objectives	12.5%

Details of specific performance targets for the Bonus Banking Plan have not been provided as they are deemed commercially sensitive. They will be disclosed retrospectively in next year's Annual Report on Remuneration.

DIRECTORS' REMUNERATION REPORT

ANNUAL REPORT ON REMUNERATION CONTINUED

The Deferred Share Plan will award a maximum of 125% of base salary for achieving Stretch performance with 35% of maximum payable at Target performance. The 2019 performance measure will be absolute growth in organic non-UK revenue as, in line with the ISBP, the Board has agreed that a critical aim for the Company is to deliver growth in international revenue. This is at the heart of our strategy to drive sustainable growth and follows significant success in FY18. The DSP awards will be subject to two performance underpins:

- To ensure that we deliver strong margins, the profit margin on non-UK revenue in FY19 must be the same or higher than the profit margin on non-UK revenue in FY18.
- Group underlying profit outturn for FY19 must be maintained at the end of the three-year vesting period. If this is not maintained then, at a minimum, 50% of the award will lapse. For the purposes of the FY19 DSP award, this will be the actual underlying operating profit (£m) for FY19 which must be achieved in FY22.

The Remuneration Committee Chairman wrote to major shareholders and voting advisory bodies in relation to the FY19 DSP performance measure.

Awards will be made in June 2019 based on FY19 performance. Details of performance targets for the Deferred Share Plan have not been provided as they are deemed commercially sensitive. They will be disclosed retrospectively in next year's Annual Report on Remuneration.

Salary and benefits

Salaries will be reviewed effective from 1 September 2018. No changes are envisaged to the implementation of benefits policy.

Remuneration Committee meetings, activities and decisions 2018

The following table provides a summary of all the key activities during the year. There was full attendance at each meeting.

	Base salary	Incentives	Share awards	Governance	Resourcing
May 2017		FY17 final results	2014 PSP vesting	Shareholder feedback on Directors' Remuneration Policy. Approve Directors' Remuneration Report	Steve Fitz-Gerald and James Willis appointments
July 2017	Executive Director and Executive Committee salary review			AGM preparation	
September 2017				Shareholder engagement Review Green Paper on Corporate Governance Reform	
November 2017	Trends in executive remuneration	FY18 half year forecast	Review of Executive Committee shareholdings	Employee engagement review	
March 2018		FY18 provisional results FY19 target setting	2015 PSP provisional vesting		Nic Anderson appointment

Effectiveness review

In 2018, the effectiveness review was undertaken internally, and the Committee was found to be functioning effectively. Considerations for 2018 include focusing on the linkage between remuneration and strategy, improving the clarity of the Directors' Remuneration Report and, having made changes to the Directors' Remuneration Policy, monitoring closely the roll-out of the Policy to ensure it operates effectively.

Remuneration consultants

The Committee undertook a thorough review and appointed FIT Remuneration Consultants as advisors from 1 April 2017 as the appointment of PwC as Independent Auditor meant that the Committee could no longer retain PwC as advisors.

The Committee has appointed FIT, an independent firm of remuneration consultants, to provide advice on market practice, corporate governance and institutional stakeholder views. Fees paid during the year for these services were £49,950.

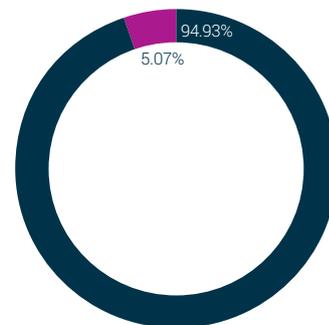
FIT provided the following additional services during the year:

- Implementation support for the Company on executive reward plans; and
- TSR performance monitoring for Performance Share Plan awards.

The Committee is satisfied the scale and nature of this work does not impact on the objectivity and independence of the advice it receives from FIT.

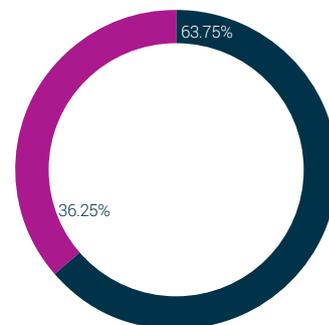
Statement of voting
Annual Report on Remuneration – 2017

Votes for	380,227,053 (94.9%)
Votes against	20,307,830 (5.1%)
Total votes cast	400,534,883 (70.6% share capital)
Abstained	51,876



Directors' Remuneration Policy – 2017

Votes for	255,350,780 (63.8%)
Votes against	145,182,781 (36.3%)
Total votes cast	400,533,561 (70.6% share capital)
Abstained	53,828



The Committee notes that, while the majority of shareholders supported our Directors' Remuneration Policy, there was a significant vote against this resolution at the 2017 AGM. In response, the Committee undertook to:

- More clearly explain the link between the Directors' Remuneration Policy, incentives and our five-year strategy
- Engage with shareholders as the implementation decisions are made in relation to the Policy
- Enhance the design and layout of the Directors' Remuneration Report to improve both transparency and clarity.

Details on the voting on all resolutions at the 2018 AGM will be announced via the RNS and posted on the QinetiQ website following the AGM.

Michael Harper
Remuneration Committee Chairman, 24 May 2018

DIRECTORS' REPORT

Statutory information contained elsewhere in the Annual Report

Information required to be part of this Directors' report can be found elsewhere in the Annual Report as indicated in the table below and is incorporated into this report by reference:

Information	Page
Corporate Governance Statement	42
Directors' details	48
Directors' interests in shares	72
Employees	32
Financial instruments: Information on the Group's financial risk management objectives and policies, and its exposure to credit risk, liquidity risk, interest rate risk and foreign currency risk	115 note 26
Greenhouse gas emissions	35
Likely future developments in the business of the Company or its subsidiaries	2-39
Results and dividends	36-39

Management report

The Strategic report on pages 2 to 39 and the Directors' report, as detailed on pages 78 to 80, including information which has been incorporated into those sections by reference, comprise the management report specified by rules 4.1.5R (2) and 4.1.8R of the FCA's Disclosure Guidance and Transparency Rules (DTRs).

Research and development

One of the Group's principal business streams is the provision of funded research and development (R&D) for customers. The Group also invests in the commercialisation of promising technologies across all areas of business.

In the financial year, the Group recorded £310.1m (2017: £306.4m) of total R&D-related expenditure, of which £284.3m (2017: £272.8m) was customer-funded work and £25.8m (2017: £33.6m) was internally funded. Additionally, £1.8m (2017: £0.4m) of late-stage development costs was capitalised and £1.5m (2017: £1.3m) of capitalised development costs was amortised in the year.

Political donations

QinetiQ does not make political donations to parties as that term would be commonly recognised. The legal definition of that term is, however, quite broad and may have the effect of covering a number of normal business activities that would not commonly be perceived to be political donations, such as sponsorship of events.

These may include legitimate interactions in making MPs and others in the political world aware of key industry issues and matters that affect QinetiQ, and that make an important contribution to their understanding of QinetiQ, the markets in which it operates and the work of their constituents.

Branches

The Company and its subsidiaries have established branches in a number of different countries; their results are, however, not material to the Group's financial results.

Share capital

As at 31 March 2018, the Company had an allotted and fully paid up share capital of 571,757,121 ordinary shares of 1p each with an aggregate nominal value of £5.7m and one Special Share with a nominal value of £1. The ordinary share total includes 4,515,868 shares held exclusive of voting rights in treasury and 1,474,128 shares held by employee share trusts.

Details of the shares in issue during the financial year are shown in note 28 on page 121.

Rights of ordinary shareholders

The holders of ordinary shares are entitled to receive the Company's Reports and Accounts, to attend and speak at general meetings of the Company, to exercise voting rights in person or by appointing a proxy, and to receive a dividend where declared or paid out of profits available for that purpose.

Rights of special shareholder

The Special Share is held by HM Government through the Secretary of State for Defence (the Special Shareholder) and it may only be held by and transferred to HM Government. It confers certain rights to protect UK defence and security interests. These include:

- The promotion and reinforcement of the MOD compliance principles which require QinetiQ to be an impartial, ethical and responsible contractor by avoiding conflicts of interest in its dealings with the MOD
- The protection of defined strategic assets of the Group, such as certain testing facilities, by providing the Special Shareholder with an option to purchase those assets in certain circumstances
- The right to require certain persons with a material interest in QinetiQ to dispose of some or all of their ordinary shares on the grounds of national security or conflict of interest
- A provisions whereby at least the Non-executive Chairman or Chief Executive Officer must be a British citizen.

The Special Share carries no financial and economic value and the Special Shareholder is not entitled to vote at a general meeting of the Company. At any time the Special Shareholder may require QinetiQ to redeem the share at par and, if wound up, the Special Shareholder would be entitled to be repaid at its nominal value before other shareholders. Any variation of the rights attached to the Special Share requires the written approval of the MOD. Further details can be found in note 28 on page 122.

Restrictions on the transfer of shares

As detailed above, the Special Share confers to require certain persons with an interest in QinetiQ's shares that exceed certain prescribed thresholds to dispose of some or all of their ordinary shares on the grounds of national security or conflict of interest.

Employee share schemes

The QinetiQ Group plc Employee Benefit Trust (the Trust) holds shares in connection with QinetiQ's employee share schemes, excluding the Share Incentive Plan. As at 31 March 2018, the Trust held 1,474,128 ordinary shares of 1p each (the Trust Shares). The Trustees of the Trust have agreed to waive their entitlement to dividends payable on the Trust Shares. The Trust holds further ordinary shares in respect of deferred shares held on behalf of participants in the Company's Deferred Annual

Bonus Plan. Dividends received by the Trust in respect of the deferred shares are paid direct to the Plan participants on receipt and are not retained in the Trust.

Equiniti Share Plan Trustees Limited acts as Trustee in respect of all ordinary shares held by employees under the QinetiQ Group plc Share Incentive Plan (the Plan). Equiniti Share Plan Trustees Limited will vote on all resolutions proposed at general meetings in accordance with voting instructions received from participants in the Plan.

Corporate sponsored nominee

In circumstances where ordinary shares are held by the corporate sponsored nominee service, Equiniti Corporate Nominees Limited will vote on all resolutions proposed at general meetings in accordance with voting instructions received from shareholders using such corporate nominee service.

Major shareholdings

In accordance with DTR 5, the Company has been notified of the following from holders representing 3% or more of the issued ordinary share capital of the Company:

Name of shareholder	At 31 March 2018 % of issued share capital*	At 16 May 2018 [#] % of issued share capital
Schroders	11.94%	11.94%
Deutsche Bank, AG.	5.82%	5.82%
Silchester International Investors LLP	–	5.01%
Investec	4.95%	4.95%
Standard Life Aberdeen plc	4.81%	4.81%
Norges Bank	3.94%	3.94%
BlackRock Inc.	Below 5% ^c	Below 5% ^c

* As notified by the shareholder and based on the issued ordinary share capital at the time of the notification.

[#] Being a date not more than a month prior to the date of the Notice of AGM.

^c Under DTR 5.1.5 (1)(a), shares held indirectly by BlackRock, Inc., would be notifiable at 5%, 10% and each 1% change thereafter since it qualifies as an EEA approved fund manager and is therefore exempt from disclosing holdings at below 5%, and 6% – 9% inclusive.

Employees

The Group is committed to the fair treatment of people with disabilities in relation to applications, training, promotion and career development. If an existing employee becomes disabled, the Company makes every effort to enable them to continue their employment and career development, and to arrange appropriate training, wherever practicable.

Directors' conflicts of interest

The Company requires Directors to disclose proposed outside business interests before they are entered into. This enables prior assessment of any conflict, or potential conflict, of interest and any impact on time commitment. An annual review of all external interests is carried out by the Board.

Directors' interests in contracts

At the date of this report, there is no contract or arrangement with the Company or any of its subsidiaries that is significant in relation to the business of the Group as a whole in which a Director of the Company is materially interested.

Indemnities

The Company has entered into indemnity deeds with all its current Directors containing qualifying indemnity provisions, as defined in Section 236 of the Companies Act 2006, under which the Company has agreed to indemnify each Director in respect of certain liabilities, which may be attached to them as Directors or as former Directors of the Company or any of its subsidiaries. All such indemnity provisions are in force as at the date of this Directors' Report.

The Directors of QinetiQ Pension Scheme Trustee Limited, a Group company and the Trustee of the QinetiQ Pension Scheme (the Scheme), benefit from an indemnity contained in the rules of the Scheme. The indemnity would be provided out of the Scheme assets.

Change of control – significant agreements

The following significant agreements contain provisions entitling the counterparties to require prior approval, exercise termination, alteration or other similar rights in the event of a change of control of the Company, or if the Company ceases to be a UK company:

- The Combined Aerial Target Service contract is a 20-year contract awarded to QinetiQ by the MOD on 14 December 2006. The terms of this contract require QinetiQ Limited to remain a UK company which is incorporated under the laws of any part of the UK, or an overseas company registered in the UK, and that at least 50% of the Board of Directors are UK nationals. The terms also contain change of control conditions and restricted share transfer conditions which require prior approval from HM Government if there is a material change in the ownership of QinetiQ Limited's share capital, unless the change relates to shares listed on a regulated market – 'material' is defined as being 10% or more of the share capital. In addition, there are restrictions on transfers of shares to persons from countries appearing on the restricted list as issued by HM Government
- The Long Term Partnering Agreement (LTPA) is a 25-year contract, which QinetiQ Limited signed on 28 February 2003, to provide test, evaluation and training services to the MOD. This contract contains conditions under which the prior approval of HM Government is required if the contractor, QinetiQ Limited, ceases to be a subsidiary of the QinetiQ Group, except where such change in control is permitted under the shareholders Agreement to which the MOD is a party
- The Company is party to a multi-currency revolving credit facility with a US\$100m tranche and a £166m tranche, provided by a consortium of banks, that expires on 29 August 2019. Under the terms of the facility, in the event of a change of control of the Company, any lender may give notice to cancel its commitment under the facility and require all outstanding amounts to be repaid.

The Directors' contracts contain no provisions for compensation for loss of office on a change of control of the Company.

Disclosures in accordance with Listing Rule 9.8.4

There are no matters requiring disclosure under the FCA's Listing Rule 9.8.4.

Articles of Association

Changes to the Articles must be submitted to shareholders for approval. Save in respect of the rights attaching to the Special Share, the Company has not adopted any special rules relating to the appointment and replacement of Directors or the amendment of the Company's Articles of Association, other than as provided under UK corporate law.

Appointment and replacement of Directors

According to the Articles of Association, all Directors are subject to election by shareholders at the first AGM following their appointment, and to re-election thereafter at intervals of no more than three years. In line with best practice reflected in the Code, however, the Company requires each serving member of the Board to be put forward for election or re-election on an annual basis at each AGM.

Powers of the Directors: allotment/purchase of own shares

At the Company's AGM held in July 2017, the shareholders passed resolutions which authorised the Directors to allot relevant securities up to an aggregate nominal value of

DIRECTORS' REPORT CONTINUED

£3,910,816 (£1,955,408 pursuant only to a rights issue), to disapply pre-emption rights (up to 5% of the issued ordinary share capital) and to purchase ordinary shares (up to 10% of the issued ordinary share capital). The authorities will remain valid until the 2018 AGM.

Resolutions in respect of the allotment of relevant securities, the disapplication of pre-exemption rights and the purchase of own shares will be laid before the 2018 AGM.

Annual General Meeting

The Company's AGM will be held on Wednesday, 25 July 2018 at 11.00am, at the offices of Ashurst LLP, Broadwalk House, 5 Appold Street, London EC2A 2AG.

Auditor

PwC has expressed its willingness to continue in office as auditor and a resolution to re-appoint them will be proposed at the AGM.

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the Group and Company financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare Group and Company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Accounting Standards (IFRS) as adopted by the EU and applicable law and have elected to prepare the Company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice or UK GAAP).

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of their profit or loss for that period.

In preparing each of the Group and Company's financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently
- Make judgements and estimates that are reasonable and prudent
- For the Group financial statements, state whether they have been prepared in accordance with IFRS as adopted by the EU and for the Company financial statements, state whether applicable UK Accounting Standards, comprising FRS 101, have been followed, subject to any material departures disclosed and explained in the Group and Company financial statements
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose reasonable accuracy at any time its financial statements comply with the Companies Act 2006 and, as regards to the Group financial statements, Article 4 of the IAS Regulation. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

In its reporting to shareholders, the Board is satisfied that the Annual Reports and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy as required by the Code.

The Directors, as at the date of this report, whose names and functions are set out on pages 48 and 49, confirm that, to the best of their knowledge:

- The Company financial statements, which have been prepared in accordance with the United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework', and applicable law), give a true and fair view of the assets, liabilities, financial position and profit of the Company
- The Group's financial statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group
- The management reporting (comprising the Directors' report and the Strategic report) includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

Scope of the reporting in this Annual Report

The Board has prepared a Strategic report which provides an overview of the development and performance of the Group's business in the year ended 31 March 2018.

For the purposes of DTR 4.1.5R(2) and DTR 4.1.8 the Directors' report confirms, that so far as they are aware, there is no relevant audit information of which the Company's auditor is unaware, and that they have taken all steps that they ought to have taken as Directors to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

By order of the Board.

Jon Messent

Company Secretary and Group General Counsel
24 May 2018

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF QINETIQ GROUP PLC

Report on the audit of the financial statements

Opinion

In our opinion:

- QinetiQ Group plc's Group financial statements and Company financial statements (the 'financial statements') give a true and fair view of the state of the Group's and of the Company's affairs as at 31 March 2018 and of the Group's profit and cash flows for the year then ended
- the Group financial statements have been properly prepared in accordance with IFRS as adopted by the European Union
- the Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework', and applicable law)
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the 'Annual Report'), which comprise: the consolidated and Company balance sheets as at 31 March 2018; the consolidated income statement and consolidated comprehensive income statement, the consolidated cash flow statement, and the consolidated and Company statements of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company.

Other than those disclosed in note 5 to the financial statements, we have provided no non-audit services to the Group or the Company in the period from 1 April 2017 to 31 March 2018.

Our audit approach

Context

In planning for our first-year audit of QinetiQ Group plc, we met with the Audit Committee and members of management across the business, to discuss and understand significant changes during the year, and to understand their perspectives on associated business risks. We used this insight, in addition to our assessment of the previous auditor's approach, when forming our own views regarding the business, as part of developing our audit plan. The Group has continued to grow organically, embedding recent acquisitions. We have considered this, as well as general market conditions, when scoping and performing our audit procedures.

Overview



- Overall Group materiality: £5.8 million based on approximately 5% of underlying profit before tax (2017: £5.5 million. Previous auditors, KPMG, based this on 4.7% of profit before tax from continuing operations normalised for specific adjusting items)
- Overall Company materiality: £4.8 million based on 1% of total assets.

- We conducted full scope audit work in the UK over QinetiQ Limited, the main trading entity of the Group which provided significant coverage over all financial statement balances, except inventory
- In addition, we performed the audit of specific inventory balances at two entities.

- Long-term contract accounting
- Provisions and contingent liabilities
- Impairment of goodwill and acquired intangibles
- Accounting for tax research and development expenditure credits.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF QINETIQ GROUP PLC CONTINUED

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industry in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group financial statements, including but not limited to, the Companies Act 2006, UK tax legislation and Single Source Contracting Regulations. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, review of correspondence with legal advisors, enquiries of management, and review of internal audit reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter

Long-term contract accounting

Refer to page 56 (Report of the Audit Committee) and page 100 (note 1, Significant accounting policies – Revenue and Profit recognition) and page 101 (note 2, Revenue).

QinetiQ Group plc have a large number of contracts which span multiple periods and are accounted for on a percentage of completion (POC) basis.

Long-term contracting accounting requires a number of judgements and management estimates to be made, particularly calculating the forecast costs to complete the contract. These judgements drive the revenue and profit recognition, and together with cash paid by the customer, impact the balance sheet position at the year end.

Onerous contract provisions are recorded where there is an expectation that a contract will be loss-making, and judgement is applied to determine the magnitude of any provision.

Particular focus is given to contracts which are technologically challenging, such as the contract with ESA regarding the BepiColombo mission to Mercury.

How our audit addressed the key audit matter

We evaluated the contract governance policies and controls in place within the business, and tested the design and operating effectiveness of key controls in place over long-term contracts.

We performed risk assessment procedures over the portfolio of contracts to identify higher-risk contracts. These higher-risk contracts were selected for detailed contract reviews. These detailed reviews involved meeting with key personnel to discuss contract performance, as well as obtaining evidence to support contract financials. Specifically our procedures included the following:

- We assessed the basis of revenue recognition to ensure it is in line with accounting standards
- We agreed overall anticipated revenue to the underlying contract and validated a sample of customer invoices through to cash receipt
- We recalculated revenue recognised and agreed both revenue, costs and associated balance sheet positions to the underlying general ledger
- We obtained evidence to corroborate management estimates and judgements, particularly around costs to complete. Where necessary, we obtained correspondence with the customer to evidence progress made on the contract during the year and remaining obligations.

We validated costs incurred and allocated to contracts during the year to supporting documentation on a Company wide basis.

For all remaining untested low-risk contracts, we selected a sample and performed testing over revenue, agreeing to supporting documentation including customer contracts and validating a sample of customer invoices to cash receipt.

We agreed contract loss provisions recorded through a combination of the procedures above in respect of the overall outcome anticipated on the contract.

Additional testing was performed, where not sufficiently covered by the above, over contract-related balance sheet positions. These have been sample tested and agreed to supporting documentation.

No material exceptions were found.

Key audit matter**Provisions and contingent liabilities**

Refer to page 56 (Report of the Audit Committee) and page 100 (note 1, Significant accounting policies – Other payables, provisions and contingent liabilities), page 114 (note 23, Provisions) and page 129 (note 32, Contingent liabilities and assets).

QinetiQ Group plc holds provisions in respect of legal, regulatory and environmental issues. (Note: Project and contract related provisions are covered within the 'long-term contract accounting' matter above).

The Group operates in regulated environments and a failure to comply with particular regulations could result in fines and/or penalties. There is judgement required in determining the significance of any instances of potential non-compliance and potential liability based on management's assessment of the most likely outcome.

The financial statements should disclose any contingent liabilities in respect of contractual, regulatory or legal issues which have not been provided for on the basis that they are not considered to qualify for recognition as provisions.

Impairment of goodwill and acquired intangibles
Refer to page 56 (Report of the Audit Committee), page 100 (Note 1, Significant accounting policies – Business combinations and related goodwill), page 107 (note 13, Goodwill) and page 109 (note 14, Intangible assets).

The carrying value of goodwill associated with the US Global Products business was written down to its recoverable amount in the year ended 31 March 2016. As a result, any deterioration in these projections or an increase in the discount rate applied may result in a further write-down being required.

In addition, the business has a material amount of acquired intangible assets, including for recent acquisitions QinetiQ Target Systems Limited and RubiKon Group Pty Ltd. There is an increased risk of impairment where the post-acquisition performance of businesses acquired is behind expectations from the time of the original acquisition.

Accounting for tax research and development expenditure credits

Refer to page 56 (Report of the Audit Committee), page 100 (note 1, Significant accounting policies – Tax), page 105 (note 8, Taxation) and page 111 (note 17, Deferred tax).

The level of current tax and deferred tax recognised requires judgement as to the likely outcome of decisions to be made by the tax authorities. This includes those related to specific tax allowances, such as the UK Research and Development Expenditure Credit (RDEC).

There is a risk that the key judgements on which the provisions are based do not take into account or do not properly reflect the latest available, reliable information or an appropriate application of relevant tax legislation, and are either under or overstated as a result.

How our audit addressed the key audit matter

We have assessed management's processes and controls over legal and regulatory claims and issues and made enquiries with in-house legal counsel.

We tested the appropriateness of management's assumptions by reference to third party evidence for key provisions recorded at the year end. In doing this, we concluded on whether our understanding of the business gained throughout the audit process corroborated the provisions recorded.

We challenged management's estimates of the most likely outcomes by critically evaluating the range of possible outcomes to determine if the amounts provided are appropriate.

We assessed the adequacy of the Group's financial statement disclosures and adherence to accounting standards.

We found that the judgements formed by management were within an acceptable range and disclosures made in the financial statements were appropriate.

We have tested the principles and mathematical integrity of the Group's discounted cash flow model used to assess goodwill and intangible assets for potential impairment. With the assistance of our valuation specialists, we assessed the growth and discount rates used in this impairment calculation, by comparing the Group's assumptions to external data. We concluded that the Group's assumptions were appropriate.

We challenged the cash flow projections used within the model by reference to current level of sales and analysis of management's historic forecasting accuracy.

We tested the sensitivity of the impairment calculation to changes in the underlying assumptions and concluded that there is sufficient headroom within the model such that no impairment is required.

We assessed whether the Group's disclosures regarding sensitivity of the outcome of the impairment assessment to changes in key assumptions properly reflected the risks inherent in the valuation of goodwill. We are satisfied that the disclosures made in the financial statements are appropriate.

We have assessed management's processes and controls over the management of tax positions.

We used our tax specialists to challenge the appropriateness of management's assumptions and estimates in relation to tax positions, including RDEC, by critically assessing the range of possible outcomes. We obtained the latest correspondence with the relevant tax authorities to corroborate management's conclusions.

We found that the judgements made by management were within an acceptable range.

We reviewed the disclosures made in respect of tax, in particular around estimates and uncertainties, and are satisfied that the disclosures made were appropriate.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF QINETIQ GROUP PLC CONTINUED

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which they operate.

The only financially significant component within the Group is QinetiQ Limited. The audit of this entity's complete financial information was performed by the Group audit team in the UK. This provided sufficient coverage over all financial statement balances, except inventory. We performed additional audit procedures over inventory balances at two further entities to ensure sufficient coverage over that financial statement line item. One entity was located within the UK and work was performed by the Group audit team. The other entity was located in the US and work was performed by our local PwC component audit team.

In addition to the above, we performed analytical procedures on the remaining entities to understand key balances and transactions in the year and performed additional procedures on any unusual balances identified.

The audit procedures performed over the complete financial information of QinetiQ Limited, accounted for 75% of total Group revenue (KPMG 2017 coverage: 78%) and 87% of underlying profit before taxation (KPMG 2017 coverage: 87%). These audit procedures, in addition to the specific audit procedures performed over inventory in two locations and goodwill and intangibles arising on acquisition, accounted for 91% of total Group assets (KPMG 2017 coverage: 81%).

The combination of the work referred to above, together with additional procedures performed at Group level, including testing of significant journals posted within the consolidation and significant adjustments made to the financial statements, gave us the evidence we needed for our opinion on the financial statements as a whole.

Only one component auditor, located in the US, was involved in the audit as all other audit procedures were performed by the Group audit team. The US business operates under a Proxy Board which is required to carry on business with the US Department of Defence. This Proxy Board places certain restrictions on access to, and communication of, information outside of the US borders. We planned our audit to ensure US personnel completed the audit work within the US and obtained approvals for transfer of information in advance of undertaking the audit work. The Group engagement leader met and agreed the audit plan with our US component audit team, in addition to agreeing the format and content of communications. We determined the level of involvement we needed to have in the audit work at this reporting entity to be able to conclude whether sufficient appropriate evidence had been obtained as a basis for our opinion on the financial statements as a whole. As the procedures performed by this component were limited to inventory only, this included discussion with the component team and attending the audit close meeting by conference call, at which the outcome of all audit findings was discussed.

The Company audit was performed by the Group audit team at QinetiQ Group plc's head office in the UK. Audit procedures were performed over the complete financial information and disclosures for statutory audit purposes only. Audit work over the Company was not required for the Group audit, as all significant balances within the Company are eliminated on consolidation.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate, on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Company financial statements
Overall materiality	£5.8 million (2017: £5.5 million).	£4.8 million.
How we determined it	Approximately 5% of underlying profit before tax. (2017: Previous auditors, KPMG, used a benchmark of 4.7% of profit before tax from continuing operations normalised for specific adjusting items.)	1% of total assets.
Rationale for benchmark applied	Based on the benchmarks used in the Annual Report, underlying profit before tax is one of the primary measures used by the shareholders in assessing the performance of the Group, and is a generally accepted auditing benchmark. It is considered appropriate to exclude specific adjusting items due to the nature of these balances as disclosed in note 4 of the financial statements.	We believe that total assets is the primary measure used by the shareholders in assessing the performance of this entity, and is a generally accepted auditing benchmark for non-trading entities. This materiality relates to the audit for the statutory entity only, as the Company was not in scope for the Group audit.

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £3.0 million and £5.3 million. Certain components were audited to a local statutory audit materiality that was also less than our overall Group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £290,000 (Group audit) (2017: £275,000) and £240,000 (Company audit) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Directors' identification of any material uncertainties to the Group's and the Company's ability to continue as a going concern over a period of at least 12 months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Company's ability to continue as a going concern.
We are required to report if the Directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006, (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the year ended 31 March 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report. (CA06)

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

- The Directors' confirmation on page 53 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The Directors' explanation on page 27 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the 'Code'); and considering whether the statements are consistent with the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit. (Listing Rules).

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF QINETIQ GROUP PLC CONTINUED

Other Code provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the Directors, on page 53 that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Company obtained in the course of performing our audit
- The section of the Annual Report on page 56 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee
- The Directors' statement relating to the Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

Responsibilities for the financial statements and the audit

Responsibilities of the Directors for the financial statements

As explained more fully in the Directors' responsibility statement, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our Auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- the Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 22 June 2017 to audit the financial statements for the year ended 31 March 2018 and subsequent financial periods. This is therefore our first year of uninterrupted engagement.

Julian Gray (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Southampton
24 May 2018



Enabling disruptive technologies for our customers

Dragonworks is QinetiQ's new centre of excellence for the development and testing of advanced laser technology at our headquarters in Farnborough. With a focus on innovation, this is a distinct example of how we are able to take an idea through the development process, from initial research to end user training.

The new facility will serve as a test bed for all technologies associated with high-energy lasers for military or commercial applications. This introduces a brand new sovereign capability which will significantly enhance the UK's ability to operate high energy lasers.

We are investing in this asset as part of our strategy to modernise the UK's test and evaluation services, which will ensure our customers can keep pace with rapid technological advances and maintain their competitive edge. The first project to be undertaken at the facility will be the assembly and testing of the laser directed energy weapon (LDEW) currently in development by the UK's Dragonfire consortium, led by MBDA. The project will culminate in operation at full-power under test conditions inside the facility in summer 2018, before it is transported to MOD Shoeburyness for long-range outdoor trials.

QinetiQ's Dragonworks facility helps our customers to understand the opportunities and challenges associated with this disruptive technology, informing their critical strategic and tactical decisions.

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CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH

	Note	2018			2017		
		Underlying*	Specific adjusting items*	Total	Underlying*	Specific adjusting items*	Total
all figures in £ million							
Revenue	2, 3	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	2	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	3, 15	(25.6)	–	(25.6)	(26.4)	–	(26.4)
Amortisation of intangible assets	3, 14	(3.7)	(2.6)	(6.3)	(2.6)	(1.0)	(3.6)
Operating profit	3	122.5	18.5	141.0	116.3	16.4	132.7
Finance income	6	0.7	4.2	4.9	1.0	–	1.0
Finance expense	6	(1.1)	–	(1.1)	(1.2)	(1.0)	(2.2)
Profit before tax	5	122.1	22.7	144.8	116.1	15.4	131.5
Taxation (expense)/income	8	(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	12	19.3p		24.4p	18.1p		21.5p
Diluted	12	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 on page 139.

CONSOLIDATED COMPREHENSIVE INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH

all figures in £ million	2018	2017
Profit for the year	138.1	123.3
<i>Items that will not be reclassified to profit or loss:</i>		
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 or loss	119.2	152.1
<i>Items that may be reclassified to profit or loss:</i>		
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 hedging derivatives	0.4	–
Fair value losses on available-for-sale investments	(0.6)	(0.4)
Total items that may be reclassified to profit or 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	–	–	–	–	–	2.7	2.7	–	2.7
Dividends	–	–	–	–	–	(34.5)	(34.5)	–	(34.5)
At 31 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	–	–	–	–	–	2.1	2.1	–	2.1
Dividends	–	–	–	–	–	(33.4)	(33.4)	–	(33.4)
At 31 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	13	101.5	107.8
Intangible assets	14	41.1	34.7
Property, plant and equipment	15	269.0	238.8
Other financial assets	24	0.3	0.5
Equity accounted investments	16	2.2	1.5
Retirement benefit surplus	30	316.2	156.0
Deferred tax asset	17	6.4	5.4
		736.7	544.7
Current assets			
Inventories	18	38.1	28.9
Other financial assets	24	16.9	10.7
Trade and other receivables	19	150.3	175.6
Investments	20	0.7	1.3
Assets held for sale	15	1.2	–
Cash and cash equivalents	24	254.1	211.8
		461.3	428.3
Total assets		1,198.0	973.0
Current liabilities			
Trade and other payables	21	(334.9)	(322.1)
Current tax	22	(8.9)	(43.7)
Provisions	23	(6.0)	(6.2)
Other financial liabilities	24	(2.6)	(0.8)
		(352.4)	(372.8)
Non-current liabilities			
Deferred tax liability	17	(66.4)	(37.0)
Provisions	23	(14.3)	(17.8)
Other financial liabilities	24	(1.9)	(0.3)
Other payables	21	(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	28	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

The financial statements were approved by the Board of Directors and authorised for issue on 24 May 2018 and were signed on its behalf by:

Mark Elliott
Chairman

Steve Wadey
Chief Executive Officer

David Smith
Chief Financial Officer

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH

all figures in £ million	Note	2018	2017
Underlying net cash inflow from operations	27	126.5	111.9
Add back 'specific adjusting items': proceeds from sale of intellectual property		5.9	–
Net cash inflow from operations		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)
Investment 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 the year		211.8	263.5
Cash and cash equivalents at end of the year	24	254.1	211.8

Reconciliation of movement in net cash for the year ended 31 March

all figures in £ million	Note	2018	2017
Increase/(decrease) in cash and cash equivalents in the year		43.5	(56.5)
Add back net cash flows 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 Group at the beginning of the year		221.9	274.5
Net cash as defined by Group at the end of the year	24	266.8	221.9
Less: other financial assets and liabilities	24	(12.7)	(10.1)
Total cash and cash equivalents	24	254.1	211.8

NOTES TO THE FINANCIAL STATEMENTS

1. Significant accounting policies

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

Accounting policies

The following accounting policies have been applied consistently to all periods presented in dealing with items that are considered material in relation to the Group's financial statements. 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 business performance, specific adjusting items need to be disclosed separately. Underlying measures of performance exclude specific adjusting items.

Specific adjusting items include the following:

Item	Distorting due to irregular nature year on year	Distorting due to fluctuating nature (size and sign)	Does not reflect in-year operational performance of continuing business
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	✓	✓	✓
Transaction costs in respect of business acquisitions	✓		✓
Impairment of goodwill and other intangible assets	✓		
The tax impact of the above	✓	✓	✓
Other significant non-recurring deferred tax movements	✓	✓	✓

The financial impact of each item is reported in note 4 to these financial statements. With effect for 2019 and the transition to IFRS 9 (Financial Instruments) mark to market revaluations on certain financial assets shall be reclassified from being measured at fair value through other comprehensive income to fair value through profit and loss. These gains or losses, should they occur for QinetiQ, will also be reported as significant adjusting items.

Basis of preparation

The Group's financial statements, approved by the Directors, have been prepared on a going concern basis as discussed in the Directors' report on page 78 and in accordance with International Financial Reporting Standards as adopted by the EU (IFRS) and the Companies Act 2006 applicable to companies reporting under IFRS. The Company has elected to prepare its parent company financial statements in accordance with UK GAAP (FRS 101); these are presented on page 131. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and other relevant financial assets and liabilities. The Group's reporting currency is Sterling and unless otherwise stated the financial statements are rounded to the nearest £100,000.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings to 31 March 2018. The purchase method of accounting has been adopted. Those subsidiary undertakings acquired or disposed of in the period are included in the consolidated income statement from the date control is obtained to the date that control is lost (usually on acquisition and disposal respectively). An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. This is the IFRS 10 definition of 'control'.

The Group comprises certain entities that are operated under the management of a Proxy Board. Details of the Proxy Board arrangements and the powers of the Proxy holders and QinetiQ management are set out in the Corporate Governance section of this Annual Report. IFRS 10 is the accounting standard now applicable in respect of consolidation of entities. This does not specifically deal with proxy situations. However, having considered the terms of the Proxy agreement, the Directors consider that the Group meets the requirements of IFRS 10 in respect of control over such affected entities and, therefore, consolidates these entities in the consolidated accounts.

An associate is an undertaking over which the Group exercises significant influence, usually from 20%–50% of the equity voting rights, in respect of financial and operating policy. A joint venture is an undertaking over which the Group exercises joint control. Associates and joint ventures are accounted for using the equity method from the date of acquisition to the date of disposal. The Group's investments in associates and joint ventures are held at cost including goodwill on acquisition and any post-acquisition changes in the Group's share of the net assets of the associate less any impairment to the recoverable amount. Where an associate or joint venture has net liabilities, full provision is made for the Group's share of liabilities where there is a constructive or legal obligation to provide additional funding to the associate or joint venture.

The financial statements of subsidiaries, joint ventures and associates are adjusted where necessary to ensure compliance with Group accounting policies.

On consolidation, all intra-group income, expenses and balances are eliminated.

Revenue

Revenue represents the value of work performed for customers, and is measured net of value added taxes and other sales taxes on the following bases:

Service contracts

The Group's service contract arrangements are accounted for under IAS 18 'Revenue' taking into account each party's enforceable rights regarding the services provided and expected manner of settlement. When the outcome of a contract involving the rendering of services can be reliably estimated, revenue associated with the transaction is recognised by reference to the stage of completion of the contract activity at the end of the reporting period and reflecting the probable economic benefits that will flow to the entity. This is normally measured by the proportion of contract costs incurred for work performed to date compared with the estimated total contract costs after making suitable allowances for technical and other risks related to performance milestones yet to be achieved. No profit is recognised on contracts until the outcome of the contract can be reliably estimated. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense. The Group generally does not undertake construction contracts.

Goods sold

Sales of goods are recognised in the income statement on delivery of the product or when the significant risks and rewards of ownership have been transferred to the customer and revenue and costs can be reliably measured.

Royalties and intellectual property

Royalty revenue is recognised over the period to which the royalty relates. Intellectual property revenue can be attributed either to perpetual licences or to limited licences. Limited licences are granted for a specified period and revenue is recognised over the period of the licence. Perpetual licences are granted for unlimited time frames and revenue is recognised when the risks and rewards of ownership are transferred to the customer.

Segmental information

Segmental information is presented according to the Group's internal management reporting structure and the markets in which it operates. Segmental results represent the contribution of the different segments to the profit of the Group. Corporate expenses are allocated to the corresponding segments. Unallocated items mainly comprise specific adjusting items. Specific adjusting items are referred to in note 4.

Segmental assets and liabilities information is not regularly provided to the Chief Operating Decision Maker.

Research and development expenditure

R&D costs incurred in respect of specific contracts placed by customers are recognised within operating costs and revenue is recognised in respect of the R&D services performed. Internally funded development expenditure is capitalised in the balance sheet where there is a clearly defined project, the expenditures are separately identifiable, the project is technically and commercially feasible, all costs are recoverable by future revenue and the resources are committed to complete the project. Such capitalised costs are amortised over the forecast period of sales resulting from the development. All other R&D costs are expensed to the income statement in the period in which they are incurred. If the research phase cannot be clearly distinguished from the development phase, the respective project-related costs are treated as if they were incurred in the research phase only and expensed.

Financing

QinetiQ Group holds no external borrowings but does have access to a revolving credit facility (undrawn during 2017 and 2018), fees for which are reported within finance costs. Costs of letters of credit are also charged to finance expense. Income earned on funds invested is reported within finance income. Exchange differences on financial assets and liabilities and the income or expense from interest hedging instruments that are recognised in the income statement are included within finance income and finance expense. Financing also includes the net finance income or expense in respect of defined benefit pension schemes.

Taxation

The taxation charge is based on the taxable profit for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes. Current tax and deferred tax are charged or credited to the income statement, except where they relate to items charged or credited to equity, in which case the relevant tax is charged or credited to equity. Deferred taxation is the tax attributable to the temporary differences that appear when taxation authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated financial statements. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using rates enacted or substantively enacted at the balance sheet date.

Any changes in the tax rates are recognised in the income statement unless related to items directly recognised in equity. Deferred tax liabilities are recognised on all taxable temporary differences excluding non-deductible goodwill. Deferred tax assets are recognised on all deductible temporary differences provided that it is probable that future taxable income will be available against which the asset can be utilised. Deferred tax assets and liabilities are offset only where there is a legally enforceable right to offset and there is an intention to settle balances on a net basis.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

1. Significant accounting policies continued

Non-current assets held for sale

Non-current assets are classified as held for sale if their carrying amount will be recovered primarily through a sales transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and expected to be completed within a year of the balance sheet date. The assets should be available for immediate sale in their present condition and actively marketed at a price that is reasonable in relation to their current fair value.

Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Any write-down to fair value less costs to sell shall be recognised directly through profit and loss as an impairment loss. No further depreciation is charged in respect of assets classified as held for sale.

Goodwill

Goodwill on acquisitions of subsidiaries is included in non-current assets. Goodwill on acquisitions of joint ventures and associates is included in the carrying value of equity accounted investments. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill related to the entity sold.

Intangible assets

Intangible assets arising from business combinations are recognised at fair value and are amortised over their expected useful lives, typically between one and 16 years. Internally generated intangible assets are recorded at cost, including labour, directly attributable costs and any third-party expenses.

The 'multi-period excess earnings' method and the 'relief-from-royalty' method are both used for fair valuing intangible assets arising from acquisitions. The multi-period excess earnings method considers the present value of net cash flows expected to be generated by customer relationships, by excluding any cash flows related to contributory assets. The relief-from-royalty method considers the discounted estimated royalty payments that are expected to be avoided as a result of the patents or trademarks being owned.

Purchased intangible assets are recognised at cost less amortisation. Intangible assets are amortised over their respective useful lives on a straight-line basis as follows:

Intellectual property rights	2–10 years
Customer relationships	1–16 years
Development costs	1–4 years
Other	1–10 years

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation. Freehold land is not depreciated. Other tangible non-current assets are depreciated on a straight-line basis over their useful economic lives to their estimated residual value as follows:

Freehold buildings	20–25 years
Leasehold land and buildings	Shorter of useful economic life and the period of the lease
Plant and machinery	3–10 years
Fixtures and fittings / office equipment	5–10 years
Computers	3–5 years
Motor vehicles	3–5 years

Assets under construction are included in property, plant and equipment on the basis of expenditure incurred at the balance sheet date. In the case of assets constructed by the Group, the value includes the cost of own work completed, including directly attributable costs and interest.

The useful lives, depreciation methods and residual values applied to property, plant and equipment are reviewed annually and, if appropriate, adjusted accordingly.

Impairment of goodwill and tangible, intangible and held for sale assets

At each reporting date the Group assesses whether there is an indication that an asset may be impaired. If the carrying amount of any asset exceeds its recoverable amount an impairment loss is recognised immediately in the income statement. In addition, goodwill is tested for impairment annually irrespective of any indication of impairment. If the carrying amount exceeds the recoverable amount, the respective asset or the assets in the cash-generating unit (CGU) are written down to their recoverable amounts. The recoverable amount of an asset or CGU is the higher of its fair value less costs to sell and its value in use. The value in use is the present value of the future cash flows expected to be derived from an asset or CGU calculated using an appropriate pre-tax discount rate. Impairment losses are expensed to the income statement.

Investments in debt and equity securities

Investments held by the Group are classified as either a current asset or as a non-current asset and those classified as available for sale are stated at fair value, with any resultant gain or loss, other than impairment losses, being recognised directly in equity. When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in the income statement.

The fair value of quoted financial instruments is their bid price at the balance sheet date. The fair value of unquoted equity investments is based on the price of the most recent investment by the Group or a third party, if available, or derived from the present value of forecast future cash flows.

Inventories

Inventory and work-in-progress are stated at the lower of cost and net realisable value. Work-in-progress and manufactured finished goods are valued at production cost. Production cost includes direct production costs and an appropriate proportion of production overheads. A provision is established when the net realisable value of any inventory item is lower than its cost. A 'market comparison' technique is used to fair value inventories acquired through a business combination. The fair value is determined based on the estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventories.

Trade and other receivables

Trade and other receivables are stated net of provisions for doubtful debts. Amounts recoverable on contracts are included in trade and other receivables and represent revenue recognised in excess of amounts invoiced. Other receivables will also include insurance recoveries where we are virtually certain of recovery.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and short-term deposits that are readily convertible into cash. In the cash flow statement overdraft balances are included in cash and equivalents.

Current and non-current liabilities

Current liabilities include amounts due within the normal operating cycle of the Group. Deferred income is included in trade and other payables and represents amounts invoiced in excess of revenue recognised. Interest-bearing current and non-current liabilities are initially recognised at fair value and then stated at amortised cost with any difference between the cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis. Costs associated with the arrangement of bank facilities or the issue of loans are held net of the associated liability presented in the balance sheet. Capitalised issue costs are released over the estimated life of the facility or instrument to which they relate using the effective interest rate method. If it becomes clear that the facility or instrument will be redeemed early, the amortisation of the issue costs will be accelerated.

Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event which can be reliably estimated, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where appropriate, provisions are determined by discounting the expected cash flows at an appropriate discount rate reflecting the level of risk and the time value of money.

Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument. The de-recognition of a financial instrument takes place when the Group no longer controls the contractual rights that comprise the financial instrument, when the instrument expires, or when the instrument is sold, terminated or exercised.

Derivative financial instruments

Derivative financial instruments are initially recognised and thereafter held at fair value, being the market value for quoted instruments or valuation based on models and discounted cash flow calculations for unlisted instruments.

Fair value hedging

Changes in the fair value of derivatives designated as fair value hedges of currency risk or interest rate risk are recognised in the income statement. The hedged item is held at fair value with respect to the hedged risk with any gain or loss recognised in the income statement.

Cash flow hedging

Changes in the fair value of derivatives designated as a cash flow hedge that are regarded as highly effective are recognised in equity. The ineffective portion is recognised immediately in the income statement. Where a hedged item results in an asset or a liability, gains and losses previously recognised in equity are included in the cost of the asset or liability. Gains and losses previously recognised in equity are removed and recognised in the income statement at the same time as the hedged transaction.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

1. Significant accounting policies continued

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities in foreign currencies are translated at period-end rates. Any resulting exchange differences are taken to the income statement. Gains and losses on designated forward foreign exchange hedging contracts are matched against the foreign exchange movements on the underlying transaction.

The individual financial statements of each Group company are presented in its functional currency. On consolidation, assets and liabilities of overseas subsidiaries, associated undertakings and joint ventures, including any related goodwill, are translated to Sterling at the rate of exchange at the balance sheet date. The results and cash flows of overseas subsidiaries, associated undertakings and joint ventures are translated to Sterling using the average rates of exchange during the period. Exchange adjustments arising from the re-translation of the opening net investment and the results for the period to the period-end rate are taken directly to equity and reported in the statement of comprehensive income.

Post-retirement benefits

The Group provides both defined contribution and defined benefit pension arrangements. The liabilities of the Group arising from defined benefit obligations are determined using the projected unit credit method. Valuations for accounting purposes are carried out bi-annually. Actuarial advice is provided by external consultants. For the funded defined benefit plans, the excess or deficit of the fair value of plan assets less the present value of the defined benefit obligation are recognised as an asset or a liability respectively. Per the Scheme rules, the Company has an unconditional right to a refund of any surplus that may arise on cessation of the Scheme in the context of IFRIC 14 paragraphs 11(b) and 12 and therefore the full net pension asset can be recognised on the Group's balance sheet and the Group's minimum funding commitments to the Scheme do not give rise to an additional balance sheet liability.

For defined benefit plans, the cost charged to the income statement consists of administrative expenses and the net interest income or expense. There is no service cost due to the fact the plans are closed to future accrual. The finance element of the pension charge is shown in finance income or expense and the administration cost element is charged as a component of operating costs in the income statement. Actuarial gains and losses and re-measurement gains and losses are recognised immediately in full through the statement of comprehensive income. Contributions to defined contribution plans are charged to the income statement as incurred.

Share-based payments

The Group operates share-based payment arrangements with employees. The fair value of equity-settled awards for share-based payments is determined on grant and expensed straight line over the period from grant to the date of earliest unconditional exercise. The fair value of cash-settled awards for share-based payments is determined each period end until they are exercised or lapse. The value is expensed straight line over the period from grant to the date of earliest unconditional exercise. The charges for both equity and cash-settled share-based payments are updated annually for non-market-based vesting conditions.

Share capital

Ordinary share capital of the Company is recorded as the proceeds received, less issue costs. Company shares held by the employee benefit trusts are held at the consideration paid. They are classified as own shares within equity. Any gain or loss on the purchase, sale or issue of Company shares is recorded in equity.

Recent accounting developments

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 statement of cash flows** – amendments to the Disclosure initiatives require 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 clarify 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.

Developments expected in future periods for which the impact has been assessed

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was published in May 2014 (amended in April 2016) and establishes a five-step model to account for revenue arising from contracts with customers. The model includes identifying the contract with the customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction price to the performance obligations in the contract and recognising the revenue when the entity satisfies a performance obligation.

The new standard shall supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a cumulative effect method is required for annual periods beginning on or after 1 January 2018 i.e. FY19 for QinetiQ. Early adoption is permitted but QinetiQ plans to adopt the new standard on the required effective date. During FY18 QinetiQ performed a detailed assessment of IFRS 15 (see below) and concluded that the impact of transitioning to IFRS 15 would not be material. We have not identified any contracts in total, or part contracts (in the form of performance obligations), where we would need to move from recognising revenue over time to recognising revenue at a point in time. The majority of QinetiQ's contracts are largely either long-term service contracts where the customer benefits from QinetiQ's performance throughout the contract, or they are long-term design, build and delivery contracts which are highly bespoke and have no alternative use to QinetiQ (and QinetiQ have a right to payment for work performed to date). Therefore, it remains appropriate to recognise revenue over time using an input-based methodology (cost-to-cost). From the reviews carried out to date, the disaggregation of the contract into distinct performance obligations does not materially alter the long-term percentage completion methodology currently applied.

Revenue on product delivery contracts is currently recognised by QinetiQ at a point in time; despite the changes in IFRS 15 this methodology is expected to be unchanged for QinetiQ. There are certain instances, though, where if the customer controls the production run (and the units produced can't be diverted to another customer) that may require revenue to be recognised over the time-frame of the production run. Due to the short time frame of the production runs the period of time will largely be within the same accounting period and the impact is usually expected to be immaterial. From a review of the contracts in progress at year end, and an assessment of how much of the closing inventory was 'controlled' by the customer, this has been determined to be immaterial.

Detailed IFRS 15 assessment

The following process was followed:

1. All major long-term service contracts (FAST, LTPA, CATS, NCSISS and MSCA), which accounts for approximately 39% of FY18 revenue, were assessed and concluded on individually.
2. Management within each business unit assessed all other contracts greater than £1m and which extended beyond FY18. These were concluded on individually within each business by considering performance obligations, transaction prices and satisfaction of performance obligations. Generally these contracts consisted of one performance obligation which is to deliver 'advice-based' services to customers over multiple periods. Conclusions drawn were similar to long-term service contracts assessed above with current treatment already being aligned with IFRS 15. The impact of adopting IFRS 15 across the business units was considered to be immaterial. Contracts which started and ended in FY18 were not assessed as these would have no impact on revenue recognition.
3. Licensing revenue earned at Boldon James was assessed separately using new guidance provided under IFRS 15. Management assessed if licences provide a 'right to use' or 'right to access' licences. An assessment was also made on whether the granting of licences and support service contracts are two distinct performance obligations. Granting of licences was assessed to provide 'right to use' with revenue recognised at a point in time. Support service contracts were assessed to be a separate performance obligation and recognised over the duration of the contract term. Boldon James current revenue recognition policy is already in compliance with IFRS 15 and no changes are required.
4. Product shipment contracts with control clauses were assessed to determine the point in time when revenue shall be recognised by considering the additional indicators highlighted in the new standard. It was determined that there was no material impact on QinetiQ point in time revenue recognition.

Internal revenue recognition accounting policies have been updated which shall be adopted consistently throughout FY19. Training and guidance has also been provided across the Group to ensure IFRS 15 compliance on all QinetiQ contracts during FY19. QinetiQ plans to adopt the new standard using the cumulative effect transitional method without using the practical expedients for modified contracts in IFRS 15.C5(c). This method would require an adjustment to the opening balance of equity in the period of adoption without having to restate comparative amounts. However, following the conclusion that the impact is not material, no adjustment will be required for the Group on implementation of IFRS 15.

Apart from providing more extensive disclosures on QinetiQ's revenue transactions, the application of IFRS 15 shall not have a significant impact on the financial position or performance of the Group. QinetiQ does not expect to adjust opening balances of equity in FY19 once the standard is adopted.

IFRS 9 financial instruments

IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities, and introduces a new impairment model for financial assets, as well as new rules for hedge accounting. The new standard shall replace IAS 39 in its entirety and is effective for annual periods beginning on or after 1 January 2018 i.e. FY19 for the Group. The Group plans to adopt the new standard on the required effective date, FY19, and shall only restate comparatives if possible without the benefit of hindsight. Hedge accounting shall be applied prospectively.

The Group assessed the impact of adopting the new standard and determined that certain financial assets shall be reclassified from being measured at fair value through other comprehensive income to fair value through profit and loss. This change will impact overall profit in FY19 as all financial asset gains or losses shall be recognised directly through profit and loss. The changes to impairment and hedge accounting will not have a material impact on the results of the Group.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

1. Significant accounting policies continued

IFRS 16 leases

The final standard, IFRS 16 leases, was published in January 2016. Under the new standard, companies will recognise new assets and liabilities, bringing added transparency to the balance sheet. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. Lessor accounting remains similar to current practice – i.e. lessors continue to classify leases as finance and operating leases. The standard will be effective for periods beginning on or after 1 January 2019 subject to EU endorsement. Management have started to assess the impact of IFRS 16 but cannot yet qualify any impact as at year-end. Details of the Group's operating leases can be found in note 25.

Developments expected in future periods with no material impact on the Group's financial statements

The Directors anticipate that the adoption of the following new, revised, amended and improved published standards and interpretations, which were in issue at the date of authorisation of these financial statements, will have no material impact on the financial statements of the Group when they become applicable in future periods:

- Amendments to IFRS 2, 4, 9 and 15.
- Amendments to IAS 40.
- IFRIC 22, 'Foreign Currency Transactions and Advance Consideration'.

Critical accounting estimates and judgements in applying accounting policies

The following commentary is intended to highlight those policies that are critical to the business based on the level of management judgement required in their application, their complexity and their potential impact on the results and financial position reported for the Group. The level of management judgement required includes assumptions and estimates about future events that are uncertain and the actual outcome of which may result in a materially different outcome from that anticipated.

Revenue and profit recognition

The estimation process required to evaluate the potential outcome of contracts and projects requires skill, knowledge and experience from a variety of sources within the business to assess the status of the contract, costs to complete, internal and external labour resources required and other factors. This process is carried out continuously throughout the business to ensure that project and contract assessments reflect the latest status of such work. Judgement is required when considering the likelihood of meeting the contractual requirements, particularly around technologically challenging contracts, and the resulting costs. Estimated contract losses are recognised as soon as anticipated and no profit is recognised on a contract until the outcome can be reliably estimated.

Business combinations and related goodwill

The Group tests annually whether goodwill has suffered any impairment. This process relies on the use of estimates of the future profitability and cash flows of its CGUs which may differ from the actual results delivered. In addition, the Group reviews whether identified intangible assets have suffered any impairment. Further details on the sensitivity of the carrying value of goodwill to changes in the key assumptions are set out in note 13.

Tax

The Group has significant levels of unused tax losses, as set out in note 8. Judgement is applied when assessing the recoverability of deferred tax assets impacting on the value of losses recognised on the balance sheet as a deferred tax asset. Judgement is also required when assessing technical uncertainties associated with tax positions. To the extent that the outcome of a tax audit differs from the tax that has been provided, adjustments will be made to current tax and deferred tax provisions held in the period the determination is made.

Other payables, provisions and contingent liabilities

The Group holds liabilities in respect of environmental and regulatory issues (see note 23). The Group operates in regulated environments and a failure to comply with particular regulations could result in fines and/or penalties. There is judgement required in determining the significance of any instances of potential non-compliance and potential liability based on management's assessment of the most likely outcome. The financial statements also disclose contingent liabilities in respect of legal claims and regulatory issues which have not been provided for on the basis that they are not considered to qualify for recognition as provisions. Judgement is required in these assessments.

Post-retirement benefits

The Group's defined benefit pension obligations and net income statement costs are based on key assumptions, including discount rates, mortality and inflation. Management exercises its best judgement, in consultation with actuarial advisors, in selecting the values for these assumptions that are the most appropriate to the Group. Small changes in these assumptions at the balance sheet date, individually or collectively, may result in significant changes in the size of the net surplus/deficit. Further details of these assumptions are set out in note 30.

2. Revenue and other income

Revenue and other income is analysed as follows:

Revenue by category

For the year ended 31 March

all figures in £ million	2018	2017
Sales of goods	85.8	90.6
Services	733.4	682.4
Royalties and licences	13.8	10.1
Revenue	833.0	783.1
Share of associates' and joint ventures' profit after tax	0.3	0.5
Other income	9.4	8.7
Other income – underlying	9.7	9.2
Gain on sale of assets (note 4)	21.1	18.4
Total other income	30.8	27.6

Revenue and profit after tax of associates and joint ventures was £13.6m and £0.6m respectively (2017: revenue of £8.2m and profit after tax of £1.0m). The figures in the table above represent the Group share of this profit after tax.

Other income is in respect of property rentals and the recovery of other related property costs. The prior year gain of £18.4m has been reclassified from operating costs.

Revenue by customer geographic location

For the year ended 31 March

all figures in £ million	2018	2017
United Kingdom	607.0	607.4
US	81.6	72.4
Other	144.4	103.3
Total	833.0	783.1

Total international revenue (US + Other) was £226.0m (2017: £175.7m). International revenue is one of the Group's KPIs.

Revenue by major customer type

For the year ended 31 March

all figures in £ million	2018	2017
UK Government	544.2	538.4
US Government	65.5	61.8
Other	223.3	182.9
Total	833.0	783.1

'Other' does not contain any customers with revenue in excess of 10% of total Group revenue.

3. Segmental analysis

The analysis by business segment is presented in accordance with IFRS 8 Operating Segments, on the basis of those reportable segments whose operating results are regularly reviewed by the Board (the Chief Operating Decision Maker as defined by IFRS 8) and are aligned with the Group's strategic direction, determined with reference to the products and services they provide, as follows:

EMEA Services provides technical assurance, test and evaluation and training services, underpinned by long-term contracts. EMEA Services comprises the following business units which are not considered reportable segments as defined by IFRS 8: Maritime, Land & Weapons; Air & Space, Cyber, Information & Training, and International business. These are aggregated into the single EMEA Services segment due to their similar characteristics including the nature of the services provided and customers.

Global Products combines all other business units not aggregated within EMEA Services. Generally these business units deliver innovative solutions and products which includes contract-funded research and development and developing intellectual property in partnership with key customers and through internal funding with potential for new revenue streams. Global Products comprises the following business units which are not considered reportable segments as defined by IFRS 8: QinetiQ North America, Space Products, OptaSense and EMEA Products. No single component represents 10% or more of the Group's revenue.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

3. Segmental analysis continued

Operating segments

	2018		2017	
	Revenue from external customers	Underlying operating profit ¹	Revenue from external customers	Underlying operating profit ¹
all figures in £ million				
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 operating profit stated before specific adjusting items ('underlying operating profit'). The specific adjusting items are detailed in note 4.

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 139.

No measure of segmental assets and liabilities is reported as this information is not regularly provided to the Chief Operating Decision Maker.

Reconciliation of total operating segments to total on an organic, constant currency basis

	2018		2017	
	Revenue from external customers	Underlying operating profit	Revenue from external customers	Underlying operating profit
all figures in £ million				
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 in which there was no contribution in the equivalent period in the prior year which was pre-ownership by the Group.

Reconciliation of segmental results to total profit

	Note	2018	2017
all figures in £ million			
Underlying operating profit		122.5	116.3
Specific adjusting items operating profit	4	18.5	16.4
Operating profit		141.0	132.7
Net finance income/(expense)	6	3.8	(1.2)
Profit before tax		144.8	131.5
Taxation expense	8	(6.7)	(8.2)
Profit for the year attributable to equity shareholders		138.1	123.3

Non-current assets* by geographic location

	UK	Rest of World	Total
All figures in £ million			
Year ended 31 March 2018	340.5	71.1	411.6
Year ended 31 March 2017	303.0	78.3	381.3

* excluding deferred tax, financial instruments and retirement benefit surplus.

Depreciation and amortisation by business segment – excluding specific adjusting items
For the year ended 31 March 2018

All figures in £ million	EMEA Services	Global Products	Total
Depreciation of property, plant and equipment	23.6	2.0	25.6
Amortisation of purchased or internally developed intangible assets	2.3	1.4	3.7
	25.9	3.4	29.3

For the year ended 31 March 2017

All figures in £ million	EMEA Services	Global Products	Total
Depreciation of property, plant and equipment	24.8	1.6	26.4
Amortisation of purchased or internally developed intangible assets	1.4	1.2	2.6
	26.2	2.8	29.0

4. 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. Further explanation of this rationale is provided in note 1 (Accounting Policies). 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	8	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

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

5. Profit before tax

The following auditor's remuneration has been charged in arriving at profit before tax:

all figures in £ million	2018	2017
Fees payable to the auditor and its associates:		
Audit of the Group's annual accounts	0.4	0.4
Audit of the accounts of subsidiaries of the Company and its associated pension scheme	0.2	0.1
Total audit fees	0.6	0.5
Audit-related assurance services	0.1	0.1
Total non-audit fees	0.1	0.1
Total auditor's remuneration	0.7	0.6

The following items have also been charged in arriving at profit before tax:

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

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

6. Finance income and expense

For the year ended 31 March

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)

7. Business combinations

Acquisitions in the year to 31 March 2018

There were no acquisitions in the year to 31 March 2018. However, payment of £1.0m consideration was made in respect of the prior year acquisition of RubiKon Group Pty Limited and £0.6m was invested in joint ventures. The remaining £0.3m deferred consideration had not been paid as at year end.

Acquisitions in the year to 31 March 2017

all figures in £ million	Date acquired	Cash consideration ¹	Goodwill	Contribution post-acquisition		
				Fair value of assets acquired	Revenue	Operating profit
Company acquired						
QinetiQ Target Systems	21 December 2016	60.3	(24.5)	35.8	6.6	1.0
RubiKon Group Pty Limited	31 January 2017	7.4	(3.9)	3.5	2.6	0.2
Total current year acquisitions		67.7	(28.4)	39.3	9.2	1.2
Less: deferred consideration		(1.3)				
Less: cash acquired		(1.7)				
Plus: transaction costs ²		1.0				
Net cash outflow in the year		65.7				

¹ Initial cash consideration includes price adjustments for working capital and net cash.

² Transaction costs have been included in 'Operating costs excluding depreciation and amortisation' as a specific adjusting item.

QinetiQ Target Systems (formerly Meggitt Target Systems)

On 21 December 2016, the Group acquired 100% of the issued share capital of Meggitt Target Systems for £60.3m. The company is a provider of unmanned aerial, naval and land-based target systems and services for test and evaluation (T&E) and operational training and rehearsal. On the date of acquisition, the company changed its name to QinetiQ Target Systems and integrated into QinetiQ's international business.

QinetiQ Target Systems provides target systems to approximately 40 countries with operations in Alberta, Canada and Kent, UK. The acquisition of Target Systems enhances QinetiQ's product portfolio, market position and ability to deliver global test and evaluation services.

RubiKon Group Pty Limited

On 31 January 2017, the Group acquired 100% of the issued share capital of RubiKon Group Pty Limited from its founder management team for £7.4m (A\$12.6m). The company provides solutions to complex logistics, supply chain management and procurement projects in defence, aerospace, mining and government markets. RubiKon is now subsumed into the Australia business.

RubiKon's integrated logistics support services are complementary to the technical engineering advice and services that the Group provides. The acquisition is also expected to provide the Group with an increased share of 'strategic partner' style contracts in the growing Australian markets through access to RubiKon's customer base.

8. Taxation

	2018			2017		
	Underlying	Specific adjusting items	Total	Underlying	Specific adjusting items	Total
all figures in £ million						
Analysis of charge						
Current UK tax (income)/expense	(0.2)	0.6	0.4	7.0	–	7.0
Current UK tax in respect of prior years	(1.0)	–	(1.0)	–	–	–
Overseas corporation tax						
Current year	4.7	–	4.7	2.0	–	2.0
Current tax expense	3.5	0.6	4.1	9.0	–	9.0
Deferred tax expense/(income)	7.9	(7.2)	0.7	3.6	(4.1)	(0.5)
Deferred tax impact of change in rates	2.4	(1.2)	1.2	(0.2)	–	(0.2)
Deferred tax in respect of prior years	(0.7)	1.4	0.7	(0.1)	–	(0.1)
Deferred tax expense/(income)	9.6	(7.0)	2.6	3.3	(4.1)	(0.8)
Taxation expense/(income)	13.1	(6.4)	6.7	12.3	(4.1)	8.2
Factors affecting tax charge/(credit) in year						
Principal factors reducing the Group's current year tax charge below the UK statutory rate are explained below:						
Profit before tax	122.1	22.7	144.8	116.1	15.4	131.5
Tax on profit before tax at 19% (2017: 20%)	23.2	4.3	27.5	23.2	3.1	26.3
Effect of:						
Expenses not deductible for tax purposes and non-taxable items	(0.2)	(3.3)	(3.5)	(0.2)	(3.3)	(3.5)
Current UK tax in respect of prior years	(1.0)	–	(1.0)	–	–	–
Research and development expenditure credits	(12.0)	–	(12.0)	(9.1)	–	(9.1)
Tax in respect of an FY09 US acquisition – payable to the tax authorities	1.0	–	1.0	1.5	–	1.5
Tax in respect of an FY09 US acquisition – recoverable from insurers	–	–	–	(1.5)	–	(1.5)
Recognition of deferred tax asset	–	(7.6)	(7.6)	–	(3.7)	(3.7)
Deferred tax impact of change in rates	1.5	(1.2)	0.3	(0.5)	–	(0.5)
Deferred tax in respect of prior years	(0.7)	1.4	0.7	(0.1)	–	(0.1)
Other deferred tax movements	(0.1)	0.2	0.1	(0.3)	(0.2)	(0.5)
Effect of different rates in overseas jurisdictions	1.4	(0.2)	1.2	(0.7)	–	(0.7)
Taxation expense/(income)	13.1	(6.4)	6.7	12.3	(4.1)	8.2
Effective tax rate	10.7%		4.6%	10.6%		6.2%

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.

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 pre-tax specific adjusting items (note 4), 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.

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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

9. 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 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) per share. The dividend, which is 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.

10. Analysis of employee costs and numbers

The largest component of operating expenses is employee costs. The year-end and average monthly number of persons employed by the Group, including Executive Directors, analysed by business segment, were:

	As at 31 March		Monthly average	
	2018 Number	2017 Number	2018 Number	2017 Number
EMEA Services	5,239	5,301	5,340	5,375
Global Products	826	853	803	739
Total	6,065	6,154	6,143	6,114

The aggregate payroll costs of these persons were as follows:

all figures in £ million	Note	2018	2017
Wages and salaries		292.3	272.9
Social security costs		28.1	27.1
Pension costs		39.6	37.8
Share-based payments costs	29	2.7	3.3
Total employee costs		362.7	341.1

11. Directors and other senior management personnel

The Directors and other senior management personnel of the Group during the year to 31 March 2018 comprise the Board of Directors and the Executive Committee. The remuneration and benefits provided to Directors and the Executive Committee are summarised below:

all figures in £ million	2018	2017
Short-term employee remuneration including benefits	8.1	7.4
Post-employment benefits	0.1	0.1
Share-based payments costs	0.7	0.8
Total	8.9	8.3

Short-term employee remuneration and benefits include salary, bonus and benefits. Post-employment benefits relate to pension amounts.

12. 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 (see note 28). 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 4) 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

13. 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

Goodwill analysed by cash-generating unit (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 has 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 segments	2018
QinetiQ North America	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

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

13. Goodwill continued

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 judgements, 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.

14. Intangible assets

Year ended 31 March 2018

all figures in £ million	Acquired intangible assets			AICC [^] and other intangible assets	Total
	Customer relationships	Other	Development costs		
Cost					
At 1 April 2017	56.0	67.5	19.7	43.3	186.5
Additions – internally developed	–	–	0.4	3.6	4.0
Additions – purchased*	–	–	1.4	7.9	9.3
Reclassification from property, plant and equipment	–	–	–	0.4	0.4
Disposals	–	–	–	(7.1)	(7.1)
Transfers	–	–	0.7	(0.7)	–
Foreign exchange	(3.3)	(4.9)	0.1	(0.4)	(8.5)
At 31 March 2018	52.7	62.6	22.3	47.0	184.6
Amortisation and impairment					
At 1 April 2017	34.9	58.8	17.8	40.3	151.8
Amortisation charge for year	1.6	1.0	1.5	2.2	6.3
Disposals	–	–	–	(7.1)	(7.1)
Foreign exchange	(2.7)	(4.4)	–	(0.4)	(7.5)
At 31 March 2018	33.8	55.4	19.3	35.0	143.5
Net book value at 31 March 2018	18.9	7.2	3.0	12.0	41.1

[^] AICC = Assets In Course Of Construction

* At year-end £8.5m of additions were cash-settled and £4.8m were not cash-settled.

'Other' consists primarily of intellectual property arising on acquisition of businesses.

Year ended 31 March 2017

all figures in £ million	Acquired intangible assets			AICC [^] and other intangible assets	Total
	Customer relationships	Other	Development costs		
Cost					
At 1 April 2016	31.9	54.8	18.5	42.2	147.4
Additions – internally developed	–	–	0.4	0.7	1.1
Additions – purchased	–	–	–	1.1	1.1
Additions – recognised on acquisitions	20.5	6.8	–	–	27.3
Disposals	–	–	(0.1)	(0.2)	(0.3)
Transfers	–	–	0.9	(0.9)	–
Foreign exchange	3.6	5.9	–	0.4	9.9
At 31 March 2017	56.0	67.5	19.7	43.3	186.5
Amortisation and impairment					
At 1 April 2016	31.2	52.6	16.5	38.8	139.1
Amortisation charge for year	0.4	0.6	1.3	1.3	3.6
Disposals	–	–	–	(0.2)	(0.2)
Foreign exchange	3.3	5.6	–	0.4	9.3
At 31 March 2017	34.9	58.8	17.8	40.3	151.8
Net book value at 31 March 2017	21.1	8.7	1.9	3.0	34.7

[^] AICC = Assets In Course Of Construction

At 31 March 2017, intangible assets of £24.2m and £3.1m were acquired as part of the QinetiQ Target Systems and RubiKon acquisitions respectively.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

15. Property, plant and equipment Year ended 31 March 2018

all figures in £ million	Land and buildings	Plant, machinery and vehicles	Computers and office equipment	Assets under construction	Total
Cost					
At 1 April 2017	331.7	198.5	52.1	34.3	616.6
Additions – purchased*	1.0	13.4	3.5	49.2	67.1
Reclassification to intangibles	–	–	–	(0.4)	(0.4)
Land and buildings assets classified as held for sale	(1.2)	–	–	–	(1.2)
Disposals	(29.2)	(32.6)	(16.6)	(2.4)	(80.8)
Transfers	1.7	16.3	11.7	(29.7)	–
Foreign exchange	(0.9)	(1.8)	(0.4)	(0.2)	(3.3)
At 31 March 2018	303.1	193.8	50.3	50.8	598.0
Depreciation					
At 1 April 2017	174.9	163.5	39.4	–	377.8
Charge for year	9.7	10.5	5.4	–	25.6
Disposals	(22.6)	(32.2)	(16.6)	–	(71.4)
Foreign exchange	(0.8)	(1.6)	(0.6)	–	(3.0)
At 31 March 2018	161.2	140.2	27.6	–	329.0
Net book value at 31 March 2018	141.9	53.6	22.7	50.8	269.0

* At year-end £46.0m of additions were cash-settled and £21.1m were not cash-settled.

Disposals of land and buildings related to surplus properties and yielded a profit of £14.6m, reported as a specific adjusting item (note 4).

Non-current assets classified as held for sale

In 2017 management made a decision to sell surplus land and buildings on the Malvern site. A large part of the assets were sold on 29 March 2018 to a property developer for £11.4m which yielded a £7.7m profit. At year-end, land with a carrying amount of £1.2m is still classified as held for sale on the balance sheet. Management estimates that the land will be sold during the first quarter of FY19 for £2.0m which is the current fair value less costs to sell. The land was valued by BNP Real Estate on 31 March 2018. There were no non-current assets classified as held for sale at 31 March 2017.

Year ended 31 March 2017

all figures in £ million	Land and buildings	Plant, machinery and vehicles	Computers and office equipment	Assets under construction	Total
Cost					
At 1 April 2016	318.4	190.7	49.2	31.8	590.1
Additions – purchased	0.8	3.1	0.8	26.0	30.7
Additions – acquisitions	0.8	0.8	0.3	–	1.9
Disposals	(0.4)	(4.9)	(3.6)	(1.2)	(10.1)
Transfers	11.2	6.5	4.6	(22.3)	–
Foreign exchange	0.9	2.3	0.8	–	4.0
At 31 March 2017	331.7	198.5	52.1	34.3	616.6
Depreciation					
At 1 April 2016	162.4	156.4	37.9	–	356.7
Charge for year	12.1	9.9	4.4	–	26.4
Disposals	(0.4)	(4.9)	(3.6)	–	(8.9)
Foreign exchange	0.8	2.1	0.7	–	3.6
At 31 March 2017	174.9	163.5	39.4	–	377.8
Net book value at 31 March 2017	156.8	35.0	12.7	34.3	238.8

16. Equity accounted investments

As at 31 March

	2018		2017	
	Joint ventures and associates financial results	Group net share of joint ventures and associates	Joint ventures and associates financial results	Group net share of joint ventures and associates
Non-current assets	0.2	0.1	0.3	0.1
Current assets	11.4	5.6	6.8	3.3
	11.6	5.7	7.1	3.4
Current liabilities	(7.1)	(3.5)	(4.2)	(2.0)
Net assets of joint ventures and associates	4.5	2.2	2.9	1.4
Other non-current investments	–	–	–	0.1
Total	4.5	2.2	2.9	1.5

During the year ended 31 March 2018 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. Deferred tax

Deferred tax assets and liabilities are offset only where there is a legally enforceable right to do so and there is an intention to settle the balances net.

Movements in the deferred tax assets and liabilities are shown below:

Year ended 31 March 2018

Deferred tax asset

all figures in £ million

	Intellectual property	Short-term timing differences	Losses	Total
At 1 April 2017	–	9.9	3.7	13.6
(Charged)/credited to income statement	3.2	(1.2)	1.9	3.9
Charged to other comprehensive income	–	(0.6)	–	(0.6)
Foreign exchange	–	(0.8)	(0.1)	(0.9)
Gross deferred tax asset at 31 March 2018	3.2	7.3	5.5	16.0
Less: liability available for offset				(9.6)
Net deferred tax asset at 31 March 2018				6.4

Deferred tax liability

all figures in £ million

	Pension surplus	Accelerated capital allowances	Acquisition intangibles	Total
At 1 April 2017	(31.4)	(4.9)	(8.9)	(45.2)
(Charged)/credited to income statement	(2.7)	(5.3)	1.5	(6.5)
Charged to other comprehensive income	(24.4)	–	–	(24.4)
Foreign exchange	–	(0.1)	0.2	0.1
Gross deferred tax liability at 31 March 2018	(58.5)	(10.3)	(7.2)	(76.0)
Less: asset available for offset				9.6
Net deferred tax liability at 31 March 2018				(66.4)

Deferred tax has been calculated using the enacted future statutory tax rates.

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.

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 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. The remaining £34.0m of losses are time limited with £5.5m expiring 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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

17. Deferred tax continued

Year ended 31 March 2017

Deferred tax asset

all figures in £ million	Pension liability	Short-term timing differences	Losses	Total
At 1 April 2016	1.5	8.0	–	9.5
(Charged)/credited to income statement	(1.7)	1.1	3.7	3.1
Charged to other comprehensive income	(31.2)	–	–	(31.2)
Transfer to current tax	–	(0.1)	–	(0.1)
Foreign exchange	–	1.0	–	1.0
Acquired in business combinations	–	(0.1)	–	(0.1)
Transfer to liability	31.4	–	–	31.4
Gross deferred tax asset at 31 March 2017	–	9.9	3.7	13.6
Less: liability available for offset				(8.2)
Net deferred tax asset at 31 March 2017				5.4

Deferred tax liability

all figures in £ million	Pension surplus	Accelerated capital allowances	Acquisition intangibles	Total
At 1 April 2016	–	(3.1)	(2.3)	(5.4)
Charged to income statement	–	(1.9)	(0.2)	(2.1)
Foreign exchange	–	0.1	(0.2)	(0.1)
Acquired in business combinations	–	–	(6.2)	(6.2)
Transfer from asset	(31.4)	–	–	(31.4)
Gross deferred tax liability at 31 March 2017	(31.4)	(4.9)	(8.9)	(45.2)
Less: asset available for offset				8.2
Net deferred tax liability at 31 March 2017				(37.0)

18. Inventories

As at 31 March

all figures in £ million	2018	2017
Raw materials	18.3	12.1
Work in progress	9.2	6.1
Finished goods	10.6	10.7
	38.1	28.9

19. Trade and other receivables

As at 31 March

all figures in £ million	2018	2017
Trade receivables	66.7	75.6
Amounts recoverable under contracts	62.3	54.5
Other receivables	7.9	32.1
Prepayments	13.4	13.4
	150.3	175.6

In determining the recoverability of trade receivables, the Group considers any change in the credit quality of the trade receivable from the date credit was granted to the reporting date. Credit risk is limited as a result of the high percentage of revenue derived from UK and US government agencies. Accordingly, the Directors believe that no credit provision in excess of the allowance for doubtful debts is required. As at 31 March 2018 the Group carried a provision for doubtful debts of £1.5m (2017: £2.0m).

The reduction in other receivables relates to recovery from insurers of amounts required to settle a tax dispute. See note 8.

Ageing of past due but not impaired receivables

all figures in £ million	2018	2017
Up to three months	10.5	5.5
Over three months	0.6	3.7
	11.1	9.2

Movements in the doubtful debt provision

all figures in £ million	2018	2017
At 1 April	2.0	4.1
Created	0.5	0.2
Released	(0.1)	(1.4)
Utilised	(0.8)	(1.0)
Foreign exchange	(0.1)	0.1
At 31 March	1.5	2.0

The maximum exposure to credit risk in relation to trade receivables at the reporting date is the fair value of trade receivables. The Group does not hold any collateral as security.

20. Current asset investments

As at 31 March

all figures in £ million	2018	2017
Current asset investments	0.7	1.3

At 31 March 2018 the Group held a 2.6% shareholding in pSivida Limited (2017: 2.6%), a company listed on NASDAQ and the Australian and Frankfurt Stock Exchanges. The investment is held at fair value using the closing share price at 31 March 2018 of A\$1.48 per share (2017: A\$2.34 per share).

21. Trade and other payables

As at 31 March

all figures in £ million	2018	2017
Trade payables	83.0	37.4
Other tax and social security	26.3	34.8
Deferred income	88.0	97.1
Accrued expenses and other payables	137.6	152.8
Total current trade and other payables	334.9	322.1
Deferred income	6.1	7.7
Other payables	12.6	4.8
Total non-current trade and other payables	18.7	12.5
Total trade and other payables	353.6	334.6

22. Current tax

As at 31 March

all figures in £ million	2018	2017
Current tax liability	8.9	43.7

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).

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

23. Provisions

Year ended 31 March 2018

all figures in £ million	Property	Other	Total
At 1 April 2017	13.0	11.0	24.0
Created in year	0.9	3.6	4.5
Released in year	(1.5)	(4.7)	(6.2)
Unwind of discount	0.1	–	0.1
Utilised in year	(1.9)	(0.1)	(2.0)
Reclassification	0.5	(0.5)	–
Foreign exchange	–	(0.1)	(0.1)
At 31 March 2018	11.1	9.2	20.3
Current liability	1.9	4.1	6.0
Non-current liability	9.2	5.1	14.3
At 31 March 2018	11.1	9.2	20.3

Property provisions relate to under-utilised properties in the UK. The extent of the provision is affected by the timing of when properties can be sub-let and the proportion of space that can be sub-let. Based on current assessment the provision will be utilised within 10 years.

Other provisions relate to environmental and other liabilities, the magnitude and timing of utilisation of which are determined by a variety of factors.

24. Net cash

As at 31 March

all figures in £ million	2018			2017		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Current financial assets/(liabilities)						
Deferred financing costs	0.1	–	0.1	0.3	–	0.3
Available-for-sale investment	15.7	–	15.7	10.4	–	10.4
Derivative financial instruments	1.1	(2.6)	(1.5)	–	(0.8)	(0.8)
Total current financial assets/(liabilities)	16.9	(2.6)	14.3	10.7	(0.8)	9.9
Non-current assets/(liabilities)						
Deferred financing costs	–	–	–	0.2	–	0.2
Derivative financial instruments	0.3	(1.9)	(1.6)	0.3	(0.3)	–
Total non-current financial assets/(liabilities)	0.3	(1.9)	(1.6)	0.5	(0.3)	0.2
Total financial assets/(liabilities)	17.2	(4.5)	12.7	11.2	(1.1)	10.1
Cash	128.0	–	128.0	88.9	–	88.9
Cash equivalents	126.1	–	126.1	122.9	–	122.9
Total cash and cash equivalents	254.1	–	254.1	211.8	–	211.8
Total net cash as defined by the Group			266.8			221.9

At 31 March 2018 the Group held £2.2m (2017: £1.5m) of cash which is restricted in its use. The available for sale investment is a 'Libor-plus' investment fund investing in a portfolio of AAA and AA-rated asset backed securities and corporate floating rate notes.

25. Operating leases

Group as a lessor

The Group receives rental income on certain properties. Primarily these are properties partially occupied by Group companies, with vacant space sub-let to third-party tenants. The Group had contracted with tenants for the following future minimum lease payments:

all figures in £ million	2018	2017
Within one year	4.6	5.3
In the second to fifth years inclusive	10.1	8.8
Greater than five years	5.3	6.1
	20.0	20.2

Group as a lessee

all figures in £ million	2018	2017
Lease and sub-lease income statement expense for the year	7.5	6.7

The Group had the following total future minimum lease payment commitments:

all figures in £ million	2018	2017
Within one year	7.5	8.2
In the second to fifth years inclusive	17.2	17.5
Greater than five years	3.5	6.1
	28.2	31.8

Operating lease payments represent rentals payable by the Group on certain property, plant and equipment. Principal operating leases are negotiated for a term of approximately 10 years.

26. Financial risk management

The Group's international operations expose it to financial risks that include the effects of changes in foreign exchange rates, interest rates, credit risks and liquidity risks.

Treasury and risk management policies, which are set by the Board, specify guidelines on financial risks and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives. Group treasury monitors financial risks and compliance with risk management policies during the year. There have been no changes in any risk management policies during the year or since the year end.

A) Fair values of financial instruments

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

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

The following table presents the Group's assets and liabilities that are measured at fair value as at 31 March 2018:

all figures in £ million	Note	Level 1	Level 2	Level 3	Total
Assets					
Available for sale investments	24	15.7	–	–	15.7
Current other investments	20	0.7	–	–	0.7
Current derivative financial instruments	24	–	1.1	–	1.1
Non-current derivative financial instruments	24	–	0.3	–	0.3
Liabilities					
Current derivative financial instruments	24	–	(2.6)	–	(2.6)
Non-current derivative financial instruments	24	–	(1.9)	–	(1.9)
Total		16.4	(3.1)	–	13.3

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

26. Financial risk management continued

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

all figures in £ million	Note	Level 1	Level 2	Level 3	Total
Assets					
Available for sale investments	24	10.4	–	–	10.4
Current other investments	20	1.3	–	–	1.3
Non-current other investments		–	–	0.1	0.1
Non-current derivative financial instruments	24	–	0.3	–	0.3
Liabilities					
Current derivative financial instruments	24	–	(0.8)	–	(0.8)
Non-current derivative financial instruments	24	–	(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.

All financial assets and liabilities had a fair value that is identical to book value at 31 March 2018 and 31 March 2017. Detailed analysis is provided in the tables below:

As at 31 March 2018

all figures in £ million	Note	Available for sale	Loans and receivables	Financial liabilities at amortised cost	Derivatives used as hedges	Total carrying value	Total fair value
Financial assets							
Non-current							
Derivative financial instruments	24	–	–	–	0.3	0.3	0.3
Current							
Trade and other receivables (excluding prepayments)	19	–	136.9	–	–	136.9	136.9
Derivative financial instruments	24	–	–	–	1.1	1.1	1.1
Current asset investments	20	0.7	–	–	–	0.7	0.7
Available for sale investment	24	15.7	–	–	–	15.7	15.7
Deferred financing costs	24	–	–	0.1	–	0.1	0.1
Cash and cash equivalents	24	–	254.1	–	–	254.1	254.1
Total financial assets		16.4	391.0	0.1	1.4	408.9	408.9
Financial liabilities							
Non-current							
Trade and other payables (excluding deferred income)	21	–	–	(12.6)	–	(12.6)	(12.6)
Derivative financial instruments	24	–	–	–	(1.9)	(1.9)	(1.9)
Current							
Trade and other payables (excluding deferred income)	21	–	–	(246.9)	–	(246.9)	(246.9)
Derivative financial instruments	24	–	–	–	(2.6)	(2.6)	(2.6)
Total financial liabilities		–	–	(259.5)	(4.5)	(264.0)	(264.0)
Total		16.4	391.0	(259.4)	(3.1)	144.9	144.9

As at 31 March 2017

all figures in £ million	Note	Available for sale	Loans and receivables	Financial liabilities at amortised cost	Derivatives used as hedges	Total carrying value	Total fair value
Financial assets							
Non-current							
Derivative financial instruments	24	–	–	–	0.3	0.3	0.3
Deferred financing costs	24	–	–	0.2	–	0.2	0.2
Other investments	16	0.1	–	–	–	0.1	0.1
Current							
Trade and other receivables (excluding prepayments)	19	–	162.2	–	–	162.2	162.2
Current asset investments	20	1.3	–	–	–	1.3	1.3
Available for sale investment	24	10.4	–	–	–	10.4	10.4
Deferred financing costs	24	–	–	0.3	–	0.3	0.3
Cash and cash equivalents	24	–	211.8	–	–	211.8	211.8
Total financial assets		11.8	374.0	0.5	0.3	386.6	386.6
Financial liabilities							
Non-current							
Trade and other payables (excluding deferred income)	21	–	–	(4.8)	–	(4.8)	(4.8)
Derivative financial instruments	24	–	–	–	(0.3)	(0.3)	(0.3)
Current							
Trade and other payables (excluding deferred income)	21	–	–	(225.0)	–	(225.0)	(225.0)
Derivative financial instruments	24	–	–	–	(0.8)	(0.8)	(0.8)
Total financial liabilities		–	–	(229.8)	(1.1)	(230.9)	(230.9)
Total		11.8	374.0	(229.3)	(0.8)	155.7	155.7

B) Interest rate risk

The Group operates an interest rate policy designed to optimise interest costs and to reduce volatility in reported earnings. The Group's current policy is to require rates to be fixed for 30%–80% of the level of borrowings, which is achieved primarily through fixed-rate borrowings. Where there are significant changes in the level and/or structure of debt, policy permits borrowings to be 100% fixed, with regular Board reviews of the appropriateness of this fixed percentage. At 31 March 2018 and 31 March 2017 the Group had no borrowings.

Financial assets/(liabilities)

As at 31 March 2018

all figures in £ million	Financial assets		Financial liabilities	
	Floating	Non-interest bearing	Floating	Non-interest bearing
Sterling	224.3	17.1	–	(4.5)
US dollar	20.5	–	–	–
Euro	7.3	–	–	–
Australian dollar	0.7	0.7	–	–
Other	1.3	–	–	–
	254.1	17.8	–	(4.5)

As at 31 March 2017

all figures in £ million	Financial assets		Financial liabilities	
	Floating	Non-interest bearing	Floating	Non-interest bearing
Sterling	187.1	10.7	–	(1.1)
US dollar	12.7	0.1	–	–
Euro	2.7	–	–	–
Australian dollar	5.1	1.3	–	–
Other	4.2	–	–	–
	211.8	12.1	–	(1.1)

Floating-rate financial assets attract interest based on the relevant national LIBID equivalent. Floating-rate financial liabilities bear interest at the relevant national LIBOR equivalent. Trade and other receivables/payables and deferred finance costs are excluded from this analysis.

Interest rate risk management

The revolving credit facility (note 26E) is floating-rate and undrawn as at 31 March 2018.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

26. Financial risk management continued

C) Currency risk

Transactional currency exposure

The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that when such a sale or purchase is certain, the net foreign exchange exposure is hedged using forward foreign exchange contracts. Hedge accounting documentation and effectiveness testing are undertaken for all the Group's transactional hedge contracts.

The table below shows the Group's currency exposures, being exposures on currency transactions that give rise to net currency gains and losses recognised in the income statement. Such exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating company involved.

Functional currency of the operating company

all figures in £ millions	Net foreign currency monetary assets/(liabilities)				
	US\$	Euro	A\$	Other	Total
31 March 2018 – Sterling	2.3	3.5	0.2	0.9	6.9
31 March 2017 – Sterling	7.5	2.9	0.1	0.6	11.1

The amounts shown in the table take into account the effect of the forward contracts entered into to manage these currency exposures.

The Group enters into forward foreign currency contracts to hedge the currency exposures that arise on sales and purchases denominated in foreign currencies, as the transaction occurs. The principal contract amounts of the outstanding forward currency contracts as at 31 March 2018 against Sterling are net US dollars bought of £10.5m (US\$12.9m), net Euros bought of £0.9m (€0.8m), net Swiss Francs bought of £19.9m (CHF 25.2m) and net Swedish Krona bought of £9.3m (SEK 105.2m).

Translational currency exposure

The Group has significant investments in overseas operations, particularly in the US. As a result, the Sterling value of the Group's balance sheet can be affected by movement in exchange rates. The Group does not hedge against translational currency exposure to overseas net assets.

D) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by a Board-approved policy of only selecting counterparties with a strong investment grade long-term credit rating for cash deposits. In the normal course of business the Group operates notional cash pooling systems, where a legal right of set-off applies.

The maximum credit-risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables, totals £271.9m (2017: £223.9m). The Group held cash and cash equivalents of £254.1m at 31 March 2018 (2017: £211.8m), which represents the maximum credit exposure on these assets. The cash and cash equivalents were held with different financial institutions which were rated single A or better, although £126.1m (2017: £122.9m) was invested in AAA-rated money funds at the year end.

E) Liquidity risk

Borrowing facilities

As at 31 March 2018 the Group had a revolving credit facility (RCF) of US\$100m and £166m (2017: US\$100m and £166m). The RCF is contracted until 2019 and is un-utilised as shown in the table below:

	Interest rate: LIBOR plus	Total £m	Drawn £m	Undrawn £m
Committed facilities 31 March 2018	0.65%	237.3	–	237.3
Freely available cash and cash equivalents				251.9
Available funds 31 March 2018				489.2
Committed facilities 31 March 2017	0.65%	245.7	–	245.7
Freely available cash and cash equivalents				210.3
Available funds 31 March 2017				456.0

Gross contractual cash flows for borrowings and other financial liabilities

The following are the contractual maturities of financial liabilities, including interest payments. The cash flows associated with derivatives that are cash flow hedges are expected to have an impact on profit or loss in the periods shown.

As at 31 March 2018

all figures in £ million	Book value	Contractual cash flows	1 year or less	1–2 years	2–5 years	More than 5 years
Financial assets						
Deferred financing costs	0.1	–	–	–	–	–
Non-derivative financial liabilities						
Trade and other payables (excluding deferred income)	(259.5)	(259.5)	(246.9)	(12.6)	–	–
Derivative financial liabilities						
Forward foreign currency contracts – cash flow hedges	(4.5)	(4.5)	(2.6)	(1.4)	(0.5)	–
	(263.9)	(264.0)	(249.5)	(14.0)	(0.5)	–

As at 31 March 2017

all figures in £ million	Book value	Contractual cash flows	1 year or less	1–2 years	2–5 years	More than 5 years
Financial assets						
Deferred financing costs	0.5	–	–	–	–	–
Non-derivative financial liabilities						
Trade and other payables (excluding deferred income)	(229.8)	(229.8)	(225.0)	(4.8)	–	–
Derivative financial liabilities						
Forward foreign currency contracts – cash flow hedges	(1.1)	(1.1)	(0.8)	(0.3)	–	–
	(230.4)	(230.9)	(225.8)	(5.1)	–	–

F) Derivative financial instruments

As at 31 March

all figures in £ million	2018			2017		
	Asset gains	Liability losses	Net	Asset gains	Liability losses	Net
Forward foreign currency contracts – cash flow hedges	1.4	(4.5)	(3.1)	0.3	(1.1)	(0.8)
Derivative assets/(liabilities) at the end of the year	1.4	(4.5)	(3.1)	0.3	(1.1)	(0.8)

As at 31 March

all figures in £ million	2018			2017		
	Asset gains	Liability losses	Net	Asset gains	Liability losses	Net
Expected to be recognised:						
In one year or less	1.1	(2.6)	(1.5)	–	(0.8)	(0.8)
Between one and two years	0.2	(1.4)	(1.2)	0.1	(0.3)	(0.2)
More than two years	0.1	(0.5)	(0.4)	0.2	–	0.2
Derivative assets/(liabilities) at the end of the year	1.4	(4.5)	(3.1)	0.3	(1.1)	(0.8)

G) Maturity of financial liabilities

As at 31 March 2018

all figures in £ million	Trade and other payables ¹	Bank borrowings and loan notes	Derivative financial instruments	Total
Due in one year or less	246.9	(0.1)	2.6	249.4
Due in more than one year but not more than two years	12.6	–	1.4	14.0
Due in more than two years but not more than five years	–	–	0.5	0.5
	259.5	(0.1)	4.5	263.9

¹ Excluding deferred income

As at 31 March 2017

all figures in £ million	Trade and other payables ¹	Bank borrowings and loan notes	Derivative financial instruments	Total
Due in one year or less	225.0	(0.3)	0.8	225.5
Due in more than one year but not more than two years	4.8	(0.2)	0.3	4.9
Due in more than two years but not more than five years	–	–	–	–
	229.8	(0.5)	1.1	230.4

¹ Excluding deferred income

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

26. Financial risk management continued

H) Sensitivity analysis

The Group's sensitivity to changes in foreign exchange rates and interest rates on financial assets and liabilities as at 31 March 2018 is set out in the following table. The impact of a weakening in Sterling on the Group's financial assets and liabilities would be more than offset in equity and income by its impact on the Group's overseas net assets and earnings respectively. Sensitivity on Group's assets other than financial assets and liabilities is not included in this analysis.

As at 31 March 2018

all figures in £ million	1% decrease in interest rates		10% weakening in Sterling	
	Equity ¹	Profit before tax	Equity	Profit before tax
Sterling	–	(2.2)	–	–
US dollar	–	(0.2)	1.7	–
Other	–	(0.1)	1.1	–

all figures in £ million	1% increase in interest rates		10% strengthening in Sterling	
	Equity ¹	Profit before tax	Equity	Profit before tax
Sterling	–	2.2	–	–
US dollar	–	0.2	(1.4)	–
Other	–	0.1	(0.9)	–

¹ This relates to the impact on items charged directly to equity and excludes the impact on profit/loss for the year flowing into equity.

As at 31 March 2017

all figures in £ million	1% decrease in interest rates		10% weakening in Sterling	
	Equity ¹	Profit before tax	Equity	Profit before tax
Sterling	–	(1.9)	–	–
US dollar	–	(0.1)	1.4	–
Other	–	(0.1)	1.5	–

all figures in £ million	1% increase in interest rates		10% strengthening in Sterling	
	Equity ¹	Profit before tax	Equity	Profit before tax
Sterling	–	1.9	–	–
US dollar	–	0.1	(1.2)	–
Other	–	0.1	(1.2)	–

¹ This relates to the impact on items charged directly to equity and excludes the impact on profit/loss for the year flowing into equity.

The amounts generated from the sensitivity analysis are forward-looking estimates of market risk assuming that certain market conditions occur. Actual results in the future may differ materially from those projected as a result of developments in global financial markets that may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the previous tables, which should not, therefore, be considered to be a projection of likely future events and losses.

The estimated changes for interest rate movements are based on an instantaneous decrease or increase of 1% (100 basis points) in the specific rate of interest applicable to each class of financial instruments from the levels effective at 31 March 2018, with all other variables remaining constant. The estimated changes for foreign exchange rates are based on an instantaneous 10% weakening or strengthening in Sterling against all other currencies from the levels applicable at 31 March 2018, with all other variables remaining constant. Such analysis is for illustrative purposes only – in practice market rates rarely change in isolation.

The impact of transactional risk on the Group's monetary assets/liabilities that are not held in the functional currency of the entity holding those assets/liabilities is minimal. A 10% weakening in Sterling would also result in a minimal increase in profit before tax.

27. Cash flows from operations

For the year ended 31 March

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 businesses	–	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
	146.6	141.2
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 to free cash flow

all figures in £ million	2018	2017
Net cash flow from operations	132.4	111.9
Less specific adjusting items: 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 and equipment	(54.5)	(32.9)
Free cash flow	56.3	76.4

Underlying cash conversion ratio

all figures in £ million	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%

28. Share capital and other reserves

Shares allotted, called up and fully paid:

	Ordinary shares of 1p each (equity)		Special Share of £1 (non-equity)		Total	
	£	Number	£	Number	£	Number
At 1 April 2016	5,866,812	586,681,200	1	1	5,866,813	586,681,201
Cancelled in the year	(149,241)	(14,924,079)	–	–	(149,241)	(14,924,079)
At 31 March 2017 and 31 March 2018	5,717,571	571,757,121	1	1	5,717,572	571,757,122

Except as noted below all shares in issue at 31 March 2018 rank pari-passu in all respects.

In May 2014 the Company initiated a £150m capital return to shareholders by way of a share buyback and this programme was complete at 31 March 2016.

A further £50m share buyback was announced in November 2015 and was completed at 31 March 2017.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

28. Share capital and other reserves continued

Rights attaching to the Special Share

QinetiQ carries out activities which are important to UK defence and security interests. To protect these interests in the context of the ongoing commercial relationship between the MOD and QinetiQ, and to promote and reinforce the Compliance Principles, the MOD holds a Special Share in QinetiQ. QinetiQ obtained MOD consent to changes in its Special Shareholder rights, which were approved by shareholders at the 2012 AGM. The changes to the Special Share were disclosed in the 2012 Annual Report. Subsequent to the changes approved at the 2012 AGM the Special Share confers certain rights on the holder:

- a) to require the Group to implement and maintain the Compliance System (as defined in the Articles of Association) so as to make at all times effective its and each member of QinetiQ Controlled Group's application of the Compliance Principles, in a manner acceptable to the Special Shareholder
- b) to refer matters to the Board for its consideration in relation to the application of the Compliance Principles
- c) to require the Board to obtain Special Shareholder's consent:
 - i) if at any time when the chairman is not a British citizen, it is proposed to appoint any person to the office of chief executive, who is not a British citizen
 - ii) if at any time when the chief executive is not a British citizen, it is proposed to appoint any person to the office of chairman, who is not a British citizen
- d) to require the Board to take action to rectify any omission in the application of the Compliance Principles, if the Special Shareholder is of the opinion that such steps are necessary to protect the defence or security interests of the United Kingdom
- e) to demand a poll at any of QinetiQ's meetings (even though it may have no voting rights except those specifically set out in the Articles).

The Special Shareholder has an option to purchase defined Strategic Assets of the Group in certain circumstances. The Special Shareholder has, inter alia, the right to purchase any Strategic Assets which the Group wishes to sell. Strategic Assets are normally testing and research facilities (see note 31 for further details).

The Special Share may only be issued to, held by and transferred to HM Government (or as it directs). At any time the Special Shareholder may require QinetiQ to redeem the Special Share at par. If QinetiQ is wound up the Special Shareholder will be entitled to be repaid the capital paid up on the Special Share before other shareholders receive any payment. The Special Shareholder has no other right to share in the capital or profits of QinetiQ.

The Special Shareholder must give consent to a general meeting held on short notice.

The Special Share entitles the Special Shareholder to require certain persons who hold (together with any person acting in concert with them) a material interest in QinetiQ to dispose of some or all of their ordinary shares in certain prescribed circumstances on the grounds of national security or conflict of interest.

The Directors must register any transfer of the Special Share within seven days.

Other reserves

The translation reserve includes the cumulative foreign exchange difference arising on translation since the Group transitioned to IFRS. Movements on hedge instruments, where the hedge is effective, are recorded in the hedge reserve until the hedge ceases. The capital redemption reserve, which was created following the redemption of preference share capital and the bonus issue of shares, cannot be distributed.

Own shares

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).

29. Share-based payments

The Group operates a number of share-based payment plans for employees. The total share-based payment expense in the year was £2.7m, of which £2.7m related to equity-settled schemes and nil related to cash-settled schemes (2017: £3.3m, of which £3.3m related to equity-settled schemes and nil to cash-settled schemes). The share-based payment charged to equity is £2.7m consisting of the £2.7m charge to the income statement and share-based payment dividend equivalents of £0.3m offset with £0.3m cash payment relating to the Bonus Banking Plan.

Performance Share Plan (PSP)

In the year, the Group made awards of conditional shares to certain UK senior employees under the PSP. The awards vest after three years with 50% of the awards subject to TSR conditions and 50% subject to EPS conditions as detailed in the Report from the Remuneration Committee.

	2018 Number of shares	2017 Number of shares
Outstanding at start of the year	8,583,157	8,914,560
Granted during the year	102,136	3,225,611
Exercised during the year	(1,136,685)	(50,000)
Forfeited/lapsed during the year	(1,560,387)	(3,507,014)
Outstanding at end of the year	5,988,221	8,583,157

PSP awards are equity-settled awards and those outstanding at 31 March 2018 had an average remaining life of 0.8 years (2017: 1.4 years). There is no exercise price for these PSP awards. Monte Carlo modelling was used to fair value the TSR element of the awards at grant date. Assumptions used in the models included 21% (2017: 23%) for the average share price volatility of the FTSE comparator group and 58% (2017: 57%) for the average correlation to the comparator group. The weighted average fair value of grants made during the year was £2.02 (2017: £1.72). The weighted average share price at date of exercise was £2.78 (2017: £2.68). Of the options outstanding at the end of the year nil were exercisable (2017: nil).

Restricted Stock Units (RSU)

In prior years the Group granted RSU awards to certain senior US employees under the RSU plan. The awards vest over one, two, three and four years. Of the 2014 awards, and the awards granted before 2012, half are dependent on achieving QNA organic profit growth targets and half on a time-based criterion. The time-based criterion requires the employee to have been in continual service up to the date of vesting. QNA organic profit growth is measured over the most recent financial year compared with the previous financial year, with 125% of this element awarded at a QNA organic profit growth rate above 15%, 100% awarded at 12.5%, 75% awarded at 10% and 25% awarded at 5%. The 2012 grants are entirely dependent on achieving QNA organic profit growth targets. 67.5% of the 2013 grants are dependent on achieving QNA organic profit growth targets and 32.5% are dependent on a time-based criterion.

	2018 Number of shares	2017 Number of shares
Outstanding at start of the year	3,750	24,375
Granted during the year	469	–
Exercised during the year	(4,219)	(20,625)
Outstanding at end of the year	–	3,750

RSUs are equity-settled awards; those outstanding at 31 March 2018 had an average remaining life of nil years (2017: 0.3 years). There is no exercise price for these RSU awards. The weighted average share price at date of exercise was £2.42 (2017: £2.27). Of the awards outstanding at the end of the year nil were exercisable (2017: nil).

Group Share Incentive Plan (SIP)

Under the QinetiQ SIP the Group offers UK employees the opportunity of purchasing up to £150 worth of shares a month at the prevailing market rate. The Group will make a matching share award of a third of the employee's payment. The Group's matching shares may be forfeited if the employee ceases to be employed by QinetiQ within three years of the award of the shares. There is no exercise price for these SIP awards.

	2018 Number of matching shares	2017 Number of matching shares
Outstanding at start of the year	828,448	805,785
Awarded during the year	342,413	323,193
Exercised during the year	(277,839)	(248,355)
Forfeited during the year	(39,510)	(52,175)
Outstanding at end of the year	853,512	828,448

SIP matching shares are equity-settled awards; those outstanding at 31 March 2018 had an average remaining life of 1.5 years (2017: 1.5 years). There is no exercise price for these SIP awards. Of the shares outstanding at the end of the year nil were exercisable (2017: nil).

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

29. Share-based payments continued

Group Deferred Annual Bonus Plan (DAB)

Under the QinetiQ DAB Plan the Group requires certain senior executives to defer part of their annual bonus as shares and be entitled to matching awards to a maximum of 1:1 based on EPS performance. The number that will vest is dependent on the growth of EPS over the measurement period of three years as detailed in the Report from the Remuneration Committee.

	2018 Number of matching shares	2017 Number of matching shares
Outstanding at start of the year	17,253	311,500
Exercised during the year	(7,148)	–
Forfeited during the year	(10,105)	(294,247)
Outstanding at end of the year	–	17,253

DAB matching shares are equity-settled awards; those outstanding at 31 March 2018 had an average remaining life of nil years (2017: 0.3 years). The weighted average share price at date of exercise was £2.63 (2017: £nil). Of the shares outstanding at the end of the year nil were exercisable.

Bonus Banking Plan (BBP)

During the year the Group granted BBP awards to certain senior executives in the UK.

	2018 Number of matching shares	2017 Number of matching shares
Outstanding at start of the year	786,195	814,778
Granted during the year	709,755	512,003
Exercised during the year	(143,923)	(534,818)
Forfeited during the year	(27,486)	(5,768)
Outstanding at end of the year	1,324,541	786,195

The BBP is a remuneration scheme that runs for four years with effect from 1 April 2014. Refer to the Directors' Remuneration Report for further details. Under the BBP a contribution will be made by the Company into the participant's plan account at the start of each plan year. 50% of the value of a participant's bonus account will be paid out annually for three years with 100% of the residual value paid out at the end of year four. 50% of the unpaid balance of a participant's bonus account will be at risk of forfeiture.

At 31 March 2018, the awards had an average remaining life of 1.5 years (2017: 1.8 years). There is no exercise price for these awards. The fair value of the awards at 31 March 2018 was £2.06 (2017: £2.80) being the Group's 30 day average share price in the period running up to 31 March. Of the awards outstanding at the end of the year nil were exercisable.

Deferred Share Plan (DSP)

During the year the Group granted DSP awards to certain senior executives.

	2018 Number of awards	2017 Number of awards
Outstanding at start of the year	–	–
Granted during the year	2,518,384	–
Outstanding at end of the year	2,518,384	–

Deferred share-based element is earned based on the satisfaction of pre-grant annual performance assessment and remains subject to a strategic growth underpin which for 2018 is operating profit. The award is subject to a three-year vesting period and a further two-year holding period. Refer to the Directors' Remuneration Report for further details.

At 31 March 2018 the awards had an average remaining life of 2.1 years. There is no exercise price for these awards. The fair value of the awards at 31 March 2018 was £2.06 being the Group's 30 day average share price in the period running up to 31 March. Of the awards outstanding at the end of the year nil were exercisable.

Share-based award pricing – other

Share-based awards that vest based on non-market performance conditions, including certain PSP, RSUs and DAB awards, have been valued at the share price at grant.

30. Post-retirement benefits

Defined contribution plans

In the UK the Group operates two defined contribution plans for the majority of its UK employees: a Group Personal Pension Plan (GPP) and a defined contribution section of the QinetiQ Pension Scheme. These are both defined contribution schemes managed by Scottish Widows. A defined contribution plan is a pension plan under which the Group and employees pay fixed contributions to a third-party financial provider. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Defined benefit pension plans

In the UK the Group operates the QinetiQ Pension Scheme (the Scheme) for a significant proportion of its UK employees. The Scheme closed to future accrual on 31 October 2013. After this date, defined benefit members transferred to a defined contribution scheme. The Scheme is a final salary plan, which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on the members' length of service and their final pensionable earnings at closure to future accrual. In the Scheme, pensions in payment are generally updated in line with the Consumer Price Index (CPI). The benefit payments are made from Trustee-administered funds. Plan assets held in trusts are governed by UK regulations as is the nature of the relationship between the Group and the Trustees and their composition. Responsibility for the governance of the Scheme – including investment decisions and contribution schedules – lies jointly with the Company and the Board of Trustees. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the Scheme's regulations.

The asset/liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated bi-annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation. In countries where there is no deep market in such bonds, the market rates on government bonds are used.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

The Group has no further payment obligations once the agreed contributions have been paid. The expected employer cash contribution to the Scheme for the year ending 31 March 2019 is £2.5m.

Triennial funding 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 31 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.

QinetiQ's Pension Funding Partnership (PFP) structure

Following the 30 June 2011 valuation, a package of pension changes was agreed with the Trustees to provide stability to the Scheme. As part of the package of proposals, on 26 March 2012 QinetiQ established the QinetiQ PFP Limited Partnership (the 'Partnership') with the Scheme. Under this arrangement, properties to the capitalised value of £32.3m were transferred to the Partnership. The transfers were affected through a 20-year sale and leaseback agreement. The Scheme's interest in the Partnership entitles it to an annual distribution of approximately £2.5m for 20 years, indexed with reference to CPI. These contributions replaced part of the regular contributions made under the past deficit recovery payments plan. The Scheme's interest in the Partnership will revert back to QinetiQ Limited in 2032.

The Partnership is controlled by QinetiQ and its results are consolidated by the Group. Under IAS 19, the interest held by the Scheme in the Partnership does not qualify as a plan asset for the purposes of the Group's consolidated financial statements and is, therefore, not included within the fair value of plan assets. As a result, the Group's consolidated financial statements are unchanged by the Partnership. In addition, the value of the property transferred to the Partnership and leased back to QinetiQ remains on the balance sheet. QinetiQ retains the operational flexibility to substitute properties of equivalent value within the Partnership and has the option to settle outstanding amounts due under the interest before 2032 if it so chooses.

Other UK schemes

In the UK the Group has a small number of employees for whom benefits are secured through the Prudential Platinum Scheme. The net pension deficits of this scheme at 31 March 2018 amounted to £nil (2017: £nil). QinetiQ also offers employees access to a Group Self Invested Personal Pension Plan, but no Company contributions are paid to this arrangement.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

30. Post-retirement benefits continued

QinetiQ Pension Scheme net pension asset

The fair value of the QinetiQ Pension Scheme 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, were:

all figures in £ million	2018			2017		
	Quoted	Not quoted in an active market	Total	Quoted	Not quoted in an active market	Total
Equities	115.8	58.9	174.7	284.0	71.4	355.4
LDI investment*	1,050.9	–	1,050.9	968.2	–	968.2
Corporate bonds	311.3	–	311.3	340.6	–	340.6
Alternative bonds**	197.9	35.0	232.9	132.3	–	132.3
Property fund	138.7	–	138.7	126.7	–	126.7
Cash and cash equivalents	80.2	–	80.2	3.1	–	3.1
Derivatives	1.8	–	1.8	–	–	–
Total market value of assets	1,896.6	93.9	1,990.5	1,854.9	71.4	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

* The Scheme has assets invested in a Liability Driven Investment portfolio. As at 31 March 2018 this hedges against 85% of the interest rate and 100% of the inflation rate risk, as measured on the Trustees' gilt-funding basis.

** Includes allocations to high-yield bonds, secured loans and emerging market debt.

The Scheme's assets do not include any of the Group's own transferable financial instruments, property occupied by, or other assets used by the Group.

Per the Scheme rules, the Company has an unconditional right to a refund of any surplus that may arise on cessation of the Scheme in the context of IFRIC 14 paragraphs 11(b) and 12 and therefore the full net pension asset can be recognised on the Group's balance sheet and the Group's minimum funding commitments to the Scheme do not give rise to an additional balance sheet liability.

Changes to the fair value of Scheme assets

all figures in £ million	2018	2017
Opening fair value of Scheme assets	1,926.3	1,410.4
Interest income on Scheme assets	49.8	47.6
Re-measurement gain on Scheme assets	34.8	492.0
Contributions by the employer	13.4	12.9
Net benefits paid out and transfers	(32.8)	(35.1)
Administrative expenses	(1.0)	(1.5)
Closing fair value of Scheme assets	1,990.5	1,926.3

Changes to the present value of the defined benefit obligation

all figures in £ million	2018	2017
Opening defined benefit obligation	(1,770.3)	(1,448.1)
Interest cost	(45.6)	(48.6)
<i>Actuarial gain/(loss) on Scheme liabilities based on:</i>		
Change in demographic assumptions	70.4	–
Change in financial assumptions	31.8	(329.4)
Experience gains	6.6	20.7
Net benefits paid out and transfers	32.8	35.1
Closing defined benefit obligation	(1,674.3)	(1,770.3)

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
Administrative expenses	(1.0)	(1.5)
Contributions by the employer	13.4	12.9
Closing net pension asset	316.2	156.0

Total expense recognised in the income statement

all figures in £ million	2018	2017
Net finance income/(expense) on the net pension asset/liability	4.2	(1.0)
Administrative expenses	(1.0)	(1.5)
Total net income/(expense) recognised in the income statement (gross of deferred tax)	3.2	(2.5)

Assumptions

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

all figures in £ million	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 assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, because of the timescale covered, may not necessarily be borne out in practice. It is important to note that these assumptions are long term and, in the case of the discount rate and the inflation rate, are measured by external market indicators. The mortality assumptions as at 31 March 2018 and 31 March 2017 were 90% of S2PMA for males and 90% of S2PFA for females, based on year of birth making allowance for improvements in mortality in line with CMI_2016 Core Projections (2017: CMI_2013 Core Projections) and a long-term rate of improvement of 1.5% per annum.

The balance sheet net pension asset is a snapshot view which can be significantly influenced by short-term market factors. The calculation of the surplus or deficit depends, therefore, on factors which are beyond the control of the Group – principally the value at the balance sheet date of equity shares (and other assets) in which the Scheme has invested and long-term interest rates which are used to discount future liabilities. The funding of the Scheme is based on long-term trends and assumptions relating to market growth, as advised by qualified actuaries and investment advisors.

The weighted average duration of the defined benefit obligation is approximately 20 years.

Sensitivity analysis of the principal assumptions

Assumption	Change in assumption	Indicative impact on 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.

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

30. Post-retirement benefits continued

Risks

Through its defined benefit pension plan, the Group is exposed to a number of risks, the most significant of which are detailed below:

Volatility in market conditions	Results under IAS 19 can change dramatically depending on market conditions. The defined benefit obligation is linked to yields on AA-rated corporate bonds, while many of the assets of the Scheme are invested in other assets. Changing markets in conjunction with discount rate volatility will lead to volatility in the net pension asset on the Group's balance sheet and in other comprehensive income. To a lesser extent this will also lead to volatility in the IAS 19 pension net finance income in the Group's income statement.
Choice of accounting assumptions	The calculation of the defined benefit obligation (DBO) involves projecting future cash flows from the Scheme many years into the future. This means that the assumptions used can have a material impact on the balance sheet position and profit and loss charge. In practice future experience within the Scheme may not be in line with the assumptions adopted. For example, members could live longer than foreseen or inflation could be higher or lower than allowed for in the DBO calculation.

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 triennial valuations are calculated on a funding basis and use a different set of assumptions, as agreed with the pension Trustees.

31. Transactions with the Ministry of Defence (MOD)

The MOD continues to own its Special Share in QinetiQ which conveys certain rights as set out in note 28. Transactions between the Group and the MOD are disclosed as follows:

Freehold land and buildings and surplus properties

Under the terms of the Group's acquisition of part of the business and certain assets of DERA from the MOD on 1 July 2001, the MOD retained certain rights in respect of the freehold land and buildings transferred.

Restrictions on transfer of title

The title deeds of those properties with strategic assets (see below) include a clause that prevents their transfer without the approval of the MOD. The MOD also has the right to purchase any strategic assets in certain circumstances.

MOD's generic compliance regime

Adherence to the generic compliance system is monitored by the Risk & CSR Committee. Refer to the Committee's report within the Corporate Governance Statement on page 60.

Strategic assets

Under the Principal Agreement with the MOD, the QinetiQ controlled Group is not permitted without the written consent of the MOD, to:

- i) dispose of or destroy all or any part of a strategic asset; or
- ii) voluntarily undertake any closure of, or cease to provide a strategic capability by means of, all or any part of a strategic asset.

The net book value of assets identified as being strategic assets as at 31 March 2018 was £5.5m (2017: £6.3m).

Long Term Partnering Agreement

On 27 February 2003 QinetiQ Limited entered into a Long Term Partnering Agreement (LTPA) to provide test and evaluation (T&E) facilities and training support services to the MOD. This is a 25-year contract with a total revenue value of up to £5.6bn, dependent on the level of usage by the MOD, under which QinetiQ Limited is committed to providing T&E services with increasing efficiencies through cost saving and innovative service delivery. Elements of the contract are subject to re-pricing every five years and elements of the contract (Test Aircrew Training and Air Ranges Modernisation) have been contracted at a fixed price to 31 March 2028.

Other contracts with MOD

The LTPA is the most significant contract QinetiQ has with the MOD. In total approximately 62% of the Group's revenue comes directly from contracts with the MOD.

32. 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, typically in respect of performance bonds and rental guarantees.

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.

33. 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 long-term contract arrangements. These primarily relate to investments under the LTPA contract.

34. Subsidiaries and other related undertakings

In accordance with section 409 of the Companies Act 2006, a full list of subsidiaries and other related undertakings as at 31 March 2018 is detailed below. Unless stated otherwise, the Group's holding comprises ordinary shares which are held indirectly by QinetiQ Group plc, with the exception of QinetiQ Group Holdings Limited which is held directly by QinetiQ Group plc. The financial year end of each undertaking is 31 March other than BQ Solutions QSTP-LLC (31 December).

Name of company	Country of incorporation	Registered office
Subsidiaries¹		
BJ Trustee Limited	England & Wales	Farnborough ⁵
Boldon James Holdings Limited	England & Wales	Farnborough ⁵
Boldon James Limited	England & Wales	Farnborough ⁵
Cody US Limited	England & Wales	Farnborough ⁵
Commerce Decisions Limited	England & Wales	Farnborough ⁵
Commerce Decisions Pty Ltd	Australia	Level 33, 101 Collins Street, Melbourne, VIC 3000, Australia
CueSim Limited	England & Wales	Farnborough ⁵
Foster-Miller Canada Limited	Canada	318 Roxton Drive, Waterloo, Ontario, N2T 1R6, Canada
Foster-Miller Inc ³	US	350 2 nd Avenue, Waltham, Massachusetts, MA 02451 1104, USA
Graphics Research Corporation Limited	England & Wales	Farnborough ⁵
Gyldan 5 Limited ²	England & Wales	Farnborough ⁵
Leading Technology Limited	England & Wales	Farnborough ⁵
Metrix UK Limited	England & Wales	Farnborough ⁵
Optasense Canada Limited ³	Canada	4 Robert Speck Parkway, Suite 1600, Mississauga ON LAZ 1S1, Canada
Optasense Holdings Limited	England & Wales	Farnborough ⁵
Optasense Inc ³	US	5885 Trinity Parkway, Suite 130, Centreville, Virginia 20120-1969, USA
Optasense Limited	England & Wales	Farnborough ⁵
Precis (2187) Limited	England & Wales	Farnborough ⁵
Precis (2188) Limited	England & Wales	Farnborough ⁵
QinetiQ Aerostructures Pty Ltd	Australia	Level 3, 210 Kings Way, South Melbourne, VIC 3205, Australia
QinetiQ Australia Pty Ltd	Australia	Level 3, 210 Kings Way, South Melbourne, VIC 3205, Australia
QinetiQ Consulting Pty Ltd	Australia	Unit 5 (Level 1), 8 Brindabella Circuit, Brindabella Business Park, Majura NSW 2609, Australia
QinetiQ Corporate Finance Limited	England & Wales	Farnborough ⁵
QinetiQ Defence Training Limited	England & Wales	Farnborough ⁵
QinetiQ Estates Limited	England & Wales	Farnborough ⁵
QinetiQ GP Limited	Scotland	50 Lothian Road, Festival Square, Edinburgh, EH3 9WJ, Scotland
QinetiQ Group Canada Inc. ³	Canada	5300 Commerce Court West, 199 Bay Street, Toronto ON M5L 1A9, Canada
QinetiQ Group Holdings Limited	England & Wales	Farnborough ⁵
QinetiQ Holdings Limited	England & Wales	Farnborough ⁵
QinetiQ Inc ³	US	5885 Trinity Parkway, Suite 130, Centreville, Virginia 20120-1969, USA

NOTES TO THE FINANCIAL STATEMENTS CONTINUED

34. Subsidiaries and other related undertakings continued

Name of company	Country of incorporation	Registered office
QinetiQ Insurance PCC Limited	Guernsey	Mill Court, La Charroterie, St Peter Port, GY1 4ET Guernsey
QinetiQ Limited	England & Wales	Farnborough ⁵
QinetiQ Novare Pty Ltd	Australia	Petrie House, level 6, 80 Petrie Terrace, Brisbane QLD 400, Australia
QinetiQ Overseas Holdings (2) Limited	England & Wales	Farnborough ⁵
QinetiQ Overseas Holdings Limited	England & Wales	Farnborough ⁵
QinetiQ Overseas Trading Limited	England & Wales	Farnborough ⁵
QinetiQ Partnership Finance Limited	England & Wales	Farnborough ⁵
QinetiQ Pension Scheme Trustee Limited	England & Wales	Farnborough ⁵
QinetiQ PFP Limited Partnership ⁶	Scotland	50 Lothian Road, Festival Square, Edinburgh, EH3 9WJ, Scotland
QinetiQ Philippines Company, Inc	Philippines	22 nd Floor Corporate Centre, 139 Valero Street, Salcedo Village, Makati City, Philippines
QinetiQ Pty Ltd	Australia	Level 33, 101 Collins Street, Melbourne, VIC 3000, Australia
QinetiQ Services Holdings Pty Ltd	Australia	Level 33, 101 Collins Street, Melbourne, Victoria 3000, Australia
Q Shelf Limited	England & Wales	Farnborough ⁵
QinetiQ Solutions Sdn. Bhd.	Malaysia	Suite 6.01, 6 th Floor, Plaza See Hoy Chan, Jalan Raja Chulan 50200, Kuala Lumpur, W.P. Kuala Lumpur, Malaysia
QinetiQ Space N.V.	Belgium	Hogenakkerhoekstraat, 9, 9150 Kruikebeke, Belgium
QinetiQ Sweden AB	Sweden	Advokatfirman Delphi, Box 1432, Stockholm, Sweden
QinetiQ Target Services Limited	England & Wales	Farnborough ⁵
QinetiQ Target Systems Limited	England & Wales	Farnborough ⁵
QinetiQ US Holdings, Inc.	US	5885 Trinity Parkway, Suite 130, Centreville, Virginia 20120-1969, USA
Redu Operational Services S.A. ¹	Belgium	Rue Devant les Hetres, 2B, 6890 Transinne, Belgium
RubiKon Group Pty Limited	Australia	Level 33, 101 Collins Street, Melbourne, Victoria 3000, Australia
Sensoptics Limited	England & Wales	Farnborough ⁵
Tarsier Limited	England & Wales	Farnborough ⁵
Trusted Experts Limited	England & Wales	Farnborough ⁵
TSG International LLC	US	350 Second Avenue, Waltham, Massachusetts 02451, USA
Associates⁴		
Redu Space Services S.A.	Belgium	Rue Devant les Hetres, 2B, 6890 Transinne, Belgium
Trillium International – I. L.P.	Cayman Islands	179 Sully's Trail, Suite 305, Pittsford, NY, 14534, USA
Joint venture		
BQ Solutions QSTP-LLC ⁷	Qatar	Qatar Science & Technology Park, Innovation Centre Building, Office 307, Doha, Qatar

¹ The Group owned 100% of the ordinary shares of the subsidiary undertakings except for Redu Operational Services S.A. (52%)

² Company limited by guarantee

³ The class of shares is common share

⁴ The Group owned 48% of Redu Space Services S.A. and 25% of Trillium International I.L.P.

⁵ Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX

⁶ Limited partnership. The partners are all wholly-owned Group companies

⁷ The Group owned 49% of BQ Solutions QSTP-LLC

35. Post balance sheet events

Post year end, in April 2018, QinetiQ entered into an agreement to acquire E.I.S. Aircraft Operations (Aircraft Operations or the Business), 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.

COMPANY BALANCE SHEET

AS AT 31 MARCH

all figures in £ million

	Note	2018	2017
Fixed assets			
Investments in subsidiary undertaking	2	468.9	466.2
		468.9	466.2
Current assets			
Debtors	3	9.2	190.0
		9.2	190.0
Current liabilities			
Creditors: amounts falling due within one year	4	(73.0)	(380.3)
Net current liabilities		(63.8)	(190.3)
Total assets less current liabilities		405.1	275.9
Net assets		405.1	275.9
Capital and reserves			
Called up equity share capital	5	5.7	5.7
Capital redemption reserve		40.8	40.8
Share premium account		147.6	147.6
Profit and loss account		211.0	81.8
Capital and reserves attributable to shareholders		405.1	275.9

The profit for the year ended 31 March 2018 was £161.7m (2017: loss of £1.6m).

The financial statements of QinetiQ Group plc (company number 4586941) were approved by the Board of Directors and authorised for issue on 24 May 2018 and were signed on its behalf by:

Mark Elliott
Chairman

Steve Wadey
Chief Executive Officer

David Smith
Chief Financial Officer

COMPANY STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH

all figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Profit and loss	Total equity
At 1 April 2017	5.7	40.8	147.6	81.8	275.9
Profit for the year	–	–	–	161.7	161.7
Purchase of own shares	–	–	–	(0.7)	(0.7)
Dividend paid	–	–	–	(34.5)	(34.5)
Share-based payments	–	–	–	2.7	2.7
At 31 March 2018	5.7	40.8	147.6	211.0	405.1
At 1 April 2016	5.9	40.6	147.6	162.8	356.9
Loss for the year	–	–	–	(1.6)	(1.6)
Purchase of own shares	–	–	–	(0.7)	(0.7)
Purchase and cancellation of shares	(0.2)	0.2	–	(47.4)	(47.4)
Dividend paid	–	–	–	(33.4)	(33.4)
Share-based payments	–	–	–	2.1	2.1
At 31 March 2017	5.7	40.8	147.6	81.8	275.9

The capital redemption reserve is not distributable and was created following redemption of preference share capital.

NOTES TO THE COMPANY FINANCIAL STATEMENTS

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable UK Accounting Standards. As permitted by section 408(4) of the Companies Act 2006, a separate profit and loss account dealing with the results of the Company has not been presented.

These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework. In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU (Adopted IFRSs), but makes amendments where necessary in order to comply with Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

- A cash flow statement and related notes
- Disclosures in respect of transactions with wholly owned subsidiaries
- Disclosures in respect of capital management
- The effects of new but not yet effective IFRSs
- Disclosures in respect of the compensation of key management personnel
- Disclosures of transactions with a management entity that provides key management personnel services to the Company;
- IFRS 2 Share Based Payments in respect of Group-settled share-based payments
- Certain disclosures required by IFRS 13 Fair Value Measurement and the disclosures required by IFRS 7.

Investments

In the Company's financial statements, investments in subsidiary undertakings are stated at cost less any impairment in value.

Share-based payments

The fair value of equity-settled awards for share-based payments is determined on grant and expensed straight line over the period from grant to the date of earliest unconditional exercise. The fair value of cash-settled awards for share-based payments is determined at each period end until they are exercised or lapse. The value is expensed straight line over the period from grant to the date of earliest unconditional exercise. The charges for both equity and cash-settled share-based payments are updated annually for non-market-based vesting conditions. Further details of the Group's share-based payment charge are disclosed in note 29 to the Group financial statements. The cost of share-based payments is charged to subsidiary undertakings.

2. Investment in subsidiary undertakings

As at 31 March

all figures in £ million	2018	2017
Subsidiary undertaking – 100% of ordinary share capital of QinetiQ Group Holdings Limited	424.3	424.3
Capital contributions arising from share-based payments to employees of subsidiaries	44.6	41.9
	468.9	466.2

The increase in Investments in subsidiary undertakings in FY18 relates to £2.7m of equity-settled schemes during the year.

A list of all subsidiary undertakings of QinetiQ Group plc is disclosed in note 34 to the Group financial statements.

3. Debtors

As at 31 March

all figures in £ million	2018	2017
Amounts owed by Group undertakings	9.2	190.0

During the year the Company received dividends from its subsidiary undertakings resulting in a decrease in amounts owed by Group undertakings.

NOTES TO THE COMPANY FINANCIAL STATEMENTS

CONTINUED

4. Creditors: amounts falling due within one year

As at 31 March

all figures in £ million

	2018	2017
Amounts owed to Group undertakings	73.0	380.3

Amounts owed to Group undertakings are unsecured, repayable on demand and bear no interest.

5. Share capital

The Company's share capital is disclosed in note 28 to the Group financial statements.

6. Share-based payments

The Company's share-based payment arrangements are set out in note 29 to the Group financial statements.

7 Other information

Directors' emoluments, excluding Company pension contributions, were £3.7m (2017: £2.9m). These emoluments were all in relation to services provided on behalf of the QinetiQ Group with no amount specifically relating to their work for the Company. Details of the Directors' emoluments, share schemes and entitlements under money purchase pension schemes are disclosed in the Remuneration Report.

The remuneration of the Company's auditor for the year to 31 March 2018 was £0.2m (2017: £0.2m), which was for audit of the Group's annual accounts and audit related assurance services. No other services were provided by the auditor to the Company.

FIVE-YEAR RECORD

For the years ended 31 March (unaudited)		2018	2017	2016	2015	2014
EMEA Services (formerly UK Services)	£m	651.4	613.5	616.4	625.6	607.0
Global Products	£m	181.6	169.6	139.3	138.2	175.6
Revenue – continuing operations	£m	833.0	783.1	755.7	763.8	782.6
Discontinued operations (US Services)	£m	–	–	–	55.7	408.8
Revenue – total Group	£m	833.0	783.1	755.7	819.5	1,191.4
EMEA Services (formerly UK Services)	£m	94.3	92.7	93.8	93.0	86.7
Global Products	£m	28.2	23.6	15.1	18.3	27.0
Underlying operating profit¹ – continuing operations	£m	122.5	116.3	108.9	111.3	113.7
Discontinued operations (US Services)	£m	–	–	–	1.2	19.0
Underlying operating profit¹ – total Group	£m	122.5	116.3	108.9	112.5	132.7
Profit before tax	£m	144.8	131.5	97.7	92.9	4.1
Profit/(loss) attributable to equity shareholders	£m	138.1	123.3	106.1	104.7	(12.7)
Underlying basic EPS ¹	Pence	19.3	18.1	16.3	15.3	16.0
Basic EPS	Pence	24.4	21.5	18.1	16.6	(1.9)
Diluted EPS	Pence	24.3	21.3	18.0	16.5	(1.9)
Dividend per share	Pence	6.3	6.0	5.7	5.4	4.6
Underlying net cash from operations ¹	£m	126.5	111.9	133.4	145.7	157.3
Net cash	£m	266.8	221.9	274.5	195.5	170.5
Average number of employees		6,143	6,114	6,266	6,454	9,134
Continuing operations²						
Orders excluding LTPA amendment and including share of JVs	£m	587.2	675.3	659.8	613.6	596.9
Underlying operating margin ¹	%	14.7	14.9	14.4	14.6	14.5
Underlying profit before tax ¹	£m	122.1	116.1	108.7	107.8	101.2
Profit before tax	£m	144.8	131.5	90.2	105.4	84.0
Profit after tax	£m	138.1	123.3	98.6	117.4	68.0
Underlying basic EPS ¹	Pence	19.3	18.1	16.3	15.2	13.8
Basic EPS	Pence	24.4	21.5	16.8	18.6	10.4
Underlying net cash from operations ¹	£m	126.5	111.9	133.4	143.9	127.0

¹ Underlying measures are stated before specific adjusting items. Definitions of underlying measures of performance are in the glossary on page 139. Underlying financial measures are presented because the Board believes these provide a better representation of the Group's long-term performance trend. For details of specific adjusting items refer to note 4 of the financial statements.

² Continuing operations excludes the financial results of the US Services business disposed in 2015.



Photo credit:
NASA

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At the forefront of space innovation

A core pillar of our strategy to grow is innovation, this spans across all our activities and is one of our major sources of competitive advantage. During the year 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.

This is a key illustration of how QinetiQ is at the forefront of some of the innovative technology that is critical to the rapidly growing space industry.

Under the three year contract, QinetiQ will qualify and produce the first flight model. This marks the next step following the successful prototyping that was developed under a previous contract with ESA. The model produced under this contract will be the first IBDM to fly to the International Space Station.

The QinetiQ IBDM system is lighter and more versatile than competing designs, can accommodate large or small spacecraft, and is compatible with the newly agreed International Docking Standard, which seeks to allow docking between multiple types of spacecraft such as Dream Chaser (SNC), Orion (Lockheed Martin) and Cygnus (Orbital ATK).

ADDITIONAL FINANCIAL INFORMATION

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 rates affecting the Group were 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

Treasury policy

The Group treasury department works within a framework of policies and procedures approved by the Audit Committee. As part of these policies and procedures, there is strict control on the use of financial instruments. Speculative trading in financial instruments is not permitted. The policies are established to manage and control risk in the treasury environment and to align the treasury goals, objectives and philosophy of the Group.

Tax risk management

QinetiQ's tax strategy is to ensure compliance with all relevant tax legislation, wherever we do business, whilst managing our effective tax rates and tax cash flows. Tax is managed in alignment with our corporate responsibility strategy in that we strive to be responsible in all our business dealings. These principles are applied in a consistent and transparent manner in pursuing the tax strategy and in all dealings with tax authorities around the world.

- Tax planning – QinetiQ manages both effective tax rate (ETR) and cash tax impacts in line with the Board-endorsed tax strategy. External advice and consultation are sought on potential changes in tax legislation in the UK, the US and elsewhere as necessary, enabling the Group to plan for and mitigate potential changes. QinetiQ does not make use of 'off-shore' entities or tax structures to focus taxable profits in jurisdictions that legislate for low tax rates.
- Relationships with tax authorities – QinetiQ is committed to building constructive working relationships with tax authorities based on a policy of full disclosure in order to remove uncertainty in its business transactions and allow the authorities to review possible risks. In the UK, QinetiQ seeks to be open and transparent in its engagement with the tax authorities by sharing with HMRC the methodologies adopted in its tax returns.



As a UK-listed company, the Group is required to adopt EU endorsed IFRS and comply with the Companies Act 2006."

- Transfer pricing – The Group does not currently have a significant level of cross-border activity but this is likely to increase as the Group pursues its policy of expanding around the globe, however, where it does have such transactions, controls are in place to ensure pricing reflects 'arm's length' principles in compliance with the OECD Transfer Pricing Guidelines and the laws of the relevant jurisdictions. The Group does not, therefore, have a significant exposure to transfer pricing legislation and has recently submitted the first "Country by Country" report under new OECD rules.
- Governance – The Board has approved this approach. The Audit Committee oversees the tax affairs and risks through periodic reviews. The governance framework is used to manage tax risks, establish controls and monitor their effectiveness. The Head of Tax is responsible for ensuring that appropriate policies, processes and systems are in place and that the tax team has the required skills and support to implement this approach.

QinetiQ's corporate tax contribution – QinetiQ is liable to pay tax in the countries in which it operates, principally the UK, the US, Australia, Canada and Belgium. Changes in tax legislation in these countries could have an adverse impact on the level of tax paid on profits generated by the Group. A significant majority of the Group's profit before tax is generated in the UK. This reflects the fact that the majority of the Group's business is undertaken, and employees are based, in the UK. Total corporation tax payments in the year to 31 March 2018 were £15.7m. The differential between the taxation expense and the tax paid in the year relates primarily to the timing of the recovery of research and development expenditure credits for which the cash is recovered in the year following the year of account. There is also an impact of deferred tax movements, whereby the income statement bears charges and credits (e.g. in respect of accelerated capital allowances) but for which there is no corporation tax paid in the year. Together, these result in the cash paid being £9.0m greater than the total expense charged to the income statement.

Accounting standards

As a UK-listed company, the Group is required to adopt EU endorsed IFRSs and comply with the Companies Act 2006. The effect of changes to financial reporting standards in the year is disclosed in note 1 to the financial statements.

GLOSSARY

AGM	Annual General Meeting	FMI	Foster-Miller, Inc. – the legal entity through which the QNA division operates	PDR	Performance development review
BBP	Bonus Banking Plan	Funded order backlog	The expected future value of revenue from contractually committed and funded customer orders	PBT	Profit before tax
CAGR	Compound Annual Growth Rate	GHG	Greenhouse gas	PSP	Performance Share Plan
C4ISR	Command, control, communications, computers, intelligence, surveillance and reconnaissance	IAS	International Accounting Standards	QNA	QinetiQ North America
COTS	Commercial off the shelf	IBDM	International Berthing Docking Mechanism	QSOS	QinetiQ Share Option Scheme
CPI	Consumer Price Index	IFRS	International Financial Reporting Standards	QTS	QinetiQ Target Systems
CR	Corporate Responsibility	IRAD	Internal research and development	R&D	Research and development
CRC	Carbon Reduction Commitment	KPI	Key Performance Indicator	RDEC	Research and development expenditure credit
CSR	Corporate Social Responsibility	LDP	Leadership development programme	SE	Strategic Enterprise
DE&S	MOD's Defence, Equipment and Support organisation	LIBID	London inter-bank bid rate	SEMAP	Systems Engineering Master Apprenticeship Programme
DHS	US Department of Homeland Security	LIBOR	London inter-bank offered rate	SPA	Special protection area
DSP	Deferred Share Plan	LTI	Lost time incident	SSRO	Single Source Regulations Office
DoD	US Department of Defense	LTPA	Long Term Partnering Agreement – 25-year contract established in 2003 to manage the MOD's test and evaluation ranges	SSSI	Site of Special Scientific Interest
EBITDA	Earnings before interest, tax, depreciation and amortisation	MDP	Modernising Defence Programme	STEM	Science, Technology, Engineering and Maths
ED&I	Equality, diversity and inclusion	MOD	UK Ministry of Defence	T&E	Test and evaluation
EDP	Engineering Delivery Partner	MSCA	Maritime Strategic Capability Agreement	T&R	Training and rehearsal
EEG	Employee Engagement Group	NCSISS	Naval Combat System Integration Support Services	TSR	Total shareholder return
EMEA	Europe, Middle East and Australasia	OHSAS	Occupational Health and Safety Advisory Services	UAV	Unmanned aerial vehicle
EPS	Earnings per share			UK	Guidelines of the Financial Reporting Council to address the principal aspects of corporate governance in the UK
ESA	European Space Agency			UK Corporate Governance Code	
ESOS	Energy Savings Opportunity Scheme			UK GAAP	UK Generally Accepted Accounting Practice
EST	Engineering, Science and Technical				
FAR	Federal Acquisition Regulations				
FCA	Financial Conduct Authority				

Alternative performance measures (APMs)

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
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 3
Underlying operating profit	Operating profit as adjusted to exclude 'specific adjusting items'	Note 3
Underlying operating margin	Underlying operating profit expressed as a percentage of revenue	Note 3
Underlying net finance income/expense	Net finance income/expense as adjusted to exclude 'specific adjusting items'	Note 6
Underlying profit before/after tax	Profit before/after tax as adjusted to exclude 'specific adjusting items'	Note 8
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 8
Underlying basic and diluted EPS	Basic and diluted earnings per share as adjusted to exclude 'specific adjusting items'	Note 12
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 27
Underlying operating cash conversion	The ratio of underlying net cash from operations to underlying operating profit	Note 27
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 27
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 24
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 4

SHAREHOLDER INFORMATION

Registrar: Equiniti Limited
www.shareview.co.uk
 Tel: 0371 384 2021

Shareholding enquiries

The Company's registrar is Equiniti. Enquiries regarding your shareholding, including the following administrative matters, should be addressed to Equiniti:

- Change of personal details such as change of name or address.
- Lost share certificates.
- Dividend payment enquiries.
- Direct dividend payments. You can have your dividends paid directly into a UK bank or building society account by completing a dividend mandate form. The associated dividend confirmation will still be sent to your registered address. If you live outside the UK, Equiniti offers a global payments service which is available in certain countries and could enable you to receive your dividends direct into your bank account in your local currency.

Contact details for registrar

By post:

Equiniti Limited, Aspect House, Spencer Road
 Lancing, West Sussex BN99 6DA

By telephone:

0371 384 2021* for UK calls, +44 (0)121 415 7576 for calls from outside the UK.

* Lines are open 8.30am to 5.30pm (UK time), Monday to Friday (excluding public holidays in England and Wales).

By email:

You can send an email enquiry securely from Equiniti's website, at <https://help.shareview.co.uk>.

Online:

Equiniti's website at <https://help.shareview.co.uk> (Shareview) includes answers to frequently asked questions and provides key forms for download. Shareview also offers online access to your shareholding where you can manage your account, register for electronic communications, see details of balance movements and complete certain amendments online, such as changes to dividend mandate instructions. You can register at www.shareview.co.uk, click on 'Register' and follow the steps.

Electronic communications

The Company offers shareholders the option to receive documentation and communications electronically, via the Company's website. The wider use of electronic communications enables fast receipt of documents, reduces the Company's printing, paper and postal costs and reduces the Company's environmental impact. Shareholders can register for electronic communications at www.shareview.co.uk and may also cast their vote for the 2018 Annual General Meeting online quickly and easily using the Sharevote service by visiting www.sharevote.co.uk.

Donating shares to charity – ShareGift

Small parcels of shares, which may be uneconomic to sell on their own, can be donated to ShareGift, the share donation charity (registered charity no. 1052686). ShareGift transfers these holdings into their name, aggregates them, and uses the proceeds to support a wide range of UK charities based on donor suggestion. If you would like further details about ShareGift, please visit www.sharegift.org, email help@sharegift.org or telephone them on 020 7930 3737.

Share price

Details of current and historical share prices can be found on the Company's website at www.QinetiQ.com/investors.

Analysis of share register at 31 March 2018

By type of holder	Total number of holdings	Percentage of holders	Total number of shares	Percentage issued capital
Individual	5,711	88.71%	5,562,263	0.97%
Institutions and others	727	11.29%	566,194,858	99.03%
Total	6,438	100%	571,757,121	100%
By size of holding				
1-500	4,280	66.48%	840,910	0.15%
501-1,000	541	8.41%	434,487	0.08%
1,001-2,500	646	10.03%	1,127,213	0.20%
2,501-5,000	356	5.53%	1,287,004	0.23%
5,001-10,000	165	2.56%	1,229,076	0.21%
10,001-100,000	240	3.73%	8,035,779	1.41%
Over 100,000	210	3.26%	558,802,652	97.72%
Total	6,438	100.00%	571,757,121	100.00%

Share fraud reporting:
www.fca.org.uk/scams

FCA Consumer Helpline:
0800 111 6768

Beware of share fraud

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment. While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

1. How to avoid share fraud
2. Keep in mind that firms authorised by the FCA are unlikely to contact you out of the blue with an offer to buy or sell shares.
3. Do not get into a conversation, note the name of the person and firm contacting you and then end the call.
4. Check the Financial Services Register from www.fca.org.uk to see if the person and firm contacting you is authorised by the FCA.
5. Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
6. Use the firm's contact details listed on the Register if you want to call it back.
7. Call the FCA on 0800 111 6768 if the firm does not have contact details on the Register or you are told they are out of date.
8. Search the list of unauthorised firms to avoid at www.fca.org.uk/scams.
9. Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme.
10. Think about getting independent financial and professional advice before you hand over any money.
11. Remember: if it sounds too good to be true, it probably is!

Report a scam

If you are approached by fraudsters please tell the FCA using the share fraud reporting form at www.fca.org.uk/scams, where you can find out more about investment scams. You can also call the FCA Consumer Helpline on 0800 111 6768.

If you have already paid money to share fraudsters you should contact Action Fraud on 0300 123 2040.

Key dates

25 July 2018	Trading update
25 July 2018	Annual General Meeting
2 August 2018	Ordinary shares marked ex-dividend
3 August 2018	Final 2018 dividend record date
31 August 2018	Final 2018 dividend payment date
30 September 2018	Half-year financial period end
15 November 2018	Half-year results announcement
February 2019	Trading update (provisional date)
31 March 2019	Financial year end
May 2019	Preliminary results announcement (provisional date)

Cautionary statement

All statements other than statements of historical fact included in this Annual Report, including, without limitation, those regarding the financial condition, results, operations and businesses of QinetiQ and its strategy, plans and objectives and the markets and economies in which it operates, are forward-looking statements. Such forward-looking statements, which reflect management's assumptions made on the basis of information available to it at this time, involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of QinetiQ or the markets and economies in which QinetiQ operates to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Nothing in this Annual Report should be regarded as a profit forecast.

This Annual Report is intended to provide information to shareholders and is not designed to be relied upon by any other party. The Company and its Directors accept no liability to any other person other than under English law.

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