QinetiQ Group plc

Full year results for the year ended 31 March 2017
For release at 0700 on 25 May 2017

Good operational delivery and strategic progress

	Statutory results		Underlying* results	
	2017	2016	**2017**	2016
Revenue	**£783.1m**	£755.7m	**£783.1m**	£755.7m
Operating profit	**£132.7m**	£75.3m	**£116.3m**	£108.9m
Profit after tax	**£123.3m**	£106.1m	**£103.8m**	£95.9m
Earnings per share	**21.5p**	18.1p	**18.1p**	16.3p
Full year dividend per share	**6.0p**	5.7p	**6.0p**	5.7p
Total orders			**£1,676.7m**	£659.8m
Orders excluding LTPA amendment			**£675.3m**	£659.8m
Net cash inflow from operations (pre-capex)			**£111.9m**	£133.4m
Net cash inflow from operations (post-capex)			**£79.0m**	£103.6m
Cash conversion ratio (post-capex)			**68%**	95%
Net cash			**£221.9m**	£274.5m

Good operational delivery in FY17

- High quality growth in total backlog from £1.3bn to £2.2bn
- 4% year-on-year revenue growth; 1% increase on an organic basis* at constant currency
- Solid operating profit enhanced by £7.4m of non-recurring trading items
- Cash conversion included c£30m working capital unwind (half related to non-recurring items)
- 5% increase in dividend; £50m share buyback completed

Strategic progress

- Secured £1bn amendment to the Long Term Partnering Agreement with the UK MOD
- Established an International business and completed two acquisitions – of Meggitt Target Systems and RubiKon Group in Australia – to support international growth
- Global agreement for next generation satellite receivers
- Invested £20m in people, technology and campaigns, funded by operational efficiencies

Focus on delivery of FY18

- Strategy implementation key to driving growth in a rapidly changing trading environment
- 74% of FY18 revenue under contract, consistent with the previous year
- Maintaining expectations for Group performance in FY18

Steve Wadey, Chief Executive Officer said:

"FY17 has been a year of building momentum for QinetiQ during which we achieved both good operational performance and significant progress in the implementation of our strategy. Operational achievements included delivering organic revenue growth for the first time for a number of years and the near doubling of the total Group backlog. To support QinetiQ's future growth, we completed our first two acquisitions and, with the LTPA amendment with the UK Ministry of Defence, secured the largest and most significant contract since privatisation.

"Rapidly changing dynamics in defence and security markets are presenting both opportunities and challenges for our industry. Although demanding, this environment is one in which QinetiQ has the potential to thrive. As a result, we are looking forward to the future with confidence and are maintaining expectations for Group performance in FY18."
ENDS

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

Other information:

There will be a presentation of the preliminary annual results to analysts at 0900 hours UK time on 25 May 2017 at the London Stock Exchange, 10 Paternoster Square, EC4M 7LS. Registration for the webcast is available at: www.QinetiQ.com/investors where the presentation will also be available. An audiocast of the event will be available on +44 (0)20 3059 8125 (confirmation: QinetiQ).

About QinetiQ:

Listed on the London Stock Exchange (LSE: QQ.L), QinetiQ is a leading science and engineering company operating primarily in the defence, security and aerospace markets. Our customers are predominantly government organisations in our home markets of the UK, the US and Australia, with a growing international and commercial presence. See www.QinetiQ.com | www.QinetiQ-blogs.com | @QinetiQ.

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Disclaimer

This document contains certain forward-looking statements relating to the business, strategy, financial performance and results of the Company and/or the industry in which it operates. Actual results, levels of activity, performance, achievements and events are most likely to vary materially from those implied by the forward-looking statements. The forward-looking statements concern future circumstances and results and other statements that are not historical facts, sometimes identified by the words 'believes',' expects', 'predicts', 'intends', 'projects', 'plans', 'estimates', 'aims', 'foresees', 'anticipates', 'targets', 'goals', 'due', 'could', 'may', 'should', 'potential', 'likely' and similar expressions, although these words are not the exclusive means of doing so. These forward-looking statements include, without limitation, statements regarding the Company's future financial position, income growth, impairment charges, business strategy, projected levels of growth in the relevant markets, projected costs, estimates of capital expenditures, and plans and objectives for future operations. Forward-looking statements contained in this announcement regarding past trends or activities should not be taken as a representation that such trends or activities will continue in the future. Nothing in this document should be regarded as a profit forecast.

The forward-looking statements, including assumptions, opinions and views of the Company or cited from third party sources, contained in this announcement are solely opinions and forecasts which are uncertain and subject to risks. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to be correct. Actual results may differ materially from those expressed or implied by these forward-looking statements. A number of factors could cause actual events to differ significantly and these are set out in the principal risks and uncertainties section of this document.

Most of these factors are difficult to predict accurately and are generally beyond the control of the Company. Any forward-looking statements made by, or on behalf of, the Company speak only as of the date they are made. Save as required by law, the Company will not publicly release the results of any revisions to any forward-looking statements in this document that may occur due to any change in the Directors' expectations or to reflect events or circumstances after the date of this document.

Chief Executive Officer's review

Market environment

FY17 was another year in which threats to global security from both state and non-state actors increased. Governments are seeking help with the rapid development of new capabilities to defeat emerging threats and ensure they meet their primary responsibility to protect and safeguard the lives of their citizens. Our expertise in science and engineering is particularly relevant in this context; we also play a vital role in making connections, be they across technologies, domains, supply chains or internationally.

FY17 performance

During the year we successfully achieved both good operational delivery and significant progress implementing our strategy. This was evidenced by the delivery of organic revenue growth for the first time in a number of years. Revenue and operating profit were stable in EMEA Services and up in Global Products, driven by growth in QinetiQ North America. We will continue to prioritise the delivery of sustainable growth with ongoing capital discipline.

Strategy

Our vision is "to be the chosen partner around the world for mission-critical solutions, innovating for our customers' advantage." To realise our vision we are implementing our three strategic priorities designed to grow the Company by focusing on our primary UK customer, on international customers and on innovation.

Our strategy is inherently outward looking, based on the needs of our customers now and in the future, and I am encouraged that our customer satisfaction scores increased this year. To meet future customer needs, we are prioritising the rapid development of new capabilities to defeat emerging threats by embracing value-creating innovation. We are also driving greater value-for-money for our customers, improving services and delivering savings in parallel. To do this we connect supply chains and choose the right strategic partners from across industry with complementary capabilities to ours so that we can offer competitive and market-leading solutions. As our total order intake and backlog demonstrate, we have been building positive momentum with the implementation of this strategy during the year.

UK Defence Test & Evaluation

Our first strategic priority is to lead and modernise UK Defence Test & Evaluation (T&E). Delivering strong T&E capability is critical to ensuring reliable, flexible and affordable delivery of military capability to protect national interests. By engaging with our customers, we have made positive progress, signing new agreements which nearly double our order book to more than £2bn and significantly improving revenue visibility and therefore the risk profile of our Company.

In September 2016, we secured an 11-year, £109m extension to the Ministry of Defence's (MOD's) Naval Combat System Integration Support Services (NCSISS) contract under which we lead the T&E, integration and development of mission systems that keep the UK's surface warships at sea and fit to fight. This is an excellent example of our strategy in action, with a focus on partnership with our customers and across the broader supply chain as we look to develop our Portsdown Technology Park site as the UK Centre of Excellence for maritime mission systems across the entire supply chain.

In December we signed an 11-year, £1bn amendment to the Long Term Partnering Agreement (LTPA), the largest and most significant contract since privatisation, which has significant mutual benefits for the MOD and QinetiQ. For the MOD, it ensures the UK has world-class competitive air ranges and training for test pilots and aircrew, and delivers the capability at less cost. For us, it provides the platform we need for growth by creating more relevant and competitive T&E capability for the UK armed forces as well as governments and commercial customers around the world. Our focus during FY18 is to re-price the remaining LTPA contract, which is due on 31 March 2018, and to work together with the MOD and industry partners to develop a long-term vision for the UK's T&E capabilities. The objective of this vision is to deliver future military capability for the next decade and beyond, addressing current and emerging threats. This will provide a platform for growth in the UK T&E market, which we estimate to be double that which we currently access, and improve our ability to win work with customers outside the UK.

International

At the beginning of FY17, we established an International business focused on developing and securing growth opportunities in prioritised territories around the world. This new International business has been established as an 'enabler' for the Group, bringing greater coherence and focus to our activities internationally in relation to both organic and inorganic efforts, and encouraging a more global mind-set.

In December 2016 we acquired Meggitt's Target Systems business, now renamed QinetiQ Target Systems (QTS), both to reinforce our core T&E value proposition and accelerate the delivery of our strategic priority to drive international growth. The business generates 90% of its revenues from outside the UK and is well aligned with our capabilities in the management of complex exercises and provision of test, evaluation and training services, thus expanding our core capability overseas. We are now uniquely placed to meet growing demand for mid- and high-fidelity targets to test defence capabilities against a greater diversity of threats. The acquisition also opens up new routes to market to promote our wider service offerings to QTS's international customer base.

A key element of our international strategy is to build our presence and capability in our home markets outside the UK, notably the US and Australia. QinetiQ North America delivered very good orders and revenue performance in FY17. With growing defence ambitions and close to the rapidly evolving Asia Pacific region, Australia is a particularly attractive market and our business there had a record year for orders. In January 2017, we also acquired RubiKon Group which brings integrated logistics support capabilities to QinetiQ Australia. RubiKon strengthens our ability to offer integrated whole programme solutions that are often required for 'strategic partner' style contracts which are being used increasingly by the Australian Government.

In FY18 we intend to build on the progress we are making in our existing home markets by increasing our sales presence in regions such as the Middle East and Asia Pacific. Negotiations over the UK's exit from the EU add complexity to our strategy for growth in Europe. However many government relationships for defence and security, particularly in Europe, are underpinned by bilateral and multilateral agreements.

Innovation

As customers demand more capability, and as the boundaries between defence and commercial technologies become increasingly blurred, value-creating innovation is vital to maintaining our distinctiveness in the marketplace. Technical innovation has been at the heart of QinetiQ's success to date, and will remain a key source of growth into the future. However, turning creativity and technical innovation into tangible value for our customers increasingly requires innovative thinking across the broader range of activities.

In FY17, we established business winning campaigns supported by Internal Research and Development (IRAD) to drive commercial innovation, new processes, and innovative business models. For each campaign we consider the people, investments and partnerships we need to be successful. For example, to support the campaign to exploit our world-class capability in secured navigation receivers, we signed a global alliance agreement with Rockwell Collins, the market leader in secure military GPS receivers.

We have identified more than 30 growth campaigns in pursuit of material opportunities, all of which are worth tens of millions of pounds and in some cases more. We are not going to win every campaign, but the scale of the total opportunity is significant over a five-to-ten-year time period. We will pursue these campaigns with vigour in FY18, as well as extending our focus to more international markets.

Transformation

We are on track to transform QinetiQ to improve customer focus and competitiveness. During the year we successfully introduced a new operating model based on matrix working to improve our responsiveness and operational effectiveness. We have also driven £20m of productivity savings that we have reinvested in business winning and IRAD to support our future growth. I appreciate that this period of significant change has been difficult for many of our employees, and this is reflected in our engagement score which fell last year although employee turnover remains low. Moving into FY18, supporting and developing the culture required to deliver our transformation is a particular goal.

Air accident

In July 2016, an air accident involving a contracted-in Yak aircraft operating in support of the Empire Test Pilots' School (ETPS) sadly resulted in the death of an RAF pilot and serious injury to the contractor pilot. We are actively supporting the subsequent official inquiries and will respond to all recommendations made.

Outlook – FY18

In EMEA Services, revenue under contract for FY18 is in line with the prior year, and the division is expected to deliver modest revenue growth this year although the lower baseline profit rate for single source contracts represents a continued headwind for operating margins.

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 contracted orders and pipeline of opportunities, as well as the anticipated full year contribution from the Target Systems acquisition, the division is expected to continue to grow in FY18.

FY18 cash flow will reflect increasing investment, with capital expenditure of £80m to £100m, to support the amendment to the Long Term Partnering Agreement announced in December 2016.

Overall for FY18, we are maintaining expectations for steady progress excluding the non-recurring benefits in FY17, supported by revenue growth and consistent with our strategy.

Outlook – longer term

Rapidly changing dynamics in defence and security markets are presenting both opportunities and challenges for our industry. We are well placed to help customers both develop capabilities to defeat new threats and achieve greater value-for-money by improving services and delivering savings in parallel. The initial progress we have made, combined with our ongoing assessment of the market environment, and, in particular, feedback from customers reinforce that we have the right strategy in place to drive future growth.

Over the longer term this strategy will create and sustain value for all our stakeholders. Our customers will benefit from better products and services, increased responsiveness, and improved value-for-money. Our shareholders will benefit because we will deliver sustainable growth in revenue, operating profit, and high-quality earnings. And our employees will benefit because they will be able to utilise their experience more widely across QinetiQ, working in integrated teams and enhancing professional satisfaction.

Steve Wadey, Chief Executive Officer, 25 May 2017.

Chief Financial Officer's review

Since joining QinetiQ from Rolls-Royce on 1 March 2017, I have been very active in getting to know the Company. In doing so, I have been impressed by the calibre of the people I have met and their commitment to serving our customers.

Thanks to the hard work of QinetiQ's former CFO David Mellors, supported by the finance team, and Dr Malcolm Coffin who acted as Interim CFO, the financial position of the Group is strong and we have a solid foundation for the future. I am excited about building on this to help QinetiQ realise its potential.

Overview of full year results

Orders, excluding the £1bn amendment to the LTPA, grew 2% to £675.3m (2016: £659.8m), and were stable on an organic basis at constant currency. Key orders won in FY17 included the award of the £109m, 11-year renewal from the UK Ministry of Defence (MOD) for the Naval Combat System Integration Support Services (NCSISS), £80m of additional orders added to the Air Strategic Enterprise contract and $41m US aircraft carrier orders.

At the beginning of the new financial year, 74% of the Group's FY18 revenue was under contract, in line with 74% a year ago.

Revenue was up 4% at £783.1m (2016: £755.7m), including favourable foreign exchange movements and the acquisition of QinetiQ Target Systems and RubiKon. Revenue grew by 1% on an organic basis, after adjusting for foreign exchange movements, acquisitions and the divestment of Cyveillance in the prior year, due primarily to a strong performance in QinetiQ North America.

Underlying operating profit* was £116.3m (2016: £108.9m). EMEA Services benefited from a non-recurring £5.2m credit relating to the release of engine servicing obligations as we invest in new aircraft for test aircrew training. Global Products benefited from favourable foreign exchange movements and £2.2m of credits relating to historical overseas contractual disputes. The impact of the lower baseline profit rate in FY17 was in line with our expectations and is outlined in further detail in the review of EMEA Services financial performance.

Total operating profit was £132.7m (2016: £75.3m), including a profit of £18.4m recognised on the disposal of property. 2016 included a £31.9m impairment of US goodwill.

Underlying profit before tax* increased 7% to £116.1m (2016: £108.7m) in line with the increase in underlying operating profit*, with underlying net finance costs* flat at £0.2m (2016: £0.2m).

Total profit before tax from continuing operations increased to £131.5m (2016: £90.2m) due to the higher underlying profit before tax and £18.4m recognised on the disposal of property. 2016 included a profit of £16.2m recognised on the disposal of Cyveillance and a £31.9m impairment of US goodwill.

Underlying basic earnings per share* were 18.1p (2016: 16.3p) benefiting from the higher underlying profit before tax and the reduced share count following the completion of the £50m share buyback. Basic earnings per share for the total Group were 21.5p (2016: 18.1p per share). The average number of shares in issue during the year, as used in the basic earnings per share calculations, was 573.9m (2016: 587.0m) and there were 564.3m shares in issue at 31 March 2017 (all net of Treasury shares).

Specific adjusting items

Specific adjusting items, shown in the 'middle column', at the profit after tax level amounted to a total credit of £19.5m (FY16 credit: £10.2m). This included a profit of £18.4m recognised on the disposal of property and £4.1m of deferred tax movements, predominantly relating to the recognition of a deferred tax asset in respect of tax losses.

The prior year included a profit of £16.2m recognised on the disposal of Cyveillance, a £7.5m gain following the closure of certain US Services warranty issues and a £31.9m impairment of US goodwill. There was also a net tax credit of £21.2m in the prior year, which included the impact of the statutory change to the research and development tax credits regime offset by the associated surrender of previously capitalised tax losses and other non-recurring deferred tax movements.

Acquisitions

On 21 December 2016, the Group acquired 100% of the issued share capital of Meggitt Target Systems for £57.5m, or £60.3m including price adjustments for working capital and net debt. The business is an international provider of unmanned aerial, naval and land-based target systems and services for T&E and operational training and rehearsal. On the date of acquisition, its name was changed to QinetiQ Target Systems and it was integrated into QinetiQ's International business and is reported in Global Products. Goodwill of £24.5m and intangible assets of £24.2m were recognised on acquisition.

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 (AUD$12.6m). This Australian company provides solutions to complex logistics, supply chain management and procurement projects. RubiKon was integrated into the Group's Australia business and goodwill of £3.9m and intangible assets of £3.1m were recognised on acquisition.

Net finance costs

Net finance costs were £1.2m (2016: £1.3m). The underlying net finance costs* were £0.2m (2016: £0.2m), with an additional £1.0m (2016: £1.1m) in respect of the pension net finance expense reported within specific adjusting items*.

Taxation

The underlying effective tax rate of 10.6% (2016: 11.8%) continues to be below the UK statutory rate, primarily as a result of the benefit of research and development expenditure credits in the UK. 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 benefit of net R&D expenditure credits retained by the Group remains in the tax line.

At 31 March 2017, the Group had unused tax losses of £141.7m (2016: £154.8m) which are available for offset against future profits. A deferred tax asset of £3.7m has been recognised in the year, with the income statement credit classified as a specific adjusting item. This asset is in respect of £18.8m of UK losses and £1.4m of Canadian losses. No deferred tax asset is recognised in respect of the remaining £121.5m of losses due to the uncertainty over the timing of their utilisation. The Group has £66.5m of time-limited losses of which US capital losses of £30.0m will expire in 2020. Of the remaining £36.5m time-limited losses, £4.4m will expire in 2034, £22.7m in 2035 and £9.4m in 2036. Deferred tax has been calculated using the enacted future statutory tax rates.

The current tax liability is £43.7m as at 31 March 2017 (31 March 2016: £39.9m). This includes 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. An insurance policy was taken out by the Group at the point of acquisition and, if the court's decision is final, the funds required to settle this dispute will be provided by the insurers. Hence, an offsetting receivable is reported on the balance sheet as at 31 March 2017 (included within trade and other receivables).

Cash flow, working capital and net cash

The underlying cash conversion* ratio, which is after capex and pension deficit repair payments, was 68% (2016: 95%), delivering a net cash flow from operations* of £79.0m (2016: £103.6m). The working capital movements were in line with expectations and include a £7m payment for a very old overseas dispute which had been fully provided for in a previous year, the £5.2m engine-servicing obligation release in EMEA Services and £2.2m of releases relating to overseas contractual disputes in Global Products. Excluding non-recurring items the underlying cash conversion* ratio would have been 80%.

Net capex increased to £32.9m (2016: £29.8m) and is expected to increase to £80m-£100m in FY18 as we invest in core contracts including the LTPA following the contract amendment announced in December 2016. The additional capex will be recovered in full under existing LTPA terms and modernises capabilities as a platform for growth.

At 31 March 2017, the Group had £221.9m net cash, compared to £274.5m net cash at 31 March 2016. The reduction was primarily due to a £65.7m outflow in respect of the two acquisitions, the completion of the £50m share buyback and £33.4m of dividends. In aggregate these exceeded the operating cash inflow for the year.

Total committed facilities available to the Group at year end, consisting of a revolving credit facility which is currently undrawn, amounted to £245.7m (2016: £235.6m), the increase being solely due to foreign exchange movements.

Capital allocation

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

The £50m share repurchase, which was announced in November 2015, was completed by 31 March 2017.

Dividend

The Board proposes a final dividend of 4.0p (2016: 3.8p) making the full-year dividend 6.0p (2016: 5.7p). Subject to approval at the Annual General Meeting, the final dividend will be paid on 1 September 2017 to shareholders on the register at 4 August 2017. The full year dividend represents an increase of 5% in line with the Group's progressive dividend policy.

Pensions

The net pension asset under IAS19, before adjusting for deferred tax, was £156.0m (31 March 2016: liability £37.7m). The market value of the assets at 31 March 2017 was £1,926.3m (2016: £1,410.4m) and the present value of scheme liabilities was £1,770.3m (2016: £1,448.1m). The movement from a liability to an asset was driven by an increase in asset prices and the benefit of our continued strategy to reduce risk through hedging.

The key assumptions used in the IAS 19 valuation of the scheme were:

Assumption	**31 March 2017**	**31 March 2016**
Discount rate	2.60%	3.40%
CPI inflation	2.35%	2.10%
Life expectancy - male (currently aged 40)	91	91
Life expectancy - female (currently aged 40)	93	93

Each assumption is selected by the Group in consultation with the Company actuary and takes account of industry practice amongst comparator listed companies. The sensitivity of each of the key assumptions is shown in the following table.

Assumption	Change in assumption	Indicative effect on scheme liabilities (before deferred tax)
Discount rate – small movement	Increase / decrease by 0.1%	Decrease / increase by £35m
Discount rate – large movement	Increase by 1.0%	Decrease by £320m
Discount rate – large movement	Decrease by 1.0%	Increase by £422m
Inflation	Increase / decrease by 0.1%	Increase / decrease by £34m
Life expectancy	Increase by 1 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 2017, this hedges against 63% of the interest rate risk and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis.

The last triennial valuation of the scheme, on a funding basis, was a net surplus of £31.0m as at 30 June 2014, although if a funding valuation was carried out today the valuation could be a net deficit and may differ materially from the IAS19 accounting valuation due to the inherent methodology differences. There has been no change to the cash contributions required under the recovery plan, which continues to require £13m of Company contributions per annum until 31 March 2018. The next actuarial valuation is due as at 30 June 2017.

David Smith, Chief Financial Officer, 25 May 2017.

Operating review

EMEA Services

	2017 £m	2016 £m
Orders[(1)]	**520.9**	495.4
Total orders	**1,522.3**	495.4
Revenue	**613.5**	616.4
Underlying operating profit*	**92.7**	93.8
Underlying operating margin*[(2)]	**15.1%**	15.2%
Book to bill ratio[(1)]	**1.3x**	1.2x
Funded backlog[(1)]	**813.6**	719.1
Total funded backlog	**2,019.8**	1,123.8

(1) Excludes the £998m third-term of the LTPA contract agreed in 2013 and the £1bn contract amendment signed in December 2016. B2B ratio is orders won divided by revenue recognised, excluding the LTPA contract.
(2) The 2017 margin excluding the £5.2m non-recurring release in respect of LTPA engine servicing obligations was 14.3%.

Overview

EMEA (Europe, Middle East and Australasia) Services combines world-leading expertise with unique facilities to provide technical assurance, test and evaluation and training services, underpinned by long-term contracts that provide good visibility of revenues and cash flows. The division is also a market leader in research and advice in specialist areas such as C4ISR, weapons and energetics, cyber security and procurement advisory services.

Financial performance

Orders, excluding the £1bn LTPA amendment, grew 5% to £520.9m (2016: £495.4m) including the award of the £109m 11-year renewal from the MOD for the Naval Combat System Integration Support Services (NCSISS), and £80m of additional orders added to the Air Strategic Enterprise contract.

The £1bn amendment to the LTPA signed during the year has significantly increased total EMEA Services backlog. The remaining LTPA contract is due to be repriced on 31 March 2018.

Revenue was flat on both a reported basis and an organic constant currency basis with a broadly consistent performance across all business units within the division. The impact of the RubiKon acquisition, which completed in January 2017, and favourable foreign exchange movements were largely offset by the Cyveillance disposal in the prior year.

At the beginning of the new financial year, 79% of EMEA Services' FY18 revenue was under contract, compared with 77% at the beginning of the prior year.

Underlying operating profit* reduced to £92.7m (2016: £93.8m). FY17 underlying operating profit* included a £5.2m credit relating to the release of engine servicing obligations as we invest in new aircraft for test aircrew training. There were other contract adjustments impacting on the results, but the financial impact of these was not material in aggregate. Excluding the £5.2m credit, a £3m credit in FY16 and the effect of foreign exchange and acquisitions, underlying operating profit fell by £4.6m, predominantly driven by the lower baseline profit rate for single source contracts. The impact of the lower baseline profit rate in FY17 was in line with our expectations.

As we anticipated, the baseline profit rate for new and renewed single source contracts signed in FY18 will fall by 149 basis points from the FY17 baseline rate. Including the LTPA contract, 76% of EMEA Services revenue (2016: 74%) is derived from single source contracts, an increased proportion of which is now contracted on a long-term basis. For example, the 11-year, £1bn amendment to the LTPA, signed in December 2016, was contracted using the FY17 single source profit formula.

FY17 review

Air & Space (30% of EMEA Services revenue)

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

Modernising UK Test & Evaluation

- The Strategic Enterprise model for aircraft engineering services has now been in place for a year, delivering savings to the MOD. £80m of additional contracts were added to the model during the year to provide in-service support for eight aircraft including the Apache, Puma and Merlin helicopters and Tornado fast jets, as well as test and evaluation services for the Wildcat Future Air to Surface Guided Weapon programme.
- The business is focused on the modernisation of test aircrew training provided by the Empire Test Pilots' School which achieved Approved Training Organisation status during the year allowing it to train civil test pilots. Investment in new aircraft and a revised syllabus will allow it to pursue opportunities for growth.
- During the year Boeing Defence UK identified MOD Boscombe Down, which we operate and manage on behalf of the MOD, as the preferred site for its future UK headquarters and European hub for maintenance, repair and overhaul.

Investing in innovation

- The business' relationship with the European Space Agency continues with its transceiver operating successfully as part of the ExoMars mission to Mars, despite the Schiaparelli lander on which it was mounted being lost. The business is continuing to deploy significant resources to develop the gridded ion engine electric propulsion system for the flight module to be used on ESA's BepiColombo mission to Mercury. This ambitious, multi-spacecraft mission is due to launch in October 2018.
- The business secured £2m of research funding to lead a team to upgrade the scale models used in the Farnborough wind tunnel using technology adapted from F1 motor racing, leading to improved efficiency and increased capacity.
- It unveiled an innovative material, Titan Weave, that reduces the weight of aircraft and is three times stronger than current materials used to protect against bird strikes and other impacts.
- It entered a teaming agreement with Thales and Textron to provide an innovative offer to the MOD for the Air Support to Defence Operational Training Programme.

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.

Modernising UK Test & Evaluation

- The business delivered the successful trial of the new Spear 3 missile system planned for the UK's F-35 Lightning II stealth fighter aircraft.
- It secured an 11-year contract extension worth £109m for the Naval Combat Systems Integration & Support Services based at Portsdown Technology Park. Later in the year the site hosted the Royal Navy's Information Warrior exercise designed to develop and test new information warfare capabilities through a series of trials, including defensive cyber operations, digital influence operations and artificial intelligence.

- The business led a team from across QinetiQ to deliver Unmanned Warrior for the Royal Navy, a demonstration by 40 companies of how autonomous vehicles under the water, on the surface and in the air, can be used for future operations such as mine hunting.
- Later in 2017, it will host another international exercise at MOD Hebrides – Formidable Shield.
- To enable similar exercises to take place, the business is modernising the air ranges, with work beginning to upgrade facilities and tracking radar at the Hebrides range.

Investing in innovation

- The business is a member of a UK industrial consortium, called Dragonfire, which won a £30m contract for a Capability Demonstrator Programme for laser technology. The demonstration is reliant on an innovative QinetiQ-developed technology, with the trials taking place on LTPA sites.
- It won an £8m contract to implement and evaluate vehicle survivability for Dstl, including installing a Soft-Kill Defensive Aids System on a Challenger 2 tank.
- It also won a £5m contract to deliver a Real Time Simulation System for the Sentry E-3D aircraft to enable effective operations with NATO countries.

<u>Cyber, Information & Training (CIT) (17% of EMEA Services revenue)</u>

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.

Modernising UK Test & Evaluation

- The business won a £10m contract to link existing Typhoon synthetic training at RAF bases to the QinetiQ-run Distributed Synthetic Air Land Training (DSALT) facility at RAF Waddington, building towards the MOD's ambition to integrate all synthetic training into one programme.
- It delivered a cyber range for an Army exercise as part of a growing capability to support customers in the test and evaluation of cyber operations.

Building an international company

- The business delivered its stand-off threat detection system, SPO-NX, to the US Transportation Security Administration (TSA) for use at several high-profile events, including the Presidential inauguration.

Investing in innovation

- The business leads research framework contracts for the UK MOD, managing a network of more than 100 UK SMEs, as well as innovation initiatives for local and regional governments to support local business growth.
- This includes bringing together expertise in technology horizon scanning, human sciences, commercial-off-the-shelf exploitation and experimentation as a service to help customers keep pace with the rapidly evolving technical and social media landscape.
- During the year the business secured contracts totalling £10m for secured navigation, working with European and UK Government customers to enable the effective exploitation by users of the Galileo constellation of satellites – the European Union version of GPS which goes live in FY21. This included the first demonstration of accessing the encrypted Public Regulated Service (PRS) in real-life applications. The business has built on this success by agreeing a partnership to go to market with Rockwell Collins around the globe.

International (8% of EMEA Services revenue)

On 1 April 2016 a new International business was established to deliver our capabilties in international markets.

- In January 2017, the Group acquired RubiKon Group, an Australian integrated logistics support provider. The acquisition allows QinetiQ Australia to provide a more comprehensive service offering to customers and pursue ‘strategic partner’ opportunities with the Australian Government.
- QinetiQ Australia continued to develop its core capabilities, extending contracts for the provision of integrated engineering services at the Defence Science and Technology Group’s Fishermen’s Bend workshop in Port Melbourne, and for Aircraft Structural Integrity services. Through RubiKon, it also signed a new strategic support partnering contract for the replacement of the AP-3C Orion fleet with a combination of unmanned and manned aircraft.
- Our business in Australia also grew order intake, including contracts to support tanker aircraft, Navy guided weapons systems, ground-based air defence, and the Australian Artillery Regiment.
- QinetiQ Canada achieved its first home win with a contract to provide advice to the Royal Canadian Coast Guard.
- A new QinetiQ office is also being established in Malaysia to support sales and marketing in South East Asia.

EMEA Services FY18 outlook

In EMEA Services revenue under contract for FY18 is in line with the prior year, and the division is expected to deliver modest revenue growth this year although the lower baseline profit rate for single source contracts represents a headwind for operating margins.

Global Products

	2017 £m	2016 £m
Orders	**154.4**	164.4
Revenue	**169.6**	139.3
Underlying operating profit*	**23.6**	15.1
Underlying operating margin*	**13.9%**	10.8%
Book to bill ratio	**0.9x**	1.2x
Funded backlog	**158.9**	139.1

Overview

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

Financial performance

Orders reduced to £154.4m (2016: £164.4m) as a result of a strong comparative year which included a large pipeline contract in OptaSense and a five-year £10m contract to provide materials research and advice to the UK MOD. Order flow in QinetiQ North America (QNA) was strong, including $41m of US aircraft carrier orders during the year.

The Global Products division had 55% of its FY18 revenue already under contract at the beginning of the new financial year compared with 64% at the same time last year, reflecting the shorter contract cycle of the division.

Revenue was up 22% on a reported basis at £169.6m (2016: £139.3m) including the impact of the acquisition of QinetiQ Target Systems and favourable foreign exchange movements. On an organic constant currency basis revenue grew by 8% due to a strong performance in QNA, driven by product shipments relating to the new US aircraft carriers, together with growth in OptaSense.

Underlying operating profit* increased to £23.6m (2016: £15.1m), including the impact of the acquisition of QinetiQ Target Systems, favourable foreign exchange movements and £2.2m of credits relating to historical overseas contractual disputes. With these items removed, underlying operating profit increased by £3.6m driven by QNA and OptaSense.

FY17 review

QinetiQ North America (41% of Global Products revenue)

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

- QNA delivered very good orders and revenue performance in FY17 driven by the continued strength of its US military robot business, sales of aircraft armour, and its continued role supporting the next generation of US Navy aircraft carriers.
- In total, the business was awarded more than $40m of orders for unmanned ground vehicles principally for the reset of robots previously used in operations and for capability upgrades such as detection of CBRNE (chemical, biological, radiological, nuclear and explosives).
- The business is bidding for multi-year Programs of Record, that are under way now or will be under way this year. These Programs of Record will be funded out of the Department of

Defense's base budget for TALON-class and Dragon Runner-class systems, robotic applique kits for route clearance vehicles and squad mission equipment transports.

- In October 2016, it announced a strategic partnership with the Estonian company Milrem for Titan, a modular, hybrid military unmanned ground vehicle (UGV) for dismounted troop support.
- QNA also confirmed a $41m contract with General Atomics which follows the initial $16m announced in December 2015. The business will deliver control hardware and software for the Electromagnetic Aircraft Launch System and the Advanced Arresting Gear to be installed on the US Navy's next aircraft carrier, the John. F. Kennedy (CVN 79).
- In September, QNA launched a new meteorological sensing product, iQ-3, that provides real-time atmospheric data in support of military requirements such as artillery fire support, tactical weather modelling, and air drop.
- Its LineWatch product, which accurately measures the current and voltage of power distribution lines, is being piloted by ten North American utility companies following the delivery of its first production unit in FY16.
- In international markets, robots, vehicle protection, and soldier protection systems, remain highly relevant as security challenges and instability persist in the Middle East and elsewhere.
- In addition to product sales, QNA is building its base of contract R&D projects to drive technology development, explore new customer problems and expand its competitive offerings. Progress continues with awards for an airborne wind profiling radar, robotic enhancement projects, a turbine-based power and thermal management system, and a number of other commercial research and development projects.

<u>OptaSense (15% of Global Products revenue)</u>

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

- The OptaSense subsidiary grew last year, driven principally by continued strength in its pipeline sensing business and some recovery in the North American oil and gas market.
- The business is delivering the system for the world's largest distributed fibre sensing project for the 1,850km Trans-Anatolian Natural Gas Pipeline (TANAP) that runs from Azerbaijan, through Georgia and Turkey, to Europe.
- Following the establishment of an advisory board to provide expertise in key target markets, OptaSense has signed an agreement to work together with Siemens to pursue new opportunities in the rail sector.
- The business is also undertaking collaborative research with Stanford School of Earth, Energy and Environmental Sciences in California that includes the installation of a fibre-optic seismic array on the Stanford campus to better understand the complex geology of the Bay Area.

Space Products (11% of Global Products revenue)

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

- The business secured a €2m contract with the European Space Agency to develop the next generation computer and power management system for its PROBA family of satellites, in addition to other development funding.
- Its P200 satellite, the latest evolution of the PROBA series, was also listed in the NASA catalogue which will help facilitate the procurement of spacecraft by US federal agencies and their affiliates.
- Under other contracts awarded during the year the business supported the development of a spacecraft for the Argentinian space programme, and a satellite for a joint European and Chinese solar wind programme.
- It also secured further funding to continue the development of its International Berthing and Docking Mechanism (IBDM) for spacecraft.

EMEA Products (33% of Global Products revenue)

EMEA Products provides research services and bespoke technological solutions developed from intellectual property spun out from EMEA Services.

- In December 2016, the Group acquired the Target Systems business from Meggitt PLC, adding aerial, land and maritime targets to the portfolio of products and services offered by QinetiQ. Focus to date has been on integration and realising synergies, with early contract wins in the United Arab Emirates. In April 2017 QinetiQ Target Systems successfully completed its first commercial flight of the Banshee Jet 110 aerial target.
- During the year, the US Defense Advanced Research Projects Agency (DARPA) invested a further $3m in QinetiQ's electric hub-drive technology that will improve mobility and survivability of future military ground vehicles. The new agreement builds on previous contract awards and will take the technology from concept design to the building and testing phase, including production of two fully working units.
- QinetiQ remains a leader in the research and development of stealth technologies and advanced materials. We continue to support the UK's sovereign capability in this area and deliver projects for other allied nations.
- Subsidiaries Boldon James and Commerce Decisions are reported in EMEA Products. Boldon James further expanded its product portfolio with the introduction of several new enhancements to its data classification offering, which it provides to large military and commercial organisations.

Global Products FY18 outlook

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 contracted orders and pipeline of opportunities, as well as the anticipated full year contribution from the Target Systems acquisition, the division is expected to continue to grow in FY18.

Principal risks and uncertainties

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

- Reduced spending in the core markets in which the Group operates;
- Failure to execute the international strategy or adequately to mitigate specific risks arising from international business;
- Failure to create a culture of innovation or to invest adequately in, or create value from, our innovation investment;
- The transformation programme does not result in change that embeds and created value from increased innovation and competitiveness;
- A future skills shortage;
- Group performance is adversely affected by application of the Single Source Contract Regulations;
- A breach of data security, cyber attacks or IT systems failure could have an adverse impact on our customers' operations;
- The Group operates in highly regulated environments and recognises that its operations have the potential to have an impact on a variety of stakeholders; and
- A material element of the Group's revenue is derived from one contract (the LTPA contract).

Consolidated income statement
for the year ended 31 March

all figures in £ million	Note	**2017** Underlying	Specific adjusting items*	Total	2016 Underlying	Specific adjusting items*	Total
Revenue	2	**783.1**	**-**	**783.1**	755.7	-	755.7
Operating costs excluding depreciation, amortisation and impairment		**(647.0)**	**17.4**	**(629.6)**	(630.5)	0.3	(630.2)
Other income		**9.2**	**-**	**9.2**	9.5	-	9.5
EBITDA (earnings before interest, tax, depreciation and amortisation)		**145.3**	**17.4**	**162.7**	134.7	0.3	135.0
Depreciation and impairment of property, plant and equipment	4	**(26.4)**	**-**	**(26.4)**	(23.0)	-	(23.0)
Impairment of goodwill		**-**	**-**	**-**	-	(31.9)	(31.9)
Amortisation and impairment of intangible assets		**(2.6)**	**(1.0)**	**(3.6)**	(2.8)	(2.0)	(4.8)
Operating profit/(loss)		**116.3**	**16.4**	**132.7**	108.9	(33.6)	75.3
Gain on business divestments		**-**	**-**	**-**	-	16.2	16.2
Finance income	6	**1.0**	**-**	**1.0**	1.0	-	1.0
Finance expense	6	**(1.2)**	**(1.0)**	**(2.2)**	(1.2)	(1.1)	(2.3)
Profit/(loss) before tax	4	**116.1**	**15.4**	**131.5**	108.7	(18.5)	90.2
Taxation (expense)/income	7	**(12.3)**	**4.1**	**(8.2)**	(12.8)	21.2	8.4
Profit for the year from continuing operations		**103.8**	**19.5**	**123.3**	95.9	2.7	98.6
Profit for the year from discontinued operations		**-**	**-**	**-**	-	7.5	7.5
Profit for the year attributable to equity shareholders		**103.8**	**19.5**	**123.3**	95.9	10.2	106.1
Earnings per share							
Basic - continuing operations	8	**18.1p**		**21.5p**	16.3p		16.8p
Basic - total Group	8	**18.1p**		**21.5p**	16.3p		18.1p
Diluted - continuing operations	8	**17.9p**		**21.3p**	16.2p		16.7p
Diluted - total Group	8	**17.9p**		**21.3p**	16.2p		18.0p

* For details of ‘specific adjusting items’ refer to note 3.

Consolidated statement of comprehensive income

for the year ended 31 March

all figures in £ million	2017	2016
Profit for the year	**123.3**	106.1
Items that will not be reclassified to profit or loss:		
Actuarial gain/(loss) recognised in defined benefit pension schemes	**183.3**	(10.6)
Tax on items that will not be reclassified to profit and loss	**(31.2)**	2.1
Total items that will not be reclassified to profit or loss	**152.1**	(8.5)
Items that may be reclassified to profit or loss:		
Foreign currency translation differences for foreign operations	**12.2**	3.2
Recycling of currency translation differences to the income statement on disposal of foreign subsidiary	**-**	1.7
Decrease in fair value of hedging derivatives	**-**	(0.1)
Fair value losses on available-for-sale investments	**(0.4)**	(0.6)
Total items that may be reclassified to profit or loss	**11.8**	4.2
Other comprehensive income/(expense) for the year, net of tax	**163.9**	(4.3)
Total comprehensive income for the year	**287.2**	101.8

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 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**
At 1 April 2015	6.1	40.4	147.6	0.1	(6.8)	110.6	298.0	0.1	298.1
Profit for the year	-	-	-	-	-	106.1	106.1	0.1	106.2
Other comprehensive income/(expense) for the year, net of tax	-	-	-	(0.1)	4.9	(9.1)	(4.3)	-	(4.3)
Purchase of own shares	-	-	-	-	-	(0.7)	(0.7)	-	(0.7)
Purchase and cancellation of shares	(0.2)	0.2	-	-	-	(46.9)	(46.9)	-	(46.9)
Share-based payments	-	-	-	-	-	4.7	4.7	-	4.7
Dividends	-	-	-	-	-	(32.3)	(32.3)	-	(32.3)
At 31 March 2016	5.9	40.6	147.6	-	(1.9)	132.4	324.6	0.2	324.8

Consolidated balance sheet
as at 31 March

all figures in £ million	Note	**2017**	2016
Non-current assets			
Goodwill	10	**107.8**	73.1
Intangible assets		**34.7**	8.3
Property, plant and equipment		**238.8**	233.4
Other financial assets		**0.5**	0.6
Investments		**1.5**	0.9
Retirement benefit surplus	12	**156.0**	-
Deferred tax asset		**5.4**	4.1
		544.7	320.4
Current assets			
Inventories		**28.9**	19.0
Other financial assets		**10.7**	10.8
Trade and other receivables		**175.6**	156.2
Investments		**1.3**	1.7
Cash and cash equivalents		**211.8**	263.5
		428.3	451.2
Total assets		**973.0**	771.6
Current liabilities			
Trade and other payables		**(322.1)**	(338.7)
Current tax		**(43.7)**	(39.9)
Provisions		**(6.2)**	(5.3)
Other financial liabilities		**(0.8)**	(0.2)
		(372.8)	(384.1)
Non-current liabilities			
Retirement benefit obligation	12	**-**	(37.7)
Deferred tax liability		**(37.0)**	-
Provisions		**(17.8)**	(13.8)
Other financial liabilities		**(0.3)**	(0.2)
Other payables		**(12.5)**	(11.0)
		(67.6)	(62.7)
Total liabilities		**(440.4)**	(446.8)
Net assets		**532.6**	324.8
Capital and reserves			
Ordinary shares		**5.7**	5.9
Capital redemption reserve		**40.8**	40.6
Share premium account		**147.6**	147.6
Translation reserve		**10.3**	(1.9)
Retained earnings		**328.0**	132.4
Capital and reserves attributable to shareholders of the parent company		**532.4**	324.6
Non-controlling interest		**0.2**	0.2
Total shareholders' funds		**532.6**	324.8

Consolidated cash flow statement

for the year ended 31 March

all figures in £ million	Note	**2017**	2016
Net cash inflow from operations	14	**111.9**	133.4
Tax (paid)/received		**(3.0)**	27.9
Interest received		**1.0**	0.9
Interest paid		**(0.6)**	(0.6)
Net cash inflow from operating activities		**109.3**	161.6
Purchases of intangible assets		**(2.2)**	(1.6)
Purchases of property, plant and equipment		**(30.7)**	(28.6)
Proceeds from sale of property, plant and equipment		**14.3**	0.4
Acquisition of businesses (net of cash acquired)		**(65.7)**	(0.6)
Sale of investment in subsidiary		**-**	28.0
Net cash outflow from investing activities		**(84.3)**	(2.4)
Purchase of own shares		**(48.1)**	(48.6)
Dividends paid to shareholders		**(33.4)**	(32.3)
Capital element of finance lease rental payments		**-**	(1.4)
Capital element of finance lease rental receipts		**-**	1.5
Net cash outflow from financing activities		**(81.5)**	(80.8)
(Decrease)/increase in cash and cash equivalents		**(56.5)**	78.4
Effect of foreign exchange changes on cash and cash equivalents		**4.8**	0.8
Cash and cash equivalents at beginning of year		**263.5**	184.3
Cash and cash equivalents at end of year	11	**211.8**	263.5

Reconciliation of movement in net cash

for the year ended 31 March

all figures in £ million	Note	**2017**	2016
(Decrease)/increase in cash and cash equivalents in the year		**(56.5)**	78.4
Add back net cash flows not impacting net cash		**-**	(0.1)
Change in net cash resulting from cash flows		**(56.5)**	78.3
Other movements including foreign exchange		**3.9**	0.7
(Decrease)/Increase in net cash as defined by the Group		**(52.6)**	79.0
Net cash as defined by Group at the beginning of the period		**274.5**	195.5
Net cash as defined by Group at the end of the period	11	**221.9**	274.5
Less: other financial assets and liabilities		**(10.1)**	(11.0)
Total cash and cash equivalents	11	**211.8**	263.5

1. Significant accounting policies

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 the financial information, specific adjusting items need to be disclosed separately because of their size and nature. Underlying measures of performance excludes specific adjusting items.

Specific adjusting items include:

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

Basis of preparation

The financial information in this preliminary announcement has been extracted from the Group's consolidated financial statements for the year ended 31 March 2017. The Group's financial statements have been prepared on a going concern basis 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 financial information included within the preliminary announcement has been prepared using accounting policies consistent with International Financial Reporting Standards (IFRSs) as endorsed by the European Union. The accounting policies followed are the same as those published by the Group within its Annual Report for the year ended 31 March 2017 which will be available on the Group's website, www.QinetiQ.com subject to the changes noted below. The preliminary announcement was approved by the Board of Directors on 25 May 2017. The financial information in this preliminary announcement does not constitute the statutory accounts of QinetiQ Group plc ('the Company') within the meaning of section 435 of the Act.

The statutory accounts for 2017 were approved by the Board of Directors on 25 May 2017 and will be delivered to the Registrar of Companies following the Company's Annual General Meeting on 19 July 2017. The financial information for 2016 is derived from the statutory accounts for 2016 which have been delivered to the Registrar of Companies. The auditors have reported on the 2017 and 2016 accounts. The reports were (i) unqualified; (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report; and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings to 31 March 2017. 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 the 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.

Recent accounting developments

Developments adopted by the Group in 2017 with no material impact on the financial statements

The following EU-endorsed Standards and amendments, improvements and interpretations are effective for accounting periods beginning on or after 1 January 2016 and have been adopted with no material impact on the Group's financial statements:

- IFRS 11 Joint arrangements – amendment to add guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business.
- IAS 16 Property, plant and equipment – amendments that change the financial reporting for bearer plants such as grape vines and rubber trees. Bearer plants should now be accounted for in the same way as property, plant and equipment. The produce growing on bearer plants will remain within the scope of IAS 41.
- IAS 16 Property, plant and equipment and IAS 38 Intangible assets – clarification of acceptable methods of depreciation and amortisation.
- IAS 27(R) Separate financial statements – amendment allowing entities to use the equity method to account for investment in subsidiaries, joint ventures and associates in their separate financial statements.
- IAS 1 Presentation of financial statements – amendment to improve presentation and disclosure in financial reports.
- IFRS 10 Consolidated financial statements and IAS 28 Investments in associates and joint ventures – amendments to both applying the consolidation exemption and also on the sale or contribution of assets (note not yet endorsed for use in the EU).
- Annual improvements 2012-2014 cycle:
    - IFRS 5 Non-current assets held for sale and discontinued operations – amendment regarding methods of disposal.
    - IFRS 7 Financial instruments: Disclosures – amendment regarding servicing contracts and the transfer of financial assets to a third party under conditions which allow the transferor to derecognise the asset but retain continuing involvement in them. A second amendment clarifies that some interim disclosures in IFRS 7 are not required.
    - IAS 19 Employee benefits – amendment regarding discount rates; when determining the discount rate for post-employment benefit obligations, it is the currency that the liabilities are denominated in that is important and not the country where they arise.
    - IAS 34 Interim financial reporting – amendment requiring 'information disclosed elsewhere in the interim financial report' to be cross-referenced from the interim financial statement to the location of that information.

Developments expected in future periods of which the impact is being assessed

IFRS 15 Revenue from Contracts with Customers: The final Standard was published in May 2014 and the IASB has taken the decision to defer the effective date of IFRS 15 to 1 January 2018 i.e. FY19 for QinetiQ. The new Standard introduces a five-step model to the principle of revenue recognition. The framework 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 revenue when (or as) the entity satisfies a performance obligation.

QinetiQ is currently undertaking an assessment of the impact of the new standard on its financial statements when adopted. At the current time it is not possible to quantify the impact on revenue. Issues being analysed on a contract-by-contract basis include whether the current methodology for recognising revenue over time remains appropriate, the treatment of contract modifications, variable consideration, determination and distinction of performance obligations, determination of agency and principal relationships, collectability and licences. QinetiQ observes that where services provided by QinetiQ are substantially the same over the life of the contract, QinetiQ will apply the series guidance stated in IFRS 15. This is not expected to affect the overall amount of revenue recognised under a contract but it may affect the phasing.

The Group's on-going IFRS 15 project includes development of new internal revenue recognition accounting policies and guidance and further training across the Group in order to apply the requirements of IFRS 15 to all QinetiQ contracts and further work is being undertaken to quantify the impact of the transition to this new standard with effect from 2019.

QinetiQ is also undertaking an analysis of the transitional guidance which allows for two different approaches; the retrospective method (with optional practical expedients) or the cumulative effect method. Under the retrospective method, QinetiQ would need to restate prior year comparatives and recognise the cumulative effect of applying the new standard in equity at the start of the earliest presented comparative period. Under the cumulative method, QinetiQ would apply the new standard as of the date of initial application, with no restatement of comparative period amounts. It would record the cumulative effect of initially applying the new standard – which would affect revenue and costs – as an adjustment to the opening balance of equity at the date of initial application. Under the cumulative effect method, the provisions of the new standard apply only to contracts that are open (i.e. not complete) under previous GAAP at the date of initial application. QinetiQ acknowledges that the disclosure requirements under IFRS 15 are more prescriptive and extensive than under current GAAP.

IFRS 16 Leases: The final Standard 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 from 1 January 2019 subject to EU endorsement.

IFRS 9 Financial Instruments: This new Standard on accounting for financial instruments will replace IAS 39 Financial Instruments: Recognition and Measurement. It is effective for accounting periods beginning on or after 1 January 2018.

2. Segmental analysis

Operating segments

For the year ended 31 March

all figures in £ million	**2017**		2016	
	Revenue	**Underlying operating profit***	Revenue	Underlying operating profit*
EMEA Services	**613.5**	**92.7**	616.4	93.8
Global Products	**169.6**	**23.6**	139.3	15.1
Total operating segments	**783.1**	**116.3**	755.7	108.9
*Underlying operating margin**		***14.9%***		*14.4%*

Reconciliation of total operating segments to total on an organic, constant currency basis

For the year ended 31 March

all figures in £ million	**2017**		2016	
	Revenue	**Underlying operating profit***	Revenue	Underlying operating profit*
Total operating segments	**783.1**	**116.3**	755.7	108.9
Less: divested business (Cyveillance)	**-**	**-**	(8.0)	0.3
Less: acquired businesses	**(9.2)**	**(1.2)**	-	-
Total operating segments on an organic basis	**773.9**	**115.1**	747.7	109.2
Adjust to constant prior year exchange rates	**(18.6)**	**(2.5)**	-	-
Total operating segments on an organic, constant currency basis	**755.3**	**112.6**	747.7	109.2
*Organic revenue growth at constant currency**	***1%***		*(1%)*	

Reconciliation of segmental results to total profit

For the year ended 31 March

all figures in £ million	Note	**2017**	2016
Underlying operating profit[1]		**116.3**	108.9
Specific adjusting items operating profit/(loss)	3	**16.4**	(33.6)
Operating profit		**132.7**	75.3
Net finance expense	6	**(1.2)**	(1.3)
Gain on business divestments		**-**	16.2
Profit before tax		**131.5**	90.2
Taxation (expense)/income	7	**(8.2)**	8.4
Profit for the year from continuing operations		**123.3**	98.6
Discontinued operations			
Profit from discontinued operations, net of tax	3	**-**	7.5
Profit for the year attributable to equity shareholders		**123.3**	106.1

[1] The measure of profit presented to the chief operating decision maker is underlying operating profit (as defined in glossary).

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

3. ‘Specific adjusting items’

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

all figures in £ million	Note	**2017**	2016
Profit on disposal of property		**18.4**	0.3
Acquisition costs		**(1.0)**	-
Specific adjusting items before amortisation, depreciation and impairment		**17.4**	0.3
Impairment of goodwill		**-**	(31.9)
Amortisation of intangible assets arising from acquisition		**(1.0)**	(2.0)
Specific adjusting items operating profit/(loss)		**16.4**	(33.6)
Gain on business divestments (sale of Cyveillance)		**-**	16.2
Defined benefit pension scheme net finance expense		**(1.0)**	(1.1)
Specific adjusting items profit/(loss) before tax		**15.4**	(18.5)
Specific adjusting items - tax	7	**4.1**	21.2
Total specific adjusting items profit after tax – continuing operations		**19.5**	2.7
Profit on disposal of subsidiary – discontinued operations		**-**	7.5
Total specific adjusting items profit after tax		**19.5**	10.2

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

all figures in £ million	**2017**	2016
Underlying profit after tax - total Group	**103.8**	95.9
Total specific adjusting items profit after tax (see above)	**19.5**	10.2
Total profit for the year attributable to equity shareholders	**123.3**	106.1

4. Profit before tax

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

all figures in £ million	**2017**	2016
Depreciation of property, plant and equipment:		
Owned assets: depreciation	**(26.4)**	(23.4)
Owned assets: impairment reversal	**-**	0.4
Foreign exchange (loss)/gain	**(0.2)**	0.2
Research and development expenditure - customer funded contracts	**(272.8)**	(277.6)
Research and development expenditure - Group funded	**(33.6)**	(23.2)

5. Business combinations

Acquisitions in the year to 31 March 2017

all figures in £ million

					Contribution post-acquisition	
Company acquired	**Date acquired**	**Cash consideration[1]**	**Goodwill**	**Fair value of assets acquired[2]**	**Revenue**	**Operating profit**
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[3]		1.0				
Net cash outflow in the year		**65.7**				

[1] Initial cash consideration includes price adjustments for working capital and net debt.
[2] Fair value of assets acquired are provisional.
[3] 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 was 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 is to enhance QinetiQ's product portfolio, market position and ability to deliver global test and evaluation services. If the acquisition had occurred on the first day of the financial year, Group revenue for the year would have been £806.3m and the Group profit before tax would have been £136.6m.

The following table summarises the recognised amounts of assets acquired and liabilities assumed at the date of acquisition and the adjustments required to the book values of the assets and liabilities in order to present the net assets of these businesses at fair value and in accordance with Group accounting policies. The fair values remain provisional, but will be finalised within 12 months of acquisition.

all figures in £ million	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets	-	24.2	24.2
Property, plant and equipment	1.9	-	1.9
Inventory	8.6	1.6	10.2
Trade and other receivables	6.8	-	6.8
Cash and cash equivalents	1.5	-	1.5
Trade and other payables	(3.7)	-	(3.7)
Corporation tax	0.1	-	0.1
Deferred tax liability	-	(5.2)	(5.2)
Net assets acquired	**15.2**	**20.6**	**35.8**
Goodwill			24.5
			60.3
Consideration satisfied by:			
Cash			60.1
Deferred consideration			0.2
Total consideration			**60.3**

The fair value adjustments include £24.2m in relation to the recognition of acquired intangibles assets, of which £17.4m relates to customer relationships and £6.8m relates to intellectual property. The goodwill is attributable mainly to the skills and technical talent of Target Systems' work force and the synergies expected to be achieved from integrating the companies into the Group's existing business.

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 (AUD$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 provide. 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. If the acquisition had occurred on the first day of the financial year, Group revenue for the period would have been £790.5m and the Group profit before tax would have been £132.5m.

The following table summarises the recognised amounts of assets acquired and liabilities assumed at the date of acquisition and the adjustments required to the book values of the assets and liabilities in order to present the net assets of these businesses at fair value and in accordance with Group accounting policies. The fair values remain provisional, but will be finalised within 12 months of acquisition.

all figures in £ million	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets	-	3.1	3.1
Property, plant and equipment	-	-	-
Trade and other receivables	2.4	-	2.4
Cash and cash equivalents	0.2	-	0.2
Trade and other payables	(1.0)	-	(1.0)
Other non-current liabilities	(0.1)	-	(0.1)
Deferred tax liability	(0.1)	(1.0)	(1.1)
Net assets acquired	**1.4**	**2.1**	**3.5**
Goodwill			3.9
			7.4
Consideration satisfied by:			
Cash			6.3
Deferred consideration			1.1
Total consideration			**7.4**

The fair value adjustments include £3.1m in relation to the recognition of acquired intangibles assets (customer relationships) less the recognition of deferred tax liability of £1.0m in relation to these intangibles assets. The goodwill is attributable mainly to the skills and technical talent of RubiKon's work force and the synergies expected to be achieved from integrating the company into the Group's existing business.

6. Finance income and expense

For the year ended 31 March

all figures in £ million	2017	2016
Receivable on bank deposits	**1.0**	1.0
Finance income	**1.0**	1.0
Amortisation of recapitalisation fee	**(0.3)**	(0.3)
Payable on bank loans and overdrafts	**(0.6)**	(0.6)
Unwinding of discount on financial liabilities	**(0.3)**	(0.3)
Finance expense before specific adjusting items	**(1.2)**	(1.2)
Specific adjusting items:		
Defined benefit pension scheme net finance expense	**(1.0)**	(1.1)
Total finance expense	**(2.2)**	(2.3)
Net finance expense	**(1.2)**	(1.3)

7. Taxation

all figures in £ million	2017 Before specific adjusting items*	2017 Specific adjusting items*	2017 Total	2016 Before specific adjusting items*	2016 Specific adjusting items*	2016 Total
Analysis of charge						
Current UK tax expense/(income)	**7.0**	**-**	**7.0**	2.2	(35.6)	(33.4)
Overseas corporation tax						
Current year	**2.0**	**-**	**2.0**	2.4	-	2.4
Current tax expense/(income)	**9.0**	**-**	**9.0**	4.6	(35.6)	(31.0)
Deferred tax expense/(income)	**3.6**	**(4.1)**	**(0.5)**	7.7	20.0	27.7
Deferred tax impact of change in rates	**(0.2)**	**-**	**(0.2)**	(0.2)	-	(0.2)
Deferred tax in respect of prior years	**(0.1)**	**-**	**(0.1)**	0.7	(5.6)	(4.9)
Deferred tax expense/(income)	**3.3**	**(4.1)**	**(0.8)**	8.2	14.4	22.6
Taxation expense/(income)	**12.3**	**(4.1)**	**8.2**	12.8	(21.2)	(8.4)
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/(loss) before tax	**116.1**	**15.4**	**131.5**	108.7	(18.5)	90.2
Tax on profit/(loss) before tax at 20% (2016: 20%)	**23.2**	**3.1**	**26.3**	21.7	(3.7)	18.0
Effect of:						
Expenses not deductible for tax purposes and non-taxable items	**(0.2)**	**(3.3)**	**(3.5)**	3.7	4.5	8.2
Research and development expenditure credits	**(9.1)**	**-**	**(9.1)**	(13.7)	(36.8)	(50.5)
Tax in respect of an FY09 US acquisition - payable to the tax authorities	**1.5**	**-**	**1.5**	16.2	-	16.2
Tax in respect of an FY09 US acquisition - recoverable from insurers	**(1.5)**	**-**	**(1.5)**	(16.2)	-	(16.2)
(Recognition)/utilisation of deferred tax asset in respect of losses	**-**	**(3.7)**	**(3.7)**	-	25.2	25.2
Deferred tax impact of change in rates	**(0.5)**	**-**	**(0.5)**	(0.2)	-	(0.2)
Deferred tax in respect of prior years	**(0.1)**	**-**	**(0.1)**	0.7	(5.6)	(4.9)
Other deferred tax movements	**(0.3)**	**(0.2)**	**(0.5)**	-	(4.8)	(4.8)
Effect of different rates in overseas jurisdictions	**(0.7)**	**-**	**(0.7)**	0.6	-	0.6
Taxation expense/(income)	**12.3**	**(4.1)**	**8.2**	12.8	(21.2)	(8.4)
Effective tax rate	**10.6%**		**6.2%**	11.8%		(9.3%)

* Details of specific adjusting items can be found in note 3.

At 31 March 2017 the Group had unused tax losses of £141.7m (2016: £154.8m) which are available for offset against future profits. A deferred tax asset of £3.7m has been recognised in the year, with the income statement credit classified as a specific adjusting item. This asset is in respect of £18.8m of UK losses and £1.4m of Canadian losses. No deferred tax asset is recognised in respect of the remaining £121.5m of losses due to the uncertainty over the timing of their utilisation. The Group has £66.5m of time limited losses of which US capital losses of £30.0m will expire in 2020. The remaining £36.5m of losses are time limited with £4.4m expiring in 2034, £22.7m in 2035 and £9.4m in 2036. A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and to 18% (effective 1 April 2020) had previously been substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the company's future current tax charge accordingly. The deferred tax assets and liabilities at 31 March 2017 have been calculated based on these rates.

Factors affecting future tax charges

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 in the UK. 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 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.

8. Earnings per share

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

For the year ended 31 March		2017	2016
Weighted average number of shares	Million	**573.9**	587.0
Effect of dilutive securities	Million	**4.8**	3.7
Diluted number of shares	Million	**578.7**	590.7

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

Underlying EPS

For the year ended 31 March		2017	2016
Profit attributable to equity shareholders	£ million	**123.3**	106.1
Remove profit after tax in respect of specific adjusting items*	£ million	**(19.5)**	(10.2)
Underlying profit after taxation	**£ million**	**103.8**	95.9
Weighted average number of shares	Million	**573.9**	587.0
Underlying basic EPS	**Pence**	**18.1**	16.3
Diluted number of shares	Million	**578.7**	590.7
Underlying diluted EPS	**Pence**	**17.9**	16.2

Basic and diluted EPS - continuing operations

For the year ended 31 March		2017	2016
Profit attributable to equity shareholders	£ million	**123.3**	98.6
Weighted average number of shares	Million	**573.9**	587.0
Basic EPS - continuing operations	**Pence**	**21.5**	16.8
Diluted number of shares	Million	**578.7**	590.7
Diluted EPS - continuing operations	**Pence**	**21.3**	16.7

Basic and diluted EPS - total Group

For the year ended 31 March		2017	2016
Profit attributable to equity shareholders	£ million	**123.3**	106.1
Weighted average number of shares	Million	**573.9**	587.0
Basic EPS - total Group	**Pence**	**21.5**	18.1
Diluted number of shares	Million	**578.7**	590.7
Diluted EPS - total Group	**Pence**	**21.3**	18.0

* For details of 'specific adjusting items' refer to note 3.

9. Dividends

An analysis of the dividends paid and proposed in respect of the years ended 31 March 2017 and 2016 is provided below:

	Pence per share	£m	Date paid/ payable
Interim 2017	**2.0**	**11.5**	**Feb 2017**
Final 2017 (proposed)	**4.0**	**22.6**	**Sept 2017**
Total for the year ended 31 March 2017	**6.0**	**34.1**	
Interim 2016	1.9	11.1	Feb 2016
Final 2016	3.8	21.9	Sept 2016
Total for the year ended 31 March 2016	5.7	33.0	

The Directors propose a final dividend of 4.0p (2016: 3.8p) per share. The dividend, which is subject to shareholder approval, will be paid on 1 September 2017. The ex-dividend date is 3 August 2017 and the record date is 4 August 2017.

10. Goodwill

all figures in £ million	2017	2016
Cost		
At 1 April	**171.5**	183.3
Acquisitions	**28.4**	-
Disposals	**-**	(16.2)
Foreign exchange	**20.5**	4.4
At 31 March	**220.4**	171.5
Impairment		
At 1 April	**(98.4)**	(76.1)
Disposals	**-**	11.0
Impairment	**-**	(31.9)
Foreign exchange	**(14.2)**	(1.4)
At 31 March	**(112.6)**	(98.4)
Net book value at 31 March	**107.8**	73.1

Goodwill as at 31 March 2017 was allocated across two cash generating units ('CGUs') within the EMEA Services segment and two CGUs within the Global Products segment.

QinetiQ Target Systems Limited was acquired during the year (on 21 December 2016) and the goodwill arising of £24.5m was allocated to the existing UK Global Products CGU. The Group acquired RubiKon Group Pty Limited on 31 January 2017 and the goodwill arising of AUD $6.7m (£3.9m) was allocated to the existing Australia CGU.

Goodwill is attributable to the excess of consideration over the fair value of net assets acquired and includes expected synergies, future growth prospects and employee knowledge, expertise and security clearances. The Group tests each CGU for impairment annually, or more frequently if there are indications that goodwill might be impaired.

Impairment testing is dependent on management's estimates and judgments, particularly as they relate to the forecasting of future cash flows, the discount rates selected and expected long-term growth rates. Significant headroom exists in all CGUs with the exception of US Global Products (see below) and management considers that there are no likely variations in the key assumptions which would lead to an impairment being recognised in any of the other CGUs.

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 two-year period. Discounted cash flows for the US Global Products CGU were based on a Board-approved three-year plan, reflecting increases in revenue from new product lines. 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 2.0% - 2.4% (2016: 2.0% - 2.4%). The US terminal growth rate was 2.0% (2016: 2.4%). 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 to appropriately estimate a market participant discount rate. The pre-tax discount rates applied for the two EMEA Services CGUs were 10.9% and 16.1%, for the UK Global Products CGU was 10.8% and for the US Global Products CGU was 11.2%.

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

US Global Products
The carrying value of the goodwill for the US Global Products CGU, which had been written down in the prior year, was £43.4m as at 31 March 2017 (2016: £37.9m). The recoverable amount of this CGU as at 31 March 2017, based on value in use and calculated using the assumptions noted above, is marginally higher than the carrying value of net operating assets (of £49.5m) and no further impairment is required in the year to 31 March 2017. 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 or a decrease in the terminal growth rate by 1% would not cause the net operating assets to exceed their recoverable amount. However, a reduction of £1.5m in the terminal year cash flows would lead to the recoverable amount no longer exceeding the carrying value. Any additional reduction in terminal year cash flows would result in an impairment of the goodwill of this CGU.

Other CGUs
The UK Global Products CGU and the two individual CGUs within EMEA Services all have significant headroom. An increase in the discount rate or a decrease in the terminal growth rate by 1% would not cause the net operating assets to exceed their recoverable amount. The carrying value of goodwill for the UK Global Products CGU as at 31 March 2017 was £30.3m (2016: £5.5m). The carrying values of goodwill for the two EMEA Services CGUs as at 31 March 2017 were £27.5m and £6.6m (2016: £27.5m and £2.2m). The Directors have not identified any other likely changes in other significant assumptions between 31 March 2017 and the signing of the financial statements that would cause the carrying value of the recognised goodwill to exceed its recoverable amount.

11. Net cash

As at 31 March

all figures in £ million	2017 Assets	2017 Liabilities	2017 Net	2016 Assets	2016 Liabilities	2016 Net
Current financial assets/(liabilities)						
Borrowings – deferred financing costs	**0.3**	**-**	**0.3**	0.3	-	0.3
Available for sale investment[1]	**10.4**	**-**	**10.4**	9.9	-	9.9
Derivative financial instruments	**-**	**(0.8)**	**(0.8)**	0.6	(0.2)	0.4
Total current financial assets/(liabilities)	**10.7**	**(0.8)**	**9.9**	10.8	(0.2)	10.6
Non-current assets/(liabilities)						
Deferred financing costs	**0.2**	**-**	**0.2**	0.5	-	0.5
Borrowings	**0.2**	**-**	**0.2**	0.5	-	0.5
Derivative financial instruments	**0.3**	**(0.3)**	**-**	0.1	(0.2)	(0.1)
Total non-current financial assets/(liabilities)	**0.5**	**(0.3)**	**0.2**	0.6	(0.2)	0.4
Cash[2]	**88.9**	**-**	**88.9**	68.4	-	68.4
Cash equivalents	**122.9**	**-**	**122.9**	195.1	-	195.1
Total cash and cash equivalents	**211.8**	**-**	**211.8**	263.5	-	263.5
Total net cash as defined by the Group			**221.9**			274.5

[1] The available for sale investment is a 'Libor-plus' investment fund. The investment objective of the fund is to produce an interest rate based return, primarily through investment in a portfolio of AAA and AA-rated asset backed securities and corporate floating rate notes.
[2] At 31 March 2017 the Group held £1.5m (2016: £0.1m) of cash which is restricted in its use.

Reconciliation of net cash flow to movement in net cash

all figures in £ million	2017	2016
(Decrease)/increase in cash and cash equivalents in the year	**(56.5)**	78.4
Capital element of finance lease payments	**-**	1.4
Capital element of finance lease receipts	**-**	(1.5)
Change in net cash as defined by the Group resulting from cash flows	**(56.5)**	78.3
Amortisation of deferred financing costs	**(0.3)**	(0.3)
Foreign exchange and other non-cash movements	**4.2**	1.0
Movement in net cash as defined by the Group	**(52.6)**	79.0
Net cash as defined by the Group at the beginning of the year	**274.5**	195.5
Net cash as defined by the Group at the end of the year	**221.9**	274.5
Less: other financial assets and liabilities	**(10.1)**	(11.0)
Total cash and cash equivalents	**211.8**	263.5

12. Post-retirement benefits

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 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	2017 Quoted	2017 Not quoted	2017 Total	2016 Quoted	2016 Not quoted	2016 Total
Equities	**284.0**	**71.4**	**355.4**	347.9	66.1	414.0
Liability Driven Investments[1]	**968.2**	**-**	**968.2**	362.8	-	362.8
Corporate bonds	**340.6**	**-**	**340.6**	314.2	-	314.2
Alternative bonds[2]	**132.3**	**-**	**132.3**	176.6	-	176.6
Property fund	**126.7**	**-**	**126.7**	126.6	-	126.6
Cash and other	**3.1**	**-**	**3.1**	16.2	-	16.2
Total market value of assets	**1,854.9**	**71.4**	**1,926.3**	1,344.3	66.1	1,410.4
Present value of Scheme liabilities			**(1,770.3)**			(1,448.1)
Net pension asset/(liability) before deferred tax			**156.0**			(37.7)
Deferred tax (liability)/asset			**(31.4)**			1.5
Net pension asset/(liability) after deferred tax			**124.6**			(36.2)

[1] As at 31 March 2017 the assets in the LDI portfolio hedge against 63% of the interest rate and 100% of the inflation rate risk, as measured on the Trustee's gilt-funding basis. The increase in the year of £605.4m is split between performance of the LDI funds, with valuation gains of £355.2m, and asset reallocations of £250.2m, with £179.8m switched out of equities and £70.4m out of alternative bonds.

[2] Includes allocations to high-yield bonds, secured loans and emerging market debt.

Changes to the fair value of Scheme assets

all figures in £ million	**2017**	2016
Opening fair value of Scheme assets	**1,410.4**	1,454.6
Interest income on Scheme assets	**47.6**	46.3
Re-measurement gain/(loss) on Scheme assets	**492.0**	(75.8)
Contributions by the employer	**12.9**	14.6
Net benefits paid out and transfers	**(35.1)**	(28.1)
Administrative expenses	**(1.5)**	(1.2)
Closing fair value of Scheme assets	**1,926.3**	1,410.4

Changes to the present value of the defined benefit obligation

all figures in £ million	**2017**	2016
Opening defined benefit obligation	**(1,448.1)**	(1,494.0)
Interest cost	**(48.6)**	(47.4)
Actuarial (loss)/gain on Scheme liabilities based on:		
Change in financial assumptions	**(329.4)**	40.4
Experience gains	**20.7**	24.8
Net benefits paid out and transfers	**35.1**	28.1
Closing defined benefit obligation	**(1,770.3)**	(1,448.1)

Total expense recognised in the income statement

all figures in £ million	**2017**	2016
Net finance cost on the net pension asset/liability	**1.0**	1.1
Administrative expenses	**1.5**	1.2
Total expense recognised in the income statement (gross of deferred tax)	**2.5**	2.3

Assumptions

The major assumptions used in IAS19 valuation of the Scheme were:

	2017	**2016**
Discount rate applied to Scheme liabilities	**2.60%**	3.40%
CPI inflation assumption	**2.35%**	2.10%
Assumed life expectancies in years:		
Future male pensioners (currently aged 60)	**89**	89
Future female pensioners (currently aged 60)	**91**	91
Future male pensioners (currently aged 40)	**91**	91
Future female pensioners (currently aged 40)	**93**	93

13. Contingent liabilities and assets

Subsidiary undertakings within the Group have given unsecured guarantees of £46.1m at 31 March 2017 (2016: £32.8m) in the ordinary course of business.

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

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

14. Cash flows from operations

For the year ended 31 March

all figures in £ million	2017	2016
Profit after tax for the year	**123.3**	106.1
Adjustments for:		
Tax expense/(income)	**8.2**	(8.4)
Net finance costs	**1.2**	1.3
Profit on business divestments and disposal of investments	**-**	(23.7)
Gain on sale of property	**(18.4)**	-
Transaction costs in respect of acquisition of businesses	**1.0**	-
Amortisation and impairment of purchased or internally developed intangible assets	**2.6**	2.8
Amortisation of intangible assets arising from acquisitions	**1.0**	2.0
Impairment of goodwill	**-**	31.9
Depreciation and impairment of property, plant and equipment	**26.4**	23.0
Loss on disposal of property, plant and equipment	**1.2**	1.2
Share of post-tax profit of equity accounted entities	**(0.5)**	(0.5)
Share-based payments charge	**2.1**	4.7
Changes in retirement benefit obligations	**(11.4)**	(13.4)
Net movement in provisions	**4.5**	(0.3)
	141.2	126.7
Increase in inventories	**-**	(0.2)
Decrease in receivables	**2.9**	13.8
Decrease in payables	**(32.2)**	(6.9)
Changes in working capital	**(29.3)**	6.7
Net cash inflow from operations	**111.9**	133.4

Reconciliation of net cash inflow from operations to net cash inflow from operations (post-capex)

all figures in £ million	2017	2016
Net cash inflow from operations	**111.9**	133.4
Purchases of intangible assets	**(2.2)**	(1.6)
Purchases of property, plant and equipment	**(30.7)**	(28.6)
Proceeds from sale of plant and equipment	**-**	0.4
Net cash inflow from operations (post-capex)	**79.0**	103.6

Underlying Cash Conversion Ratio

	2017	2016
Underlying operating profit - £ million	**116.3**	108.9
Net cash inflow from operations (post-capex) - £ million	**79.0**	103.6
Underlying cash conversion ratio - %	**68%**	95%

Glossary

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

Alternative performance measures ('APM's)

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

Measure	Explanation	Note reference to calculation or reconciliation to statutory measure
Organic 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	Note 2
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	N/A
Underlying net finance costs	Net finance costs excluding net pension finance costs	Note 6
Underlying profit after tax	Profit after tax as adjusted to exclude 'specific adjusting items'	Note 3
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 7
Underlying EPS	Basic earnings per share as adjusted to exclude 'specific adjusting items'	Note 8
Orders	The level of new orders (and amendments to existing orders) booked in the year.	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	N/A
Net cash flow from operations (post capex)	Net cash flow from operations before cash flows of specific adjusting items, less cash outflow on purchase of intangible assets and plant and equipment, plus proceeds from sale of plant and equipment.	Note 14
Underlying operating cash conversion	The ratio of net cash from operations (post capex) to underlying operating profit	Note 14
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 and investments; net pension finance expense; transaction costs in respect of business acquisitions; tax impact of the preceding items; and significant non-recurring deferred tax movements	Note 3