

# Our strategy is delivering – second year of growth

QinetiQ Group Plc  
Preliminary results for year ended  
31 March 2018

24 May 2018



QINETIQ

# Agenda

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1 Headlines

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2 Financial overview

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3 Strategic update

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4 Q&A

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# Our strategy is delivering – second year of growth

- Delivered second year of organic growth
  - Revenue up 6%, 3% on an organic basis
  - Operating profit up 5%, broadly flat on an organic basis
  - Solid orders performance and large backlog
  - 103% cash conversion pre-capex
  - EPS up 7%; 5% increase in full year dividend
- Driving growth through strategy implementation
  - Selected to be Engineering Delivery Partner for UK MOD
  - Won first phase of robotics program of record for US DOD
  - Grown international revenue from 21% to 27% in 2 years
  - Agreed acquisition of E.I.S. Aircraft Operations in Germany

	FY18	FY17
Revenue	<b>£833.0m</b>	£783.1m
Operating profit*	<b>£122.5m</b>	£116.3m
EPS*	<b>19.3p</b>	18.1p
Dividend	<b>6.3p</b>	6.0p
Order backlog	<b>£2.0bn</b>	£2.2bn

\* Underlying performance, before specific adjusting items, as defined in appendix.

- Priorities for the coming year
  - Conclude LTPA repricing with UK MOD
  - Win further campaigns & accelerate international growth
  - Continue investment driving sustainable growth
  - Maintaining expectations for Group performance

# Financial overview

David Smith

Chief Financial Officer

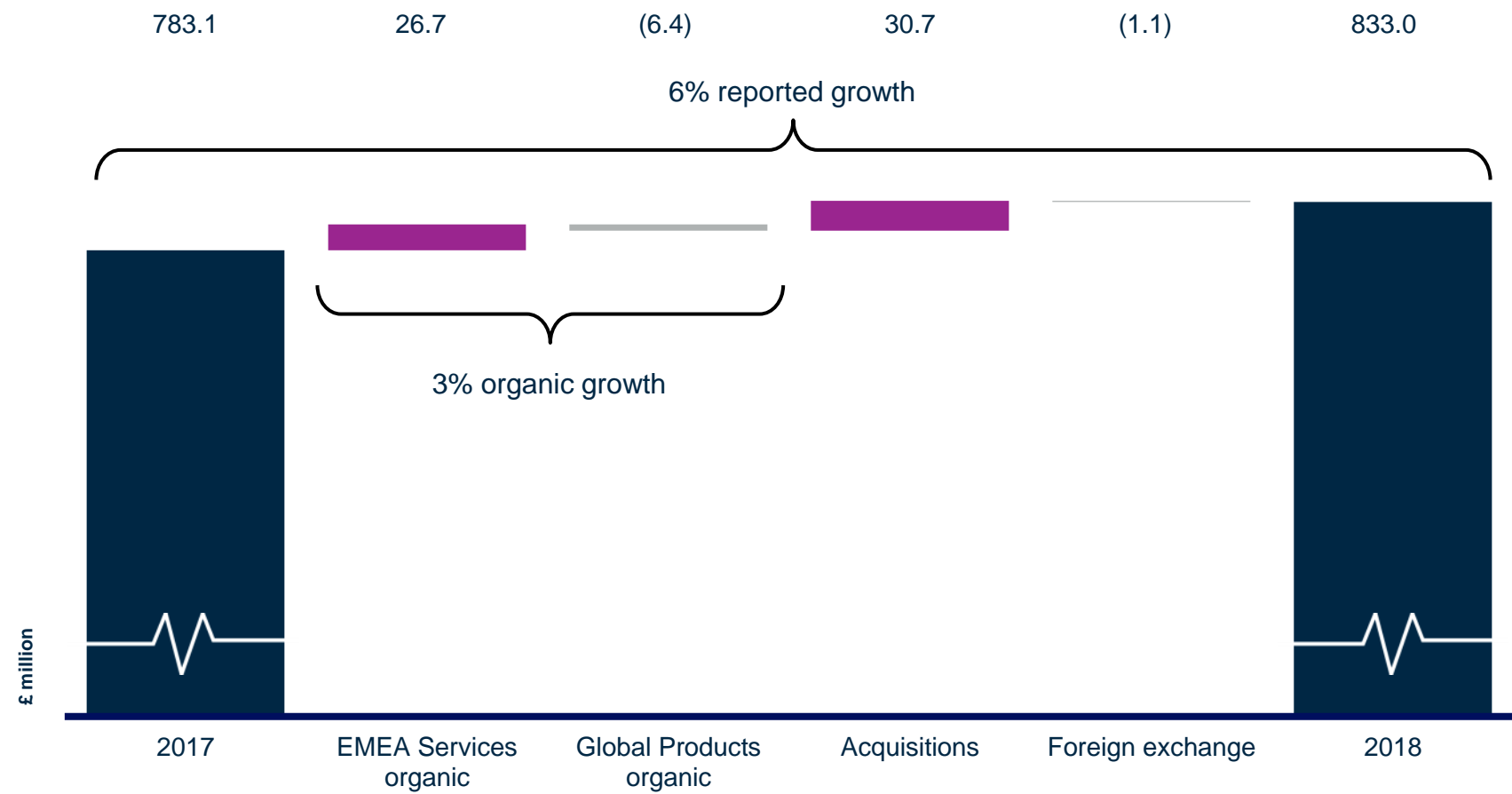
# Strong financial performance

	2018 £m	2017 £m
Revenue	<b>833.0</b>	783.1
Underlying operating profit*	<b>122.5</b>	116.3
Underlying operating margin*	<b>14.7%</b>	14.9%
Earnings per share* (pence)	<b>19.3</b>	18.1
Dividend per share (pence)	<b>6.3</b>	6.0
Total funded order backlog	<b>2,005.4</b>	2,178.7
Total orders	<b>687.4</b>	1,676.7
Orders in the period (incl JVs / excl LTPA amendments)	<b>587.2</b>	675.3
Net cash inflow from operations (pre-capex)*	<b>126.5</b>	111.9
Cash conversion (pre-capex)*	<b>103%</b>	96%
Net cash	<b>266.8</b>	221.9

\* Underlying performance, before specific adjusting items, as defined in appendix.

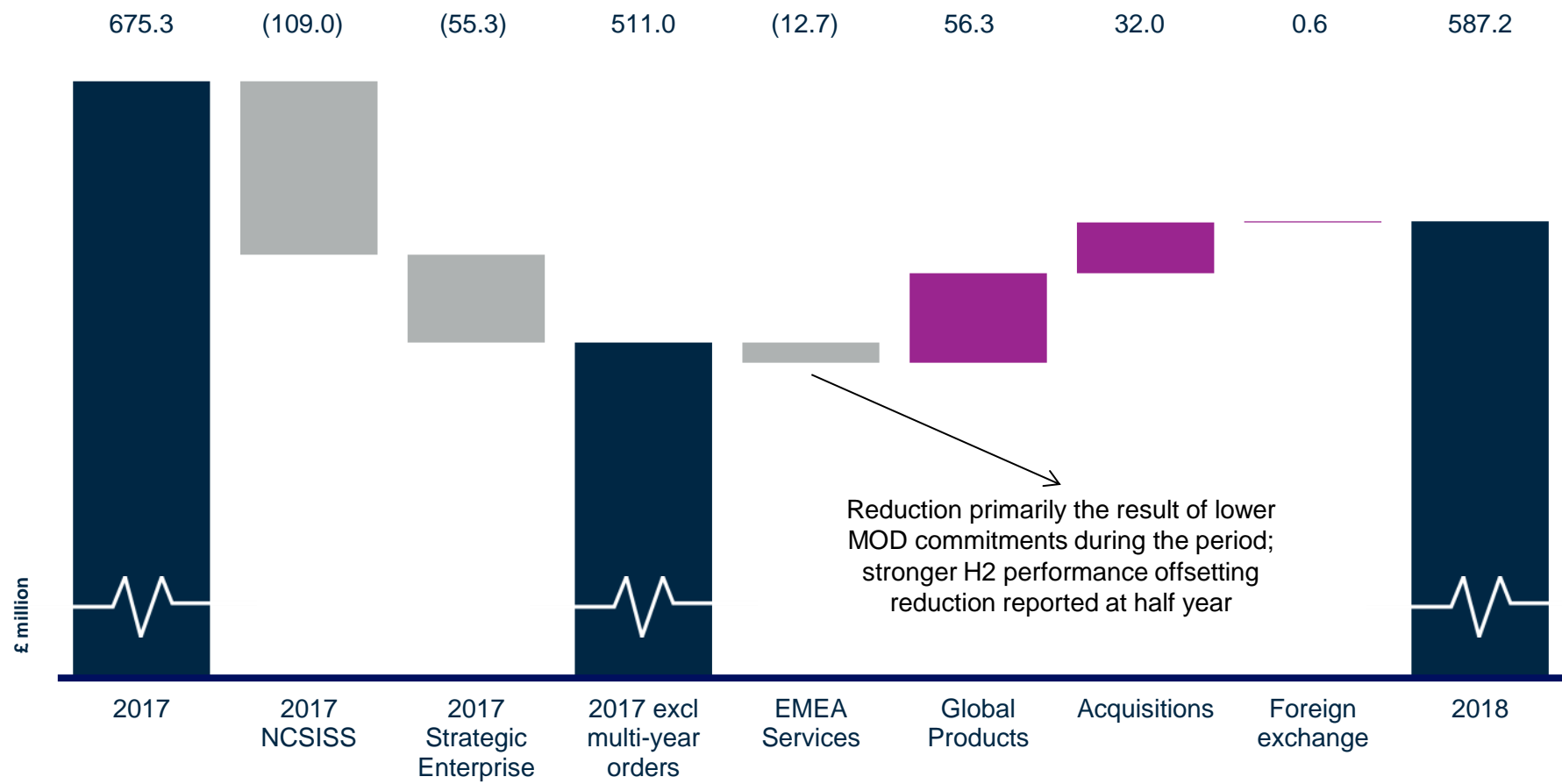
# Organic revenue growth complemented by acquisitions

## Revenues



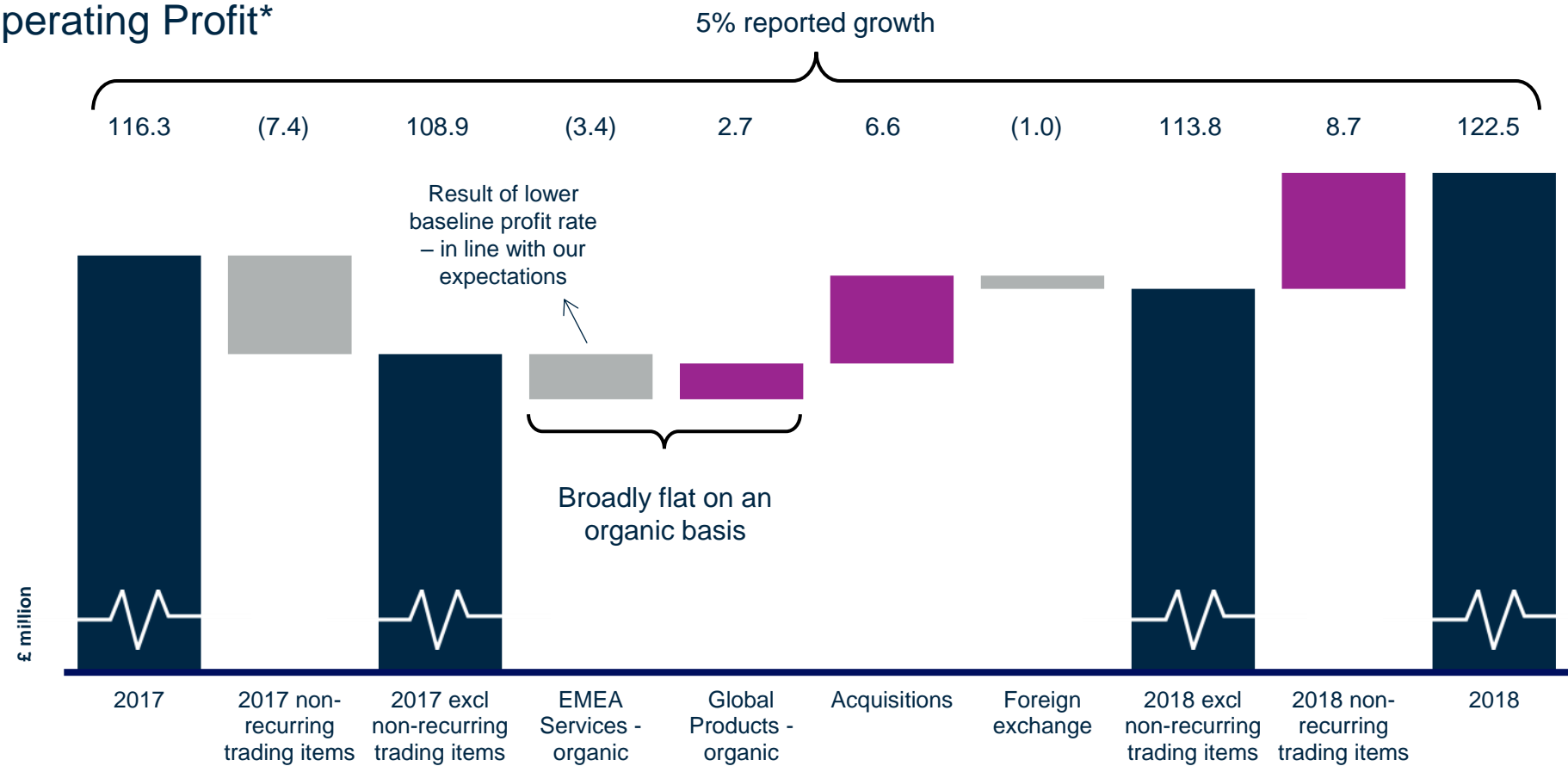
# Order growth, excluding multi-year orders in 2017

Orders



# Profit: International growth offsetting UK single source headwinds

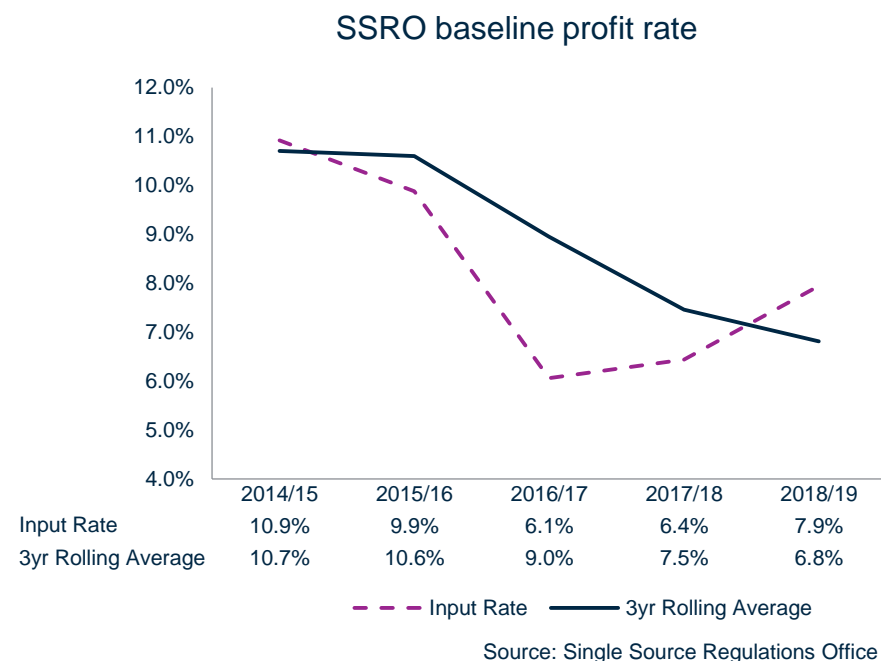
## Underlying Operating Profit\*



\* Underlying performance, before specific adjusting items, as defined in appendix.

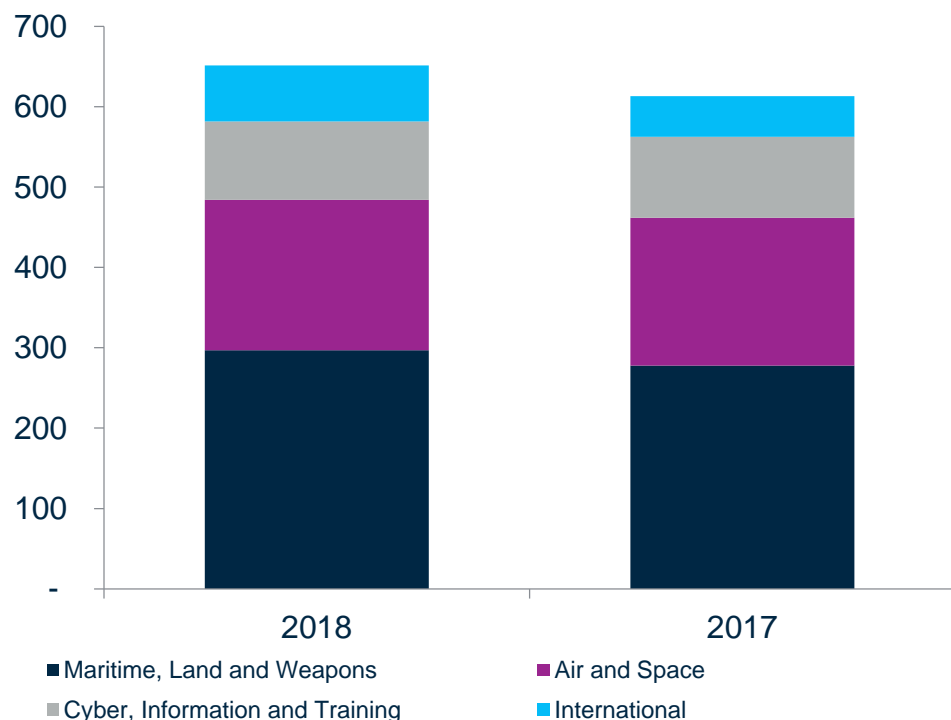
# Strong SSRO headwind in FY19, expected to reduce thereafter

- Single Source Regulations Office (SSRO) headwind to EMEA Services profit of c.£6m in FY19; headwind expected to reduce in FY20 and beyond
- Reduction driven by:
  - Increasing proportion of SSRO-derived revenue on long-term contracts which reduces overall exposure to future variations in the baseline profit rate
  - Anticipated repricing of remaining LTPA will be largest driver of headwind in FY19
  - In addition, evidence of a potential longer-term stabilisation in the baseline profit rate



# EMEA Services – encouraging organic revenue growth

FY revenue (£m)



\* Underlying performance, before specific adjusting items, as defined in appendix.

^ Adjusted for the impact of acquisitions and disposals and presented on a constant currency basis, as defined in appendix.

† Excludes LTPA contract amendments.

Book to Bill ratio is orders won divided by revenue recognised excluding the LTPA contract.

Total orders

Orders excl LTPA amendments

Revenue

Underlying operating profit\*

Underlying operating profit margin\*

Book to bill ratio†

Total funded order backlog

Funded order backlog†

Full year revenue under contract

2018

£m

2017

£m

456.1

1,522.3

355.9

520.9

651.4

613.5

94.3

92.7

14.5%

15.1%

0.8x

1.3x

1,804.9

2,019.8

709.6

813.6

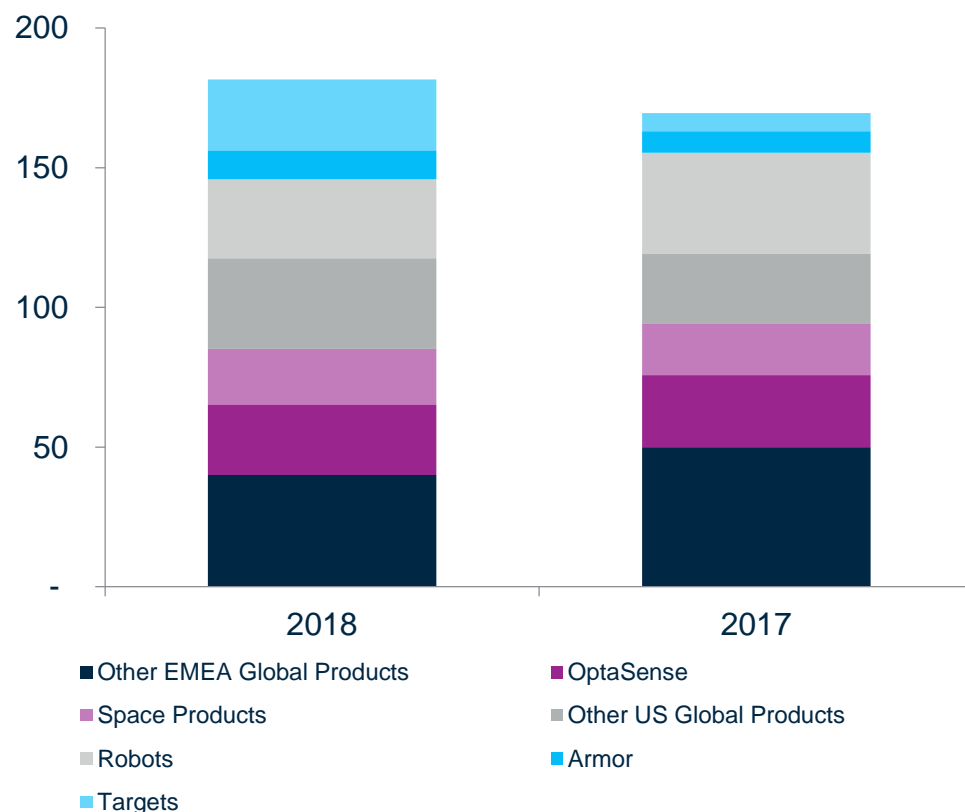
75%

79%

- Orders movement reflects multi-year contract awards in prior year including £109m NCSISS and £55m Strategic Enterprise contracts. Strong H2 performance offset reduction reported at the half year
- Revenue up 6%, 4% on an organic^ basis
- Profit assisted by £7.7m (2017: £5.2m) of non-recurring trading items
- Excluding non-recurring trading items, the RubiKon acquisition and foreign exchange, underlying operating profit fell by £3.4m, driven by the lower baseline profit rate for single source contracts, in line with our expectations

# Global Products – strong orders performance

FY revenue (£m)



\* Underlying performance, before specific adjusting items, as defined in appendix.

^ Adjusted for the impact of acquisitions and disposals and presented on a constant currency basis, as defined in appendix.

Orders

Revenue

Underlying operating profit\*

Underlying operating profit margin\*

Book to bill ratio

Funded order backlog

Full year revenue under contract

2018

£m

231.3

181.6

28.2

15.5%

1.3x

200.5

51%

2017

£m

154.4

169.6

23.6

13.9%

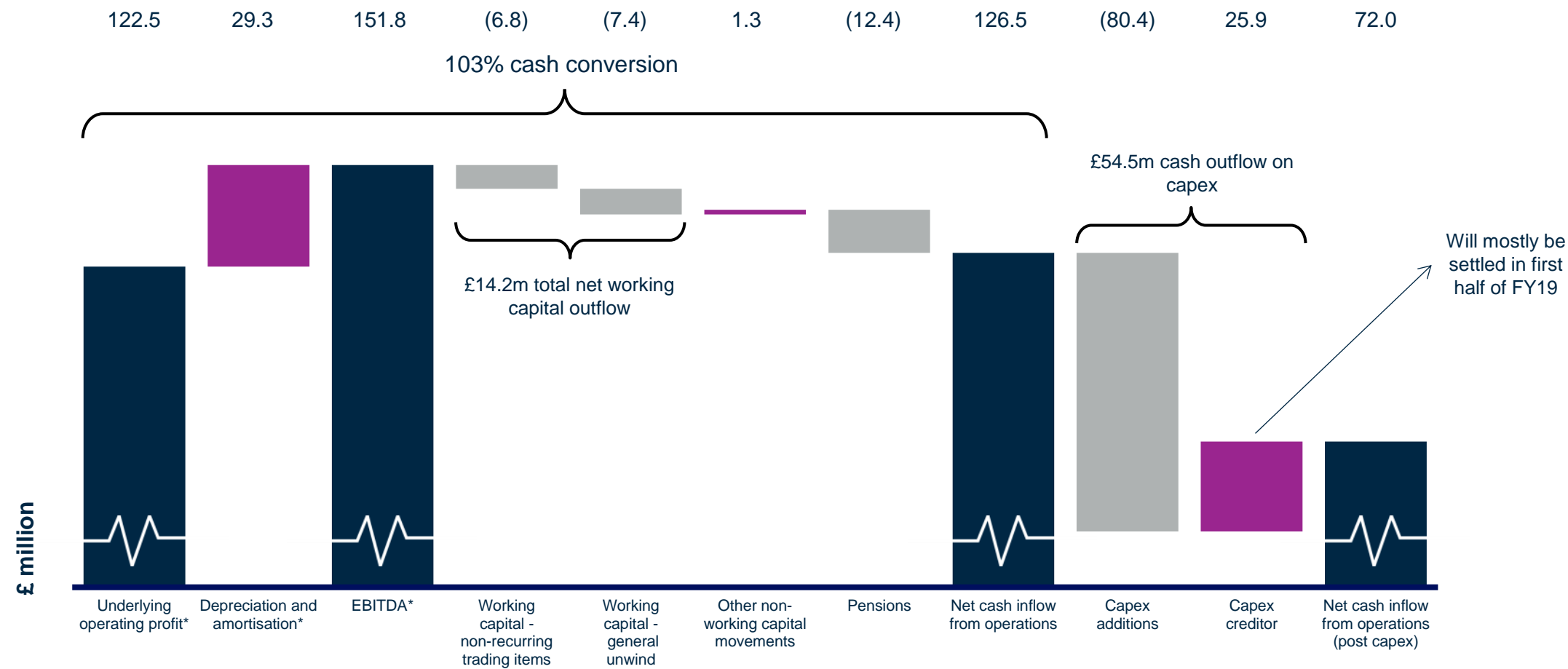
0.9x

158.9

55%

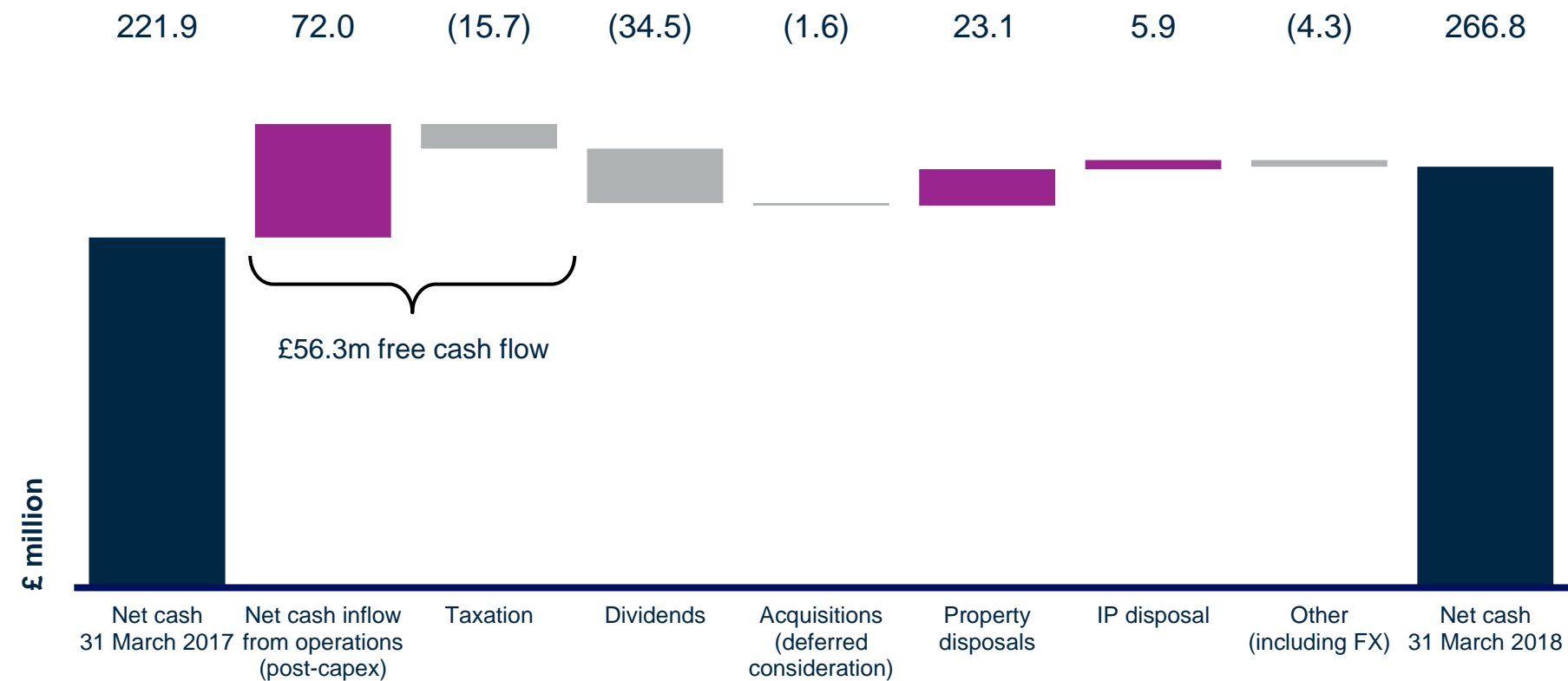
- Orders included US maritime systems contracts totalling more than US\$50m and a €25m spacecraft docking mechanism order with the European Space Agency
- 7% revenue growth driven by QinetiQ Target Systems acquisition. Revenue declined by 4% on an organic^ basis due to lower robot sales in the year
- Operating profit up £2.7m, after adjusting for acquisitions, foreign exchange and £1.0m non-recurring trading items (2017: £2.2m), driven by increased profits in OptaSense and high margins in QTS in the last quarter

# Strong cash generation



\* Underlying performance, before specific adjusting items, as defined in appendix.

# Balance sheet strength supports our growth strategy



# Confirmed pension surplus

	31 March 2018 £m	31 March 2017 £m
Market value of assets	1,990.5	1,926.3
Present value of scheme liabilities	(1,674.3)	(1,770.3)
Net pension asset before deferred tax	316.2	156.0
Deferred tax liability	(58.6)	(31.4)
Net pension asset	257.6	124.6

- Following the triennial valuation and discussions with QinetiQ's pension scheme Trustees, the Company has a confirmed actuarial pension surplus of £139.7m as at 30 June 2017
- Scheme is hedged against ~85% of interest rate risk and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis
- Accounting net pension asset of £257.6m (after deferred tax)
- Company ceased making cash deficit recovery payments of approximately £10.5m per annum from March 2018

## A clear capital allocation policy

Priority 1	Priority 2	Priority 3	Priority 4
Invest in our organic capabilities, complemented by bolt-on acquisitions where there is a strong strategic fit	Maintain the necessary balance sheet strength	Provide a progressive dividend to shareholders	Return excess cash to shareholders

## FY19 Outlook – technical factors

	FY18	FY19	
Net finance costs*	£0.4m	➡	Net finance costs expected to be flat
Effective tax rate*	10.7%	↗	Effective tax rate expected to increase with greater proportion of international revenues
Tax cash outflow	£15.7m	↓	Cash tax is expected to be lower due to the anticipated step up in capital investment in FY19 and the increased RDEC rate from 11% to 12%
Net working capital unwind (excluding non-recurring items)	£7.4m	↑	We expect to see an unwind of net working capital, excluding non-recurring items, of £15m to £25m
Pension deficit repair	£12.4m	↓	The £10.5m company cash contributions required under the recovery plan ceased in FY18. FY19 will still include c.£2.5m in respect of asset backed funding scheme
Capital expenditure	£80.4m	↗	FY19 will reflect increasing investment, with capex of £80m to £100m and cash impact of around £100 million including reduction in capex creditor. Capex includes support of the amendment to the LTPA announced in December 2016

\* Underlying performance, before specific adjusting items, as defined in appendix.

# Outlook Statement

## Outlook – FY19

- 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
- 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
- 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

# Strategic update

Steve Wadey

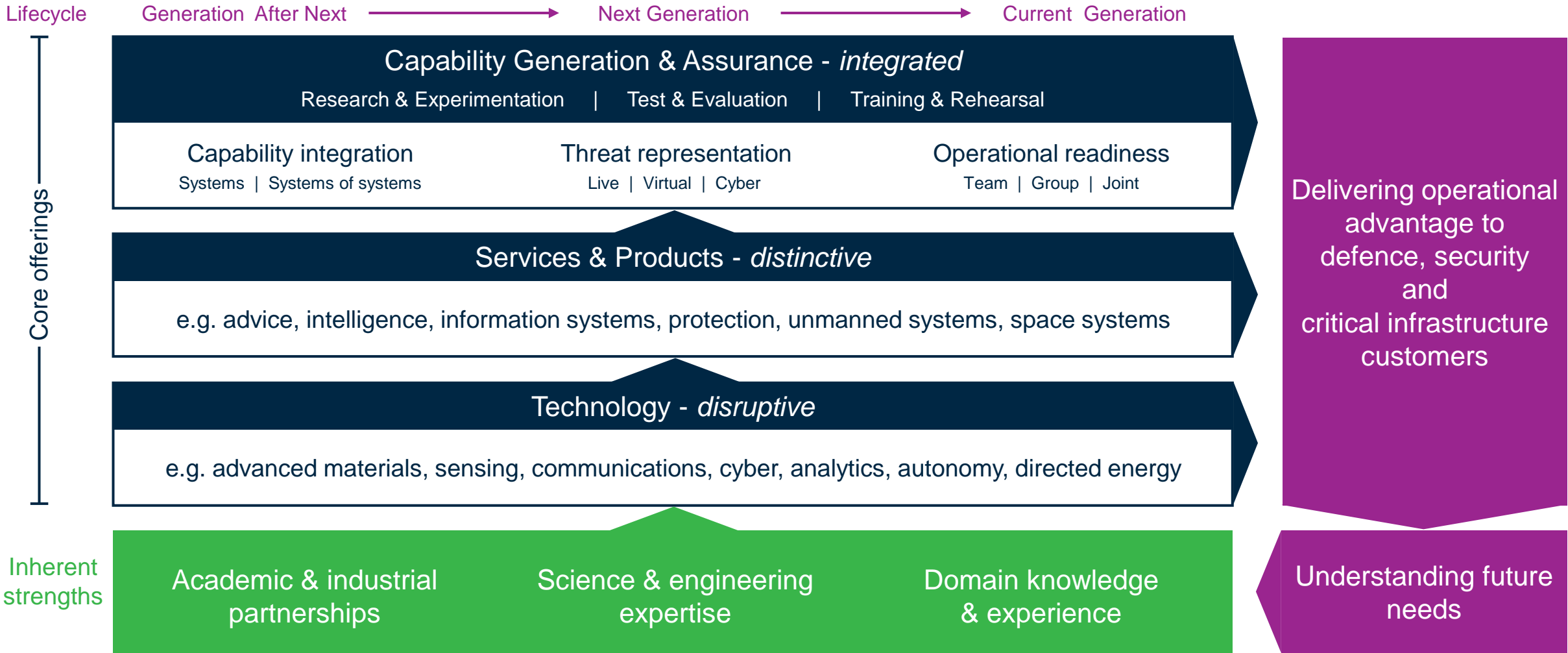
Chief Executive Officer

# Market drivers – Defence, Security & Critical Infrastructure

Themes	Enablers
<ul style="list-style-type: none"><li>– Uncertain, complex and ‘fractured’ security environment</li><li>– Acceleration of pace and asymmetry of threats</li><li>– Erosion of Western technology edge</li><li>– Commercial sector-driven innovation</li><li>– Persistent drive for budgetary efficiency</li></ul>	<ul style="list-style-type: none"><li>– Delivering integrated capability at lower cost</li><li>– Exploiting disruptive technologies</li><li>– Using information for competitive advantage</li><li>– Representing real-world threats</li><li>– Delivering joint and international operational readiness</li></ul>

Creating opportunities through our inherent strengths and strategy

# How we create value



# Delivering our vision and strategy

## Vision

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

## Strategy



### 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 customer advantage in defence, security and critical infrastructure markets

## Objectives

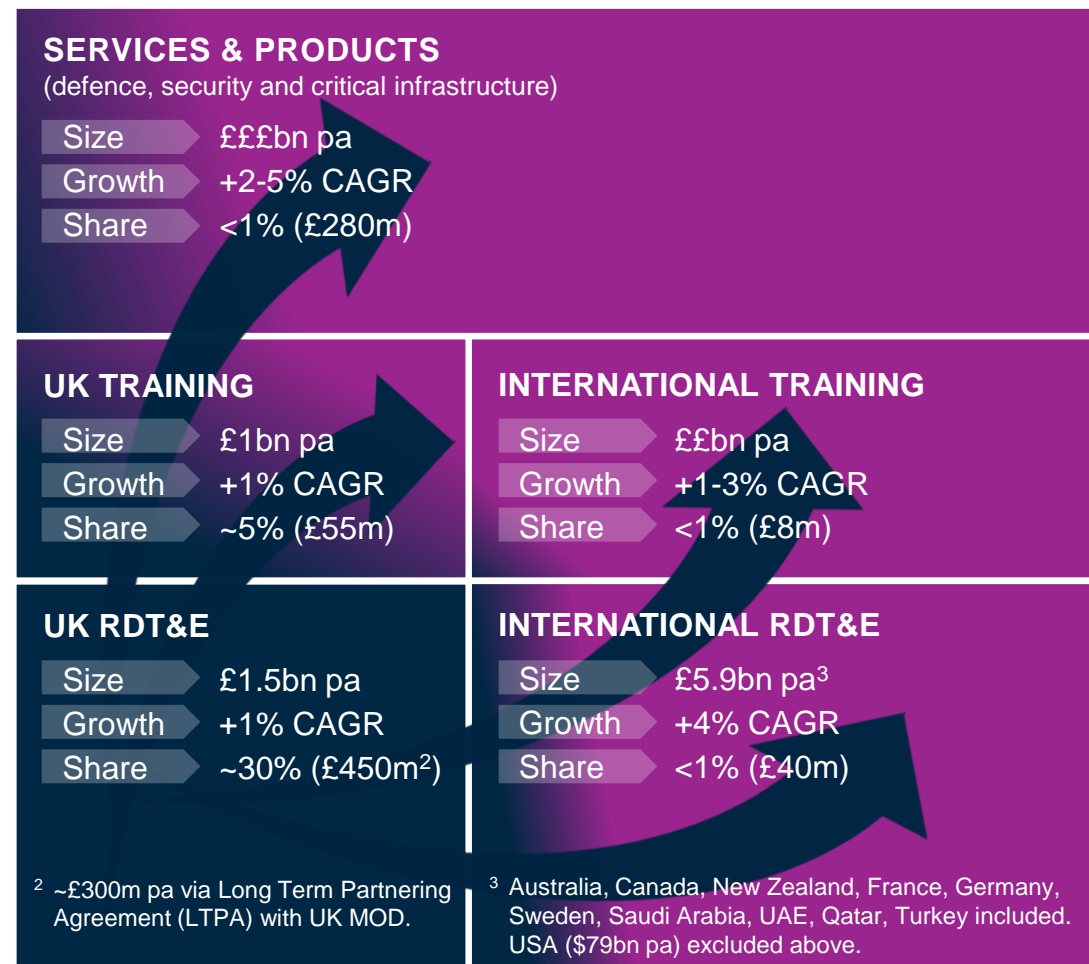
- Improve customer focus and competitiveness
- Modernise and reinvigorate the LTPA for UK MOD
- Build agile, competitive Test & Evaluation services for industry
- Improve business winning approach through campaigns
- Grow our Cyber, Information & Training business
- Accelerate growth in our US and Australian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

# Expanding into our addressable market

- Focus on core offerings
  - RDT&E<sup>1</sup> + Training: integrated capability generation & assurance
  - Services & Products: distinctive
  - Technology: disruptive
- Focus on target markets
  - Primary sectors: Defence, Security, Critical Infrastructure
  - Home countries: UK, US, Australia
  - Selected new countries in Europe, Middle East and Asia-Pacific
- Addressable market > £8bn pa: significant growth potential
  - Increasing share in existing markets
  - Leveraging strengths into attractive near-adjacent markets

Driving campaigns, joint ventures & acquisitions

<sup>1</sup> RDT&E = Research & Development and Test & Evaluation.



Source: Jane's Market Forecast, FY18 market sizing (USD/GBP exchange rate of 0.76), UK MOD. QinetiQ market share based on FY18 revenue. CAGR = compound annual growth rate (FY18-22)

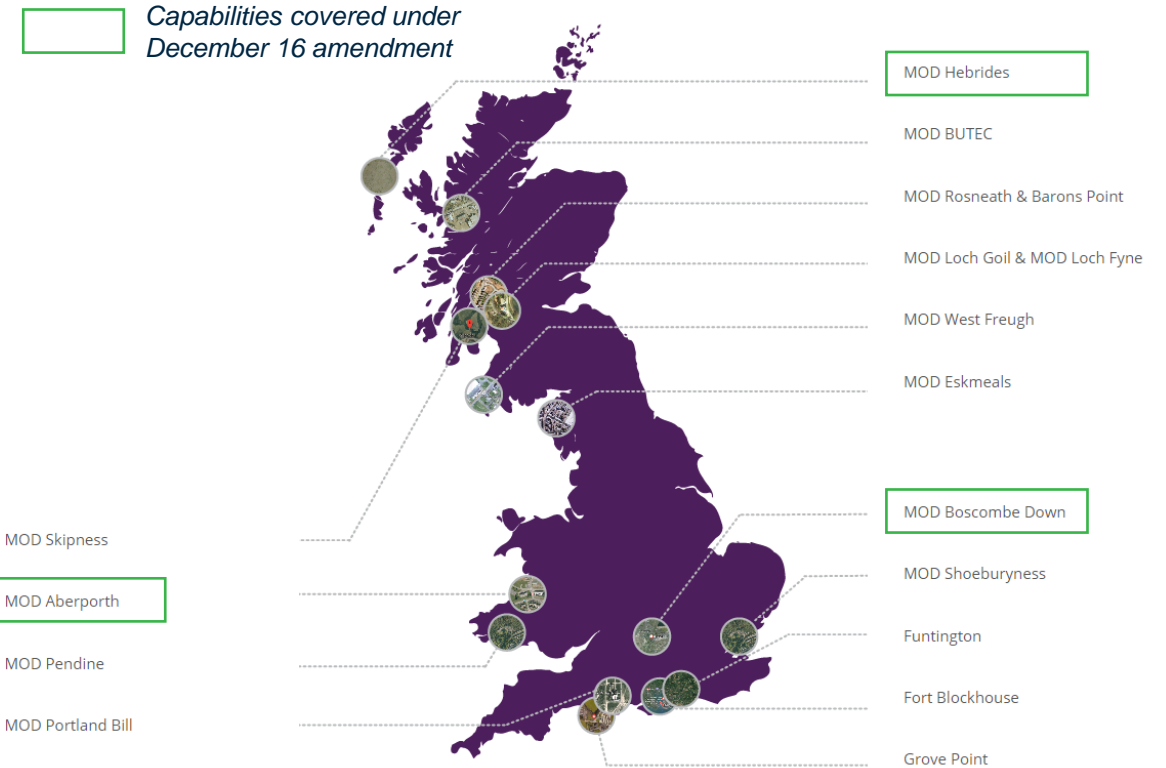
■ current market share ■ future market potential

**QINETIQ**



# Delivering modern UK Defence Test & Evaluation (1/2)

- Long Term Partnering Agreement (LTPA) with UK MOD
  - 25-year contract running until 2028, c.£300m pa revenue
  - 17 primary sites and 1,800 people across UK
- Delivering critical skills and facilities to enable generation and assurance of national defence capabilities
  - e.g. submarine and warship signature measurement
- £1bn amendment in December 2016 to modernise and deliver world-class air ranges and test aircrew training
  - Investment recovered over life of contract
  - Strong foundation securing UK customer, c.£100m pa
  - Attract further UK, international and industry users



Modernising enduring capabilities to meet future needs and creating a platform for growth



## Delivering modern UK Defence Test & Evaluation (2/2)

- Programme to modernise air ranges & test aircrew training on track
  - Delivering UK customer requirements with new capabilities from 2019
  - Enables larger more complex training exercises e.g. future Formidable Shields
  - Secured first multi-year international contracts to train Dutch & Swiss test pilots
- HMS Queen Elizabeth release to service expedited through combining Merlin Mk2 and Chinook Mk5 helicopter flying trials
  - Critical planning, trials & data analysis to establish aircraft's safe operating limits
- Constructive repricing negotiations with UK MOD for management & operation of 15 LTPA sites not covered by December 2016 amendment
  - Interim pricing arrangement for 12 months, in place from April 2018



Delivering UK customer needs and growing international users



## Building an international company (1/2)

- North America business continues to grow with strong order intake
  - Significant orders for maritime systems and TALON upgrades
  - Strategic win to upgrade sub-system on VIRGINIA Class submarines
  - Won first phase of Common Robotic System Individual (CRS-I) program of record
- Australian business growing rapidly with record order intake
  - RubiKon acquisition performing ahead of expectations
  - Secured Major Services Provider (MSP) role in partnership with Nova Systems
- Established joint ventures in Middle East to develop local capabilities
  - Leveraging key skills and experience honed in the UK
  - Secured >\$30m orders in air, land and maritime domains



Successfully growing and creating new home countries



## Building an international company (2/2)

- QinetiQ Target Systems performing and growing, acquired December '16
  - Leading position in growing target systems and services market
  - Access to >40 international customers, generating >90% revenue outside UK
  - Strengthens our T&E services and accelerates our international growth
  - New customers: South Korean Air Force and Japanese Air Self Defence Force
  - Investment underway in next generation real world threat representation
- Agreement to acquire E.I.S. Aircraft Operations, signed April '18
  - Strong track record & growth potential in cost-effective airborne training services
  - Establishes a T&E and engineering services capability in Germany
  - Strengthens our Training services and accelerates our international growth
- Export team continues to focus on attractive near-adjacent markets

International revenue grown from 21% to 27%





# Innovating for our customers' advantage

- Business winning campaigns building momentum with five down-selects<sup>1</sup>, based on major government funded programmes & strategic partnering

Programme <sup>2</sup>	Customer	Budget	FY	Duration
Engineering Delivery Partner (EDP)	UK	£1bn+	19	10 years
Defence Core Systems & Services (DCS&S)	UK	£75-120m	19	5 years
Battlefield & Tactical Communication Information Systems (BATCIS)	UK	£50-95m	19	5 years
Common Robotics System Individual (CRS-I)	US	\$429m	20	7 years
Air Support Defence Operational Training (ASDOT)	UK	£1-1.25bn	21	10 years

- £10m pa Internal Research & Development (IRAD) programme investing in new technology to underpin business winning opportunities
  - Next generation of robotics e.g. Sea Scout underwater unmanned vehicle
  - Next generation of communications e.g. Bracer secure satellite communication
  - Digitisation of Test & Evaluation: connecting & exploiting facilities



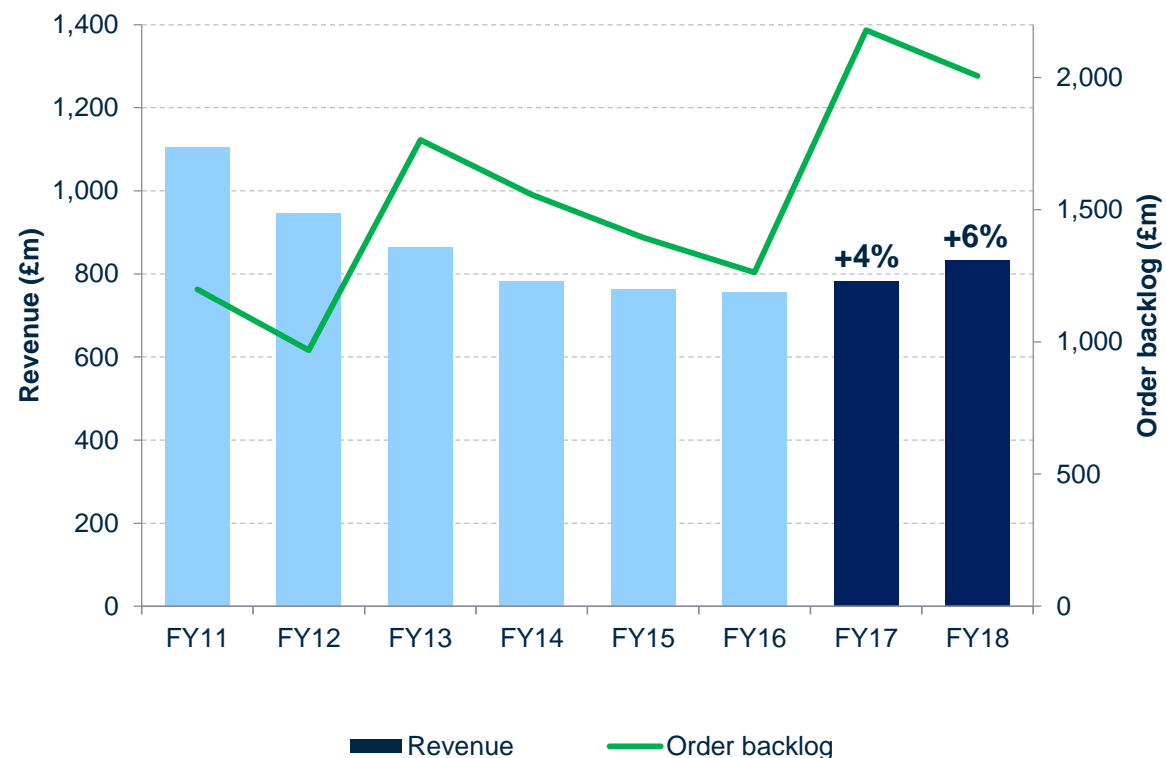
Win further campaigns and build on successful down-selects

<sup>1</sup> QinetiQ down-selected to short list of potential suppliers

<sup>2</sup> Customer published budget, anticipated financial year of decision and overall programme duration

# Our strategy is delivering – second year of growth

- Delivered 6% revenue growth and good visibility with order backlog of £2bn
  - 3% organic growth supplemented by strategic acquisitions
  - International growth offset UK single source profit headwind
- Building momentum to drive continued revenue growth
  - Strong UK single source profit headwind this year
  - Headwind expected to reduce next year and beyond
- Growing revenue to deliver increased profitability
  - Leveraging strengths into >£8bn pa addressable market
  - Continued investment driving medium-term growth



Well positioned for sustainable growth

# Questions



# Appendices



# Definitions

- Underlying performance is stated before:
  - Amortisation of intangibles arising from acquisitions
  - Pension net finance income/expense
  - Gains/losses on business divestments and disposal of investments, property and intellectual property
  - Transaction costs in respect of business acquisitions
  - Impairment of goodwill and other intangible assets
  - Tax impacts of the above items
  - Significant non-recurring deferred tax movements
- Organic revenue 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

# Acquisition of E.I.S. Aircraft Operations

## Attractive business with compelling strategic rationale

- In April 2018, QinetiQ entered into an agreement to acquire E.I.S. Aircraft Operations ('Aircraft Operations'), currently part of E.I.S. Aircraft Group, for €70 million on a cash-free, debt-free basis
- Aircraft Operations is a leading provider of airborne training services based in Germany, delivering threat representation and operational readiness for military customers
- Establishes a test and evaluation and engineering services capability in Germany, and enhances QinetiQ's access to the broader European defence market

## Supported by strong financial performance

- Generated €20.1m revenue and €5.4m EBITDA in the year to 31 December 2017
- Expect €23-25m revenue and €6m EBITDA for the year to 31 December 2018
- Depending upon timing of completion, anticipate 2-3% enhancement to QinetiQ FY19 EPS and >4% for FY20

## Completion

- The transaction is subject to certain regulatory and legal approvals and is expected to close towards the end of the first half of FY19
- 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

## Income statement including specific adjusting items\*

	2018 £m	2017 £m
Revenue	833.0	783.1
Underlying operating profit*	122.5	116.3
Underlying net finance (expense)/income*	(0.4)	(0.2)
Underlying profit before tax*	122.1	116.1
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)
Amortisation of intangibles	(2.6)	(1.0)
Pension net finance income/(expense)	4.2	(1.0)
Total specific adjusting items (pre-tax)	22.7	15.4
Profit before tax	144.8	131.5
Taxation	(6.7)	(8.2)
Profit after tax	138.1	123.3

\* Underlying performance, before specific adjusting items, as defined in appendix.

# Revenue by customer and country

## Revenue by customer (%)

2018

£833.0m

	%
MOD	62%
DoD	8%
Government agencies	16%
Commercial Defence	7%
Commercial	7%



2017

£783.1m

	%
MOD	65%
DoD	8%
Government agencies	12%
Commercial Defence	5%
Commercial	10%



## Revenue by destination country (%)

2018

£833.0m

	%
UK	73%
US	10%
Australia	7%
Other	10%



2017

£783.1m

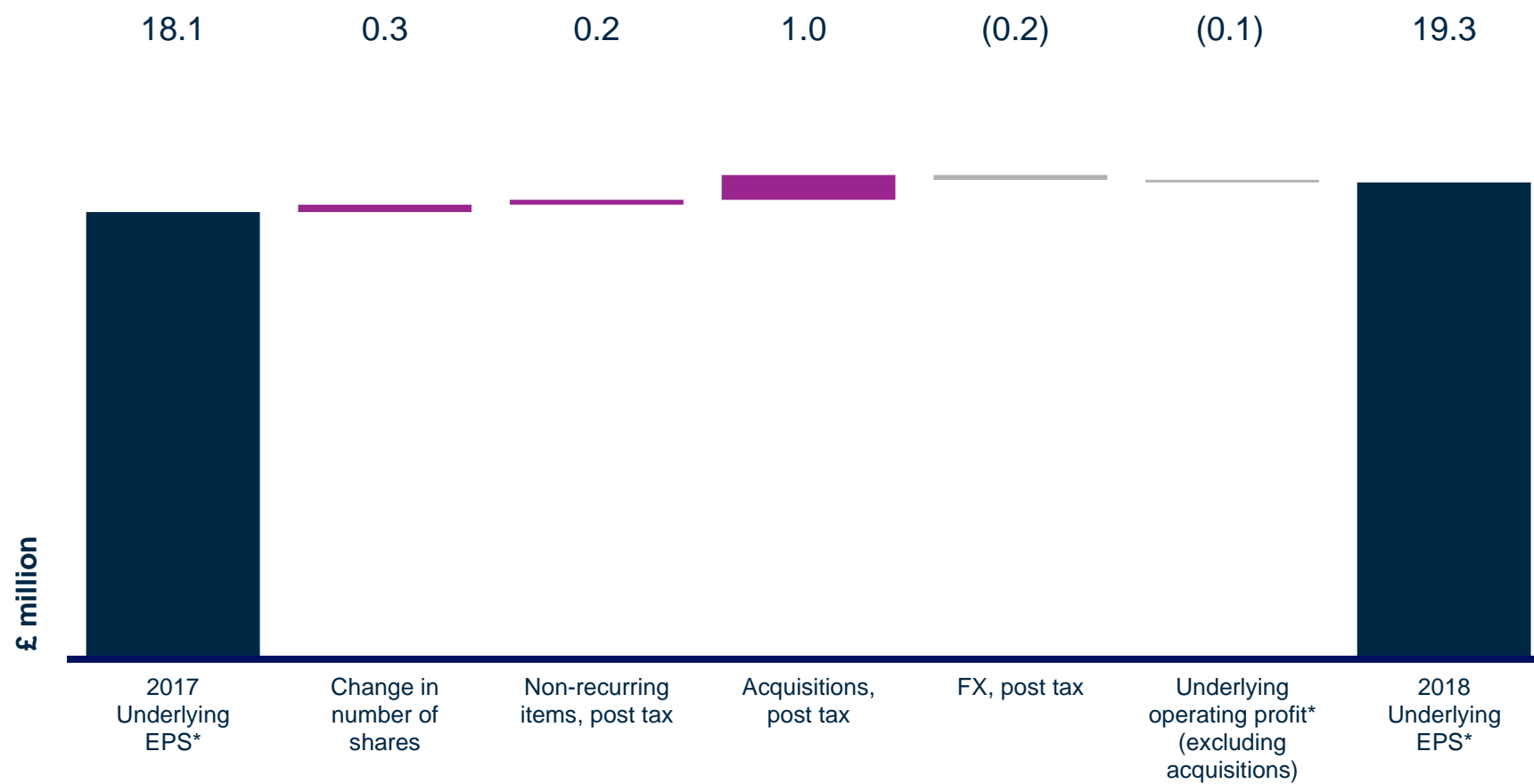
	%
UK	78%
US	9%
Australia	5%
Other	8%



# Taxation

	2018 £m	2017 £m
Underlying tax charge*	(13.1)	(12.3)
Tax on specific adjusting items	6.4	4.1
Total tax charge	(6.7)	(8.2)
Underlying tax rate*	10.7%	10.6%

## Underlying earnings per share\* (pence)



# Cash conversion

	2018 £m	2017 £m
Underlying operating profit*	122.5	116.3
Depreciation and amortisation	29.3	29.0
Changes in working capital	(14.2)	(29.3)
Loss on disposal of PPE	2.9	1.2
Share-based payments charge	2.4	2.1
Share of post-tax profit of equity accounted entities	(0.3)	(0.5)
Net movement in provisions	(3.7)	4.5
Retirement benefit contributions in excess of income statement expense	(12.4)	(11.4)
Net cash inflow from operations*	126.5	111.9
Cash conversion %*	103%	96%
Net capex	(54.5)	(32.9)
Net cash inflow from operations (post-capex)*	72.0	79.0
Net interest	-	0.4
Taxation	(15.7)	(3.0)
Free cash flow*	56.3	76.4

\* Underlying performance, before specific adjusting items, as defined in appendix.

# Movements in net cash

	2018 £m	2017 £m
<b>Free cash flow</b>	<b>56.3</b>	76.4
Dividends	(34.5)	(33.4)
Acquisition of business (deferred consideration)	(1.6)	(65.7)
Disposal of property	23.1	14.3
Disposal of IP	5.9	-
Purchase of own shares	(0.7)	(48.1)
Other (including FX)	(3.6)	3.9
<b>Change in net cash</b>	<b>44.9</b>	(52.6)
Opening net cash - 1 April	221.9	274.5
<b>Closing net cash - 31 March</b>	<b>266.8</b>	221.9

# Balance sheet

	31 March 2018 £m	31 March 2017 £m
Goodwill	101.5	107.8
Intangible assets	41.1	34.7
Property, plant and equipment	269.0	238.8
Working capital	(146.5)	(117.6)
Retirement benefit surplus (net of tax)	257.6	124.6
Other assets and liabilities	(45.2)	(77.6)
Net cash	266.8	221.9
Net assets	744.3	532.6

## Defined benefit pension scheme – balance sheet position

	31 March 2018 £m	31 March 2017 £m
Equities	174.7	355.4
LDI investment	1,050.9	968.2
Liquidity fund	311.3	340.6
Bonds	232.9	132.3
Property	138.7	126.7
Cash and cash equivalents	80.2	3.1
Derivatives	1.8	-
Market value of assets	1,990.5	1,926.3
Present value of scheme liabilities	(1,674.3)	(1,770.3)
Net pension asset before deferred tax	316.2	156.0
Deferred tax liability	(58.6)	(31.4)
Net pension asset	257.6	124.6

# Defined benefit pension scheme – key assumptions

<b>Assumptions</b>	<b>31 March 2018</b> %	<b>31 March 2017</b> %
Discount rate	<b>2.60%</b>	2.60%
Inflation (CPI)	<b>2.25%</b>	2.35%
Future male pensioners (currently aged 60)	<b>88</b>	89
Future female pensioners (currently aged 60)	<b>90</b>	91
Future male pensioners (currently aged 40)	<b>90</b>	91
Future female pensioners (currently aged 40)	<b>92</b>	93

## Sensitivity of Scheme liabilities to main assumptions:

<b>Assumption</b>	<b>Change in assumption</b>	<b>Sensitivity*</b>
Discount rate	Increase / decrease by 0.1%	Decrease / increase by £31m
Rate of inflation	Increase / decrease by 0.1%	Increase / decrease by £34m
Life expectancy	Increase by one year	Increase 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

# Credit facilities

	Maturity date	Denomination	Value in denomination	Value £m
Revolving credit facility	August 2019	GBP	166.0	166.0
Revolving credit facility	August 2019	USD	100.0	71.3
<b>Total committed facilities</b>				<b>237.3</b>

QINETIQ