Annual Report and Accounts 2007

QinetiQ

QINETIQ GROUP PLC

COMPANY Number: 4586941

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COMPANIES HOUSE

2.45p

8 9% increase in final dividend per share

9.3%

Increase in revenue to £1,150m (2006 £1,052m)

48.6%

Growth in orders to £1,214m (2006 £817m)

10.4%

Growth in underlying earnings per share to 11 3p (2006 10 2p)

31.2%

31 2% (2006 23 6%) of revenue generated by QinetiQ North America

9.2%

Underlying operating margin improved to 9 2% (2006 8 6%)

£851m

Backlog increased to £851m (2006 £608m)

QinetiQ is a leading international defence and security technology company. We develop innovative technology-based solutions and products and provide technology-rich support services for major government organisations, such as the UK MOD and the US DoD, and for commercial customers around the world.

As a leading supplier of defence research to the UK Government, we have built up significant intellectual capital and expertise. Over 13,500 employees contribute to our intellectual capital base. We are known as the people who deliver value from science and technology, creating solutions that address important problems faced by business, government and society.

The value of inventive thinking reaches beyond those solutions themselves. It touches every aspect of our business, from our talented people and innovative technology to the relationships we are building to secure our long-term future, at home and abroad. Ultimately it creates wealth for the Company, its shareholders and the global economy.

Financial summary

	2007	2006
Group revenue	£1,149 5m	£1,051 7m
Underlying operating profit	£106 0m	£90 7m
Underlying operating profit margin	9 2%	8 6%
Underlying profit before tax	£94 0m	£80 1m
Underlying earnings per share	11 3p	10 2p
Basic earnings per share	10 5p	10 0p
Net debt	£300 8m	£233 0m
Orders	£1,214 0m	£816 7m
Backlog (excluding LTPA)	£850 9m	£608 4m
Underlying effective tax rate	21 2%	22 7%
Dividend per ordinary share	3 65p	2 25p

See Glossary on page 111 for definition of Non-GAAP terms used throughout the Annual Report

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Cautionary statement

All statements other than statements of historical fact included in this document, including without limitation, those regarding the financial condition results operations and businesses of QinetiQ and its strategy plans and objectives and the markets and economies in which it operates are forward looking statements Such forward-looking statements which reflect management s assumptions made on the basis of information available to it at this time involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of QinetiQ or the markets and economies in which QinetiQ operates to be materially different from future results performance or achievements expressed or implied by such forward-looking statements Nothing in this document should be regarded as a profit forecast

Chairman's statement

I am delighted to be able to report that QinetiQ performed strongly in the year, proving that our strategy remains effective, our business model robust and that we continue to execute well against both. The Group delivered 9 3% growth in revenue and a 60 basis point improvement in underlying operating margin This resulted in 10 4% growth in underlying earnings per share to 11 3p and we are proposing a final dividend of 2 45p per share, giving a total dividend for the year of 3.65p per share

QinetiQ s principal markets in the United Kingdom and North America continue to provide good opportunities for growth and we believe that we are well positioned as an innovative, technology based solutions provider to perform strongly in future years

In the UK, the publication by the UK Ministry of Defence of the Defence Technology Strategy marked a further important step in the development of UK Government Defence Policy, building on the themes of the Defence Industrial Strategy from 2005 The report reinforces the importance of technology in meeting the armed forces' need for agility in the face of unpredictable and rapidly emerging threats and highlights the key focus areas which the MOD expects to be of most significance in the future QinetiQ is identified as a leader in the majority of these fields Defence budgets in the UK are expected to grow only modestly in future years The MOD remains a crucial customer for which we see opportunities to become an even more important supplier in the years to come, although growth in the rest of our business will result in the MOD contributing a smaller proportion of overall Group revenue QinetiQ is the first major defence company to be born in the 21st century and has the opportunity to provide a different offering to its customers based on meeting their real and immediate needs through a responsive, agile and technologically literate service based approach A clear example of this was our success this year in being appointed preferred bidder for the Defence Training Rationalisation (DTR) programme through Metrix, our joint venture with Land Securities Trillium

In North America there has been much discussion and debate over levels of US Government spending on defence and security following the congressional elections last year Although we anticipate there will be major changes in the coming years we continue to see many opportunities We believe our focus towards technology-rich service provision should allow us to continue to achieve good growth rates in this large market place A big part of our growth to date has been through the execution of our strategy to expand into the North American market and I am pleased with our reported performance in this market, which has been achieved despite the continued weakness of the US dollar against sterling Including the expected contribution from the recently completed acquisitions of Analex Corporation and ITS Corporation we now have a North American business with a pro forma turnover in excess of $900m which has moved us forward substantially towards our medium-term goal of delivering 50% of Group revenue from this market

The value of innovation is paramount for QinetiQ and we have continued to make progress on our strategy to develop commercial applications and businesses from the deep intellectual property reserves we build from solving defence problems at the leading edge of technology As well as moving some of our later stage product businesses closer to achieving mainstream revenues I am pleased at the continued stream of new technologies that have moved into our business ventures pipeline in the year which will accelerate the development of these opportunities

As I reported last year, we aimed to add to the Board one additional Non executive Director with US experience We were pleased to welcome George Tenet to the Board in October 2006 he brings an extensive understanding of the working of the US Government as well as unparalleled knowledge of defence, security and intelligence communities worldwide In February 2007, Glenn Youngkin stood down from the Board following Carlyle s disposal of their remaining shareholding in the Group I would like to thank him for the valuable contribution that he has made to the Group over the period he has served on the Board

My role as Chairman changed from Executive to Non-executive and I am pleased with the smooth transition of my executive responsibilities to Graham Love The Board now comprises two Executive Directors and seven Non-executive Directors, five of whom are considered to be independent Non-executives Additionally we are strengthening our management teams to lead further improvements in operations and penetration of target markets We have now completed our first full year as a public company and the progress we have made is in large part due to the commitment of our highly skilled people I would like to thank them for the contribution they have made to the delivery of this year s performance and look forward with confidence to further success in delivering on our strategy in the coming year

Sir John Chisholm
Chairman
31 May 2007

Chief Executive Officer's review

QinetiQ continued to make good progress during the year and delivered robust financial performance in line with our expectations. The Group executed against its strategy and progressed key contract opportunities in the year.

Performance overview

Revenue increased 9 3% to £1,149 5m and underlying operating profit increased 16 9% to £106 0m Equally importantly our order intake increased 48 6% to £1,214 0m

Net cash inflow from operating activities of £94 1m (2006 £83 3m) reflects the investment made in growing product businesses such as TALON® and Tarsier® together with a temporary build in working capital in the UK defence business across the year end which reversed early in the new financial year as expected

Underlying earnings per share increased by 10 4% to 11 3p per ordinary share We propose to increase the final dividend to shareholders to 2 45p per share, an 8 9% increase over last year, resulting in a total dividend for the year of 3 65p per share

Delivering against our strategy

Maintain and build existing relationships

QinetiQ is the MOD's second largest UK supplier and the MOD remains the Group's largest customer accounting for £584 5m (50 8%) of revenue in FY07 (FY06 £595 8m 56 7%)

Our services to the MOD include research technology design and insertion, technical advice, systems engineering, systems integration, training and simulation and test and evaluation The strength of the working partnership we have with the MOD is evidenced through the volume and value of new contracts won in the year We play key roles on many of the MOD's most important programmes and were awarded a three year extension to the Typhoon/Eurofighter support contract worth up to £53m as well as securing an important position in the next generation Taranis unmanned air vehicle programme, which will build on our previous significant research in autonomy and low observable systems Our role as a key partner for the MOD is further reinforced in the wider MOD research arena where, as this funding is increasingly opened to full competition, we have continued to win more than half of the research contracts for which we have competed Within the LTPA our composite performance scoring for the year to March 2007 has risen to 94 3% (FY06 91 6%) which is an important demonstration of our continuing focus on customer needs as we move towards the second five-year term of the LTPA in 2008

Further penetrate established defence markets
Our strategy has been to use our strong position in research and advisory services as a platform to expand into technology supply and further large scale services contracts We have seen strong continued growth of 11 4% in orders and 7 6% in revenue in Technology Supply with the contract to supply the command and control system for the MOD s CUTLASS robotics programme to Remotec UK an example of research work being pulled through into product supply Our proven track record in delivering large scale, technology led managed services programmes to the MOD has been a valuable contributor in our successful bid for the Defence Training Rationalisation (DTR) programme We continue to work with the MOD to agree the final scope of DTR and progress through to financial close Additionally we reached financial close on the 20-year Combined Aerial Target System (CATS) enhancing the service currently provided under the LTPA

We believe that many of the services that we provide within the UK also can be delivered in other overseas locations To facilitate this focus on building out into defence markets outside the UK and the US we have established a new Europe, Middle East and Australasia (EMEA) region and are pleased that Clive Richardson has joined from BAE Systems to lead this part of our business The EMEA region, which comprises all of our existing non-US operations, except for our Ventures activities, will use our well established UK platform to develop the provision of these services globally

Apply our technologies to commercial markets
Our Ventures team is focused on identifying and developing QinetiQ technologies for which significant potential commercial markets exist and growing these opportunities into profitable businesses At any given time we expect to have a portfolio of up to 20 such fledgling businesses in various stages of development A feature of all our Ventures is that we are introducing new technology and this means that there are often changes required to customer systems and processes, which has contributed to slower growth than was originally anticipated For example, Tarsier® has progressed during the year with the Vancouver system now operationally live the Dubai installation in planning, and trial systems being installed at Heathrow and Providence, Rhode Island As a result of customer feedback, we are incorporating a camera system alongside the Tarsier® unit which should, we believe, enhance future order flow Across the wider Ventures portfolio a variety of routes to accelerate value creation continue to be explored, with a drive to inject more management and financial resource, and to find valuable partners to help take products to market

In addition to the Ventures portfolio we continue to win business in adjacent commercial markets for our services and products Revenue in our Security & Dual Use sector grew by 5 9% (excluding the impact of non-recurring Liquid Crystal Display (LCD) revenues in 2006) driven by new revenues such as the optical foot measuring gauge developed and sold to Clarks, the shoe retailer

Strengthen our North American presence
QinetiQ North America (QNA) delivered underlying organic revenue growth of 14 2% in the year In particular, we have seen high demand for the TALON® robot and associated spares with now over 1 000 units shipped Order flow for TALON® continues to be strong with a further $26m order confirmed in April 2007 We believe that our growth opportunities in North America remain robust as we are positioned in the technology-rich end of the services market with strong customer relationships Our IT services business is proving resilient in the face of US Government budget pressures due to the technical differentiators we offer and the long standing customer relationships we hold with defence and security agencies During the year we made significant progress in building the QNA management team to drive the development of an integrated QinetiQ business in North America with the recruitment of Duane Andrews as CEO of the North American business Duane brings extensive experience to our QNA management team through both his industry experience and his extensive knowledge of the US Government defence procurement process

The acquisitions announced during the year of Ocean Systems Engineering Corporation (OSEC), Analex and ITS have established a business with over 5,000 employees and pro forma turnover in excess of $900m last year, which we believe is a significant platform from which we can deliver new, larger revenue opportunities By integrating our US businesses and exploiting synergies with our UK capabilities we are already seeing increased success in addressing larger US programmes than was previously possible For example, Analex has taken us into important new territory with its focus on mission critical software and systems engineering, which will form the basis of a new business stream, Mission Solutions

Acquire strong companies
We continually evaluate a substantial pipeline of acquisition opportunities globally and aim to continue enhancing our capabilities and geographic reach through selective acquisitions at reasonable prices

People
Our most important asset is our people and the successful delivery of all aspects of our strategy is dependent on the high level of commitment and professionalism which they consistently show We thank and congratulate all our staff on their success in delivering another year of strong performance for the Group

We continually review the development opportunities open to staff, and invest in new programmes where appropriate We have, for example recently launched the Competing to Win' intensive training programme designed to help our key contributors become even more effective in leading and winning major new business opportunities

We also keep remuneration and benefit packages under constant review and have used our listing on the public markets to introduce competitive reward structures, including equity based incentives

Chief Executive Officer's review continued

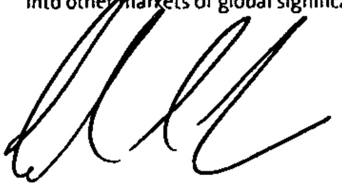
Future prospects
Going forward our strategy remains consistent with previous plans, and the focus is on execution

In the UK defence market we believe that the rapidly changing needs of our defence and security forces can only be met by the kind of agile and innovative technological services in which QinetiQ specialises In the short to medium term the effect on revenues of the introduction of competition into the MOD Research funding will cloud the overall benefit from continued growth in Technology Supply Demand for our consultancy and advisory services to the MOD remains robust, and we are developing an important new business in systems engineering and integration We look forward to entering the second five year period of the 25-year LTPA with confidence Significant incremental growth in the UK defence managed service business will be driven from the expected financial close of both packages of DTR in late 2008/early 2009

In North America our positioning as a technology-rich provider across a wide and deep customer base provides us with the platform to continue to grow at rates above the overall increases predicted in US DoD budgets in the medium term Additionally, the high end nature of our service offerings will provide us with a significant degree of insulation from the impact of future US Government budget pressures

Commercial markets for services and products for our Ventures businesses present a tremendous opportunity for the Group We aim to grow these businesses into profitable contributors to the Group and to seek external partners and funders to support their development as appropriate

We look forward to the coming year with confidence that our robust business model, the quality and commitment of our people and the strength and depth of our customer relationships provide us with a platform for continued growth in our core defence and security markets, together with increasing success in taking our technology into other markets of global significance



Graham Love
Chief Executive Officer
31 May 2007

Five year summary

Revenue (£m)

Underlying operating profit (£m)

Employees at 31 March

Our strategy

QinetiQ's strategy is to build on our pivotal position in UK defence to provide ever broader and more valuable technology-based solutions to our MOD customers, to develop our US business from the excellent platform we have created, and to exploit our technology into selected other defence and commercial markets where the opportunity exists to build a substantial business.

Our growth depends on making sure our technology solutions meet customer needs. This report highlights how we are achieving our growth strategy by focusing on some key areas – creative applications, long-term partnerships, talented people, remote controlled technologies, collaboration and sustainable solutions.

Our investment for growth is focused on five priorities. To:

Further penetrate established defence markets
by responding to changing defence requirements and supplying our technology to defence prime contractors

Maintain and build existing relationships
by understanding and responding to our customers' needs, particularly in defence

Apply our technologies to commercial markets
especially in the security, civil aviation and space markets and through new venture creation

Acquire strong companies
to complement our own capabilities and build more valuable businesses

Strengthen our North American presence
by leveraging our scale and capabilities to broaden and deepen customer relationships

Technologies that transform

Our background in defence research allows us to provide our customers with technology that is beyond the reach of most commercial organisations. By applying technology we've already researched and developed to new areas, we create solutions that solve difficult problems Our customers access leading-edge technologies while we optimise the brilliant solutions we develop

LAST® Armor protecting people

$10 million sub contract

Providing our US armour expertise to the UK MOD by giving Mastiff Protected Patrol Vehicles further protection, we are helping to safeguard a generation of military personnel LAST® Armor uses a clever high strength Velcro® to provide quick and easy application

High flying technology
The solar-powered wings of Zephyr,® our unmanned aerial vehicle, are so light the aircraft is designed to fly at high altitudes for months This will revolutionise real-time data communications and persistent observation, making it useful for a range of military and humanitarian purposes

So simple, so smart

Our Omni-ID™ tagging solution pushes the boundaries of radio frequency identification (RFID) technology Using an RFID structure that works anywhere, it makes monitoring assets simpler and brings mass market product tagging one step closer

99.99% accurate

Managing complex projects

We have an impressive track record for managing technology-rich, complex long-term projects for a wide range of customers, particularly the MOD Our customers trust us to look after their interests and use technology to improve their performance and productivity. We work hard to build and maintain these valuable relationships which allow our customers to concentrate on critical areas of their business and help us build lasting revenue streams.

Delivering peace of mind to the MOD
We provide testing, evaluation and training to the MOD to help it establish the safe operational performance of defence platforms and weapons through a 25-year Long-Term Partnering Agreement

Flight control system
Our experts provide technical advice to the MOD on the flight control system of the aircraft

Growing business with customers
We continue our work with the US Treasury Department under a two-year contract supporting the Internal Revenue Service (IRS) with IT operations and maintenance services, including the redesign of the chief counsel's intranet This follow-on contract is the latest in a long-term relationship with the Department spanning eight years

£308m contract over 20 years

Secured revenue
Our experience of aerial target programmes led to a 20-year contract with the MOD to supply a Combined Aerial Targets Service (CATS) The service will meet all of the MOD's aerial target requirements worldwide

We have supported the MOD in the evolution of the Eurofighter Typhoon since its conception 20 years ago, using our skills in a number of areas.

Human factors
Supporting the MOD to deliver crew protection and performance, including verification and testing of the Aircrew Equipment Assemblies life support and crew escape systems in partnership with BAE Systems

Safety
Decisions on the safe operation of the aircraft are made using the unique knowledge and experience provided by the QinetiQ support team

The world's best minds

We recruit and retain some of the world's best minds. Each new company we acquire adds to this pool of talent. We provide an environment in which expertise can flourish by putting together teams brimming with scientific and intellectual talent They relish the challenge of finding imaginative ways to resolve the important problems facing our customers.

tapping into 30 years of experience

Bright minds, brilliant solutions
Employees from across QinetiQ worked together to design the next generation of bomb disposal robots in the MOD CUTLASS programme They are now supporting the production of the vehicles, which will be used for anti-terrorism operations worldwide
The project drew on knowledge and experience gained through 30 years of research and development in robotics

Left Peter Horsted, CUTLASS Programme Manager
Right Jane Phillips, Business Development Manager

Dave Griffin
Senior Flight Control Engineer Dave Griffin of Analex plays a pivotal role in analysing NASA's Launch Service Program Known for his versatility and dedication to excellence, Dave's expertise helps solve highly complex problems like the Delta II Heavy flight anomaly Since we acquired Analex, he's now a valuable addition to our team

Elaine Baxter
Our employees regularly win awards for the advances they make in their fields Like Elaine Baxter, from our space division, recently recognised in the Institute of Physics Early Career Woman Physicist of the Year award, for her outstanding achievements with our TopSat micro-satellite

Left Elaine Baxter, TopSat Operations Manager

At the forefront of innovation

Over many years we have built a reputation as an intellectual powerhouse in remote controlled technologies. We have developed unmanned vehicles for use on land, at sea and in the air Our defence customers benefit from this expertise, allowing their personnel to undertake dangerous work from a safe distance. Increasingly we are helping our commercial customers see ways to exploit the potential of these technologies in new settings.

Quick thinking
In just 11 months our experts adapted REMUS, an unmanned above water vehicle, to meet an urgent operational requirement from the MOD Designed to clear mines in the shallow waters of the Umm Qasr waterway in Iraq, the vehicle has now been accepted into general service by the Royal Navy

Seeing clearly underwater
Our synthetic aperture sonar enables Bluefin unmanned underwater vehicles to provide high resolution sea bed images in a system that delivers mine countermeasures to the US Navy

high resolution survey data

Bringing together technologies
In a major co-investment programme with other defence industry experts, QinetiQ is developing communications and autonomy for a world-class unmanned aerial vehicle technology demonstrator Project Taranis, led by BAE Systems, will show how integrated systems can deliver battle-winning capabilities to the MOD

The future of autonomous flight
QinetiQ recently delivered a world first, with a successful demonstration of a single pilot flying his aircraft, while simultaneously controlling four unmanned aerial vehicles This work for the MOD demonstrates that autonomous vehicles are a realistic option for future aeronautical operations

Working in partnership

Working in partnership is fundamental to the way we do business Building and maintaining strong relationships in the UK and North America is vital to understanding and meeting our customers' needs When we work on collaborative projects, we combine our skills and technologies with other companies – large and small. We provide a link between the academic and commercial worlds, bridging the gap between research and reality.

Putting collaboration to the test
Working with Carson Helicopters to modify its helicopter blades, our engineers carried out a test programme to examine aircraft handling, performance and vibration characteristics Early results on a Sea King flight showed significant performance improvements This is thought to be the most significant modification made to a helicopter in the UK by a non aircraft manufacturer

tests show 2,000lb increase in hover capability

developing young talent

Working with leading minds
We work with several partner universities, taking an active role in furthering research and development to push the boundaries of science. As a result, we're able to capitalise on the innovations that come out of our collective research and development

Pressing the advantage
QinetiQ is working with Advantage West Midlands on a new multi-million pound project to help businesses develop and integrate innovative solutions using advanced sensor technologies

Tackling society's biggest problems

Our technologies are helping to deal with some of the biggest problems facing society, like climate change Increasingly, we help customers to improve their environmental performance, and evaluate and develop new energy and transport technologies.

Cleaning up ships
We are installing a pyrolysis unit on HMS Ocean to enable the thermal destruction of all mixed waste streams, generating lower emissions than conventional incineration This will help the Royal Navy to meet its environmental obligations

Studies for the future
We conducted a study on marine noise for the Scottish Executive as part of its Strategic Environmental Assessment of marine renewable energy devices (wave and tidal) off the coast of Scotland The findings helped the customer to make an informed choice about technology development

Fuelling the future
QinetiQ has been investigating the key issues affecting the environment and sustainability of the UK military's use of fuels by looking at future and alternative fuels This will also involve a demonstration of a military vehicle running on biodiesel derived from used cooking oil

Clearing our skies
We are a major participant in the UK Integrated Wing research project led by Airbus This project will make an important contribution to airlines meeting targets for reduced fuel burn and CO_2 emissions by 2020

Supporting renewable energy
We have successfully licensed our ZephIR® laser anemometer technology to Natural Power, a leading consultant to the international renewable energy industry The agreement allows the company to manufacture and market QinetiQ's laser anemometer technology in the wind energy market.

Business review
Market review

QinetiQ's primary markets are in defence and security. We deploy our broad and distinctive technical capabilities at the leading edge of future systems design to support today's armed forces and intelligence communities. Our principal customers include the MOD, DoD, UK and US security agencies and the major contractors who serve these organisations.

QinetiQ also services a growing number of niche civil market sectors by exploiting technology and capabilities originally developed for our defence customers

UK defence

UK defence spending is expected to remain broadly flat in real terms in the near future The UK defence budget will, like other areas of Government spending, be subject to review in the context of the 2007 Comprehensive Spending Review due to finish in the Autumn We anticipate that the MOD will respond to the change in threats it faces and budgetary pressures by focusing less on large scale new platform development in favour of upgrading existing platforms The focus of these upgrades is on improving agility, flexibility and interoperability of UK forces to ensure they are equipped for rapid global deployment alongside other international allies

The Defence Industrial Strategy white paper published by the MOD in December 2005, recognised the importance of the defence industry in meeting evolving needs, including whole life management of defence equipment, support and service provision Implementation of the DIS during the last 12 months has clarified the MOD's intent to increase the openness of equipment supply chains to promote innovation and technology insertion, with greater emphasis on managing a system of systems' architecture throughout the life of major platforms QinetiQ is well placed to benefit from this focus, both in the defence supply chain as a technology partner to the original equipment manufacturers and as a trusted provider of systems engineering experience and technology test and evaluation advice to the MOD

The publication of the UK Defence Technology Strategy in October 2006 set out the vital importance of defence research in the provision of defence capability in current and future operations The detail of this publication provided insight into the UK Government's military technology priorities and how to respond effectively to these The Government's concern about the need for appropriate sovereignty confirms the strategic importance of QinetiQ's capabilities

The MOD continues to introduce competition into its research programme QinetiQ's level of assured research work from the MOD dropped again this year, as expected, and the programme will be fully open to competition in 2008 The Company has an excellent track record of winning work in competition and the overall impact to date of the introduction of competition is much as anticipated QinetiQ's extensive network within universities and SMEs positions the Group to meet the MOD's desire to draw knowledge and technology from the wider science base in delivering research programmes

The MOD continues to utilise outsourcing, partnering and managed services arrangements to deliver improved defence services in support of the front line QinetiQ s position as preferred bidder and provisional preferred bidder for the two UK Defence Training Rationalisation (DTR) programmes provides the opportunity for significant growth of our technology enabled managed services operation building on the existing 25 year Long-Term Partnering Agreement (LTPA) commenced in 2003 and the smaller Combined Aerial Target Service (CATS) contract won in 2006

US defence

The US budget for fiscal year 2008 includes $481 billion for the Department of Defense and over $140 billion to support the 'Global War on Terror' Addressable DoD budgets are expected to grow by 3-4% per year from fiscal year 2008 to 2012 QinetiQ is well positioned to benefit from Congress' reluctance to support large, expensive programmes in favour of current ground force fighting needs in Iraq and Afghanistan DoD spending trends are strongly in favour of technology development for new missions and expanded professional services opportunities

There are several drivers of demand for QinetiQ North America's services including

- The White House performance management agenda increases emphasis on improved performance through leveraging competitive sourcing
- Declining federal workforce due to high rates of retirement and attrition necessitates obtaining expertise from outside contractors
- Continued overseas military deployments create increased demand for technical support to military personnel
- The move towards multi-year flexible contracting arrangements to meet evolving agency requirements QinetiQ has improved its position through the acquisition of selected companies with a wide portfolio of flexible contract vehicles in place

The federal IT services market has been subject to pressures in the basic management services and similar commodity services QinetiQ's offerings in this market are highly technical and rely on excellent customer relationships and a strong cadre of security-cleared employees The business is well placed within the more robust, high end of this market place

Security and counter terrorism

Governments across the world have increased their spending on homeland security, intelligence and counter-terrorism as a reaction to the emergence of new, rapidly evolving local and global threats

There is a growing focus on heightened security in public spaces such as large events and public transport There is also a large commercial market, in particular for IT security Much of the demand will be satisfied through the effective use of high technology solutions and intelligence services

Within the UK the 2012 Olympics is likely to boost demand for security products and services In the US QinetiQ has acquired the businesses of Analex and ITS to complement the existing security services provided by the North American operations and build on existing relationships within the intelligence community

Other international markets

QinetiQ provides services across other EMEA defence markets, principally from its UK operational bases These markets are experiencing similar pressures to those affecting QinetiQ's core UK and US markets QinetiQ's technology provides cost savings and innovative performance enhancements The success of technologies such as TALON® robots and Shark® electronic surveillance gives credibility to QinetiQ's offerings, and our experience in operating efficient test and evaluation capability in the UK is gaining international attention As these markets mature and their local manufacturing capabilities improve there will be a greater need for the technical consulting support and testing services offered by QinetiQ

Trend/forecast in UK defence spending
UK defence budget £ billions

Source MOD management estimates

Note UK fiscal years ended 31 March

Trend/forecast in US defence spending
US defence budget $ billions

Source DoD management estimates

Note US fiscal years ended 30 September

Business review continued

Principal risks and uncertainties

The Group's operations are exposed to a number of risks and uncertainties, the principal of which are described below.

Market competition
The defence and security markets are highly competitive The Group places great importance on the capabilities of its staff and their track record for delivering innovative solutions to complex customer requirements QinetiQ's expertise and capabilities provide a compelling proposition for customers, which is a significant advantage for the Group in competitive bidding In addition QinetiQ's long standing relationships with its customers, coupled with the investment made to sustain and enhance these, provides QinetiQ with a deep understanding of its customers' needs and how to respond to them

Significant proportion of revenue is derived from the US and UK Governments
83% of revenue is derived from contracts with the US and UK Governments This revenue is spread over many government agencies including the individual armed forces that comprise the MOD and DoD, together with other non-military agencies such as the US Department of Homeland Security, NASA, other security and intelligence agencies and the UK Highways Agency Within these agencies there are typically many distinct customer relationships and contracts which provide further mitigation of any dependence on a single customer With the exception of the LTPA no single UK contract or US task order with any part of the UK or US Governments is individually material to the Group QinetiQ monitors and directly discusses customer satisfaction to ensure excellent performance with key customers The Group s increasing number of US and UK Government orders reflects the Group's continued good relations with these customers

Dependence on governmental defence and security spending levels
A reduction in UK and US Government defence and security spending could adversely impact the Group Current UK and US defence and security spending forecasts do not indicate budget reductions but the focus of spending within the budgets will change to meet emerging needs The asymmetric nature of modern warfare and current high threat level from terrorism have resulted in increasing expenditure on capabilities that QinetiQ offers QinetiQ is positioned in important focus areas of defence and security spending per the MOD Defence Industrial Strategy, MOD Defence Technology Strategy and DoD Quadrennial Defence Review The Group will continue to review trends in defence and security expenditure in order to align the business with those trends

QinetiQ's broad reach across the defence spectrum ensures that any single delay or cancellation of a new or replacement defence platform in the UK or US defence budgets would not materially impact the Group As a technology specialist, QinetiQ is well positioned to benefit from any delay or cancellation as this will often lead to the requirement for technology insertion and upgrades to extend an existing platform's operational lifespan

The regulatory environment may adversely change
The Group's operations deal with sensitive defence and security technologies and revenue generation could be affected by changes in the geographical markets in which it can operate, or restrictions on technology transfer The majority of revenue is derived from domestic sales of services and products within the UK and US and is therefore largely unaffected by export controls and other such restrictions QinetiQ's ability to export outside of these jurisdictions is subject to export controls and other regulations and significant changes in the regulatory environment may limit QinetiQ's ability to expand into other export markets The Group has formal procedures in place to ensure that it meets all current export regulations

Significant change in demand from current campaigns in Iraq and Afghanistan
QinetiQ's overall performance in recent years has not been significantly reliant on the current allied operations in Iraq and Afghanistan While individual operating units, such as QNA's Technology business, have experienced high levels of demand for products such as the TALON® robot to help counter the threat of Improvised Explosive Devices (IEDs) other parts of the business have been subject to budgetary pressures such as services to improve the efficiency of government processes In the event of a reduction in the level of operations in Iraq and Afghanistan it is expected that such expenditure will resume

Opening of MOD research market to competition
As the MOD opens its research programme to competition, the proportion of MOD research orders the Group receives on a non-competed basis is decreasing By April 2008 all of the elements of the research programme available to industry will be let on a competed basis QinetiQ continues to win in excess of 50% of MOD research bids for which it competes, but expects its MOD research revenue to continue to decline over the next two to three years as existing contracts expire As the MOD research programmes have been opened to competition the Group has made good progress in growing into the technology supply markets To date the reduction in MOD research revenue has been broadly offset by growth in technology supply and this trend is expected to continue

Reliance on single large contract

In the current year the LTPA directly contributed 15% of Group revenue and supported a further 8 2% through tasking services using LTPA managed facilities These percentages are falling as the Group grows The Group continues to achieve high customer performance and satisfaction ratings, maintain excellent relations with the customer and anticipates that the contract will continue to run for the full duration of its initial 25-year term through to 2028 The first break point in the contract is 2013 QinetiQ's performance is regularly monitored across a number of key performance indicators QinetiQ achieved a weighted performance rating of 94% for the year ended 31 March 2007 and earned a performance bonus on this contract The loss, cancellation or termination of this contract would have a material adverse impact on the Group's future reported performance

Acquired businesses fail to perform as expected

QinetiQ has grown its North American business both organically and through acquisitions Detailed processes exist to conduct appropriate due diligence and integration planning to ensure the business is a robust and well managed concern The Group focuses on acquiring well established companies where the management and business have demonstrated a strong track record of delivery There is a risk with any acquisition programme that an acquisition may not perform as expected once under new ownership and a significant downturn in the post acquisition performance of one or more of the acquired businesses could have a material adverse impact on the Group's trading performance

Defence Training Rationalisation (DTR) programme is not brought to financial close

In January 2007, Metrix, the Group's joint venture with Land Securities Trillium was confirmed as the preferred bidder for Package 1 and the provisional preferred bidder for Package 2 for the proposed 25 year DTR contract to outsource technical training for the UK Armed Forces Currently the Group is working with the MOD to address the customer's affordability issues on Package 2 and to refine the final scope for both packages as the next stage in moving to financial close The Group anticipates that financial close will occur no earlier than late 2008/early 2009 DTR is expected to generate a significant level of revenue and profit once it is operational There is a risk that the MOD may materially change the final scope or delay or cancel the implementation of the programme, which would have a significant affect on the future expected growth of the Group Additionally, were financial close not to be reached on the DTR contract, the bid costs incurred, since preferred bidder status was achieved would need to be expensed through the income statement

Volatility in foreign exchange rates

The Group is exposed to volatility in foreign exchange rates due to its international operations The Group has limited transactional foreign exchange exposure as most of its revenues and related costs arise in the same currencies, principally sterling and US dollars The Group hedges all significant transactional foreign exchange exposure Foreign currency income statement and balance sheet translation risks are not fully hedged QinetiQ North America represents more than 30% of Group revenue and profit and a one cent movement in the dollar exchange rate has an approximate £2m impact on revenue and £0 2m on operating profit US acquisitions have been funded through US dollar borrowings thus partially mitigating the economic risk as US dollar earnings are used to service and repay US dollar denominated indebtedness

Defined benefit pension scheme deficit may increase

The Group s defined benefit pension scheme valuation is subject to market changes beyond the control of QinetiQ Actual returns achieved on assets may be lower than expected inflation could be higher than expected and life expectancy may rise faster than expected All these factors could contribute to the reported deficit increasing significantly beyond the current level The Group has made considerable additional contributions to the scheme in previous years to reduce the funding deficit over the long term Scheme member contributions have also been increased The Group has taken these actions in conjunction with the scheme trustees and continues to maintain an active dialogue with the trustees to seek to manage and contain the magnitude and volatility of the pension scheme deficit and its impact on the reported performance of the Group

The realisation of intellectual property value may be delayed

The funded research and development work the Group undertakes for defence customers creates intellectual property that the Group retains and can utilise for commercial applications Where opportunities exist the Group may seek to realise the value of the intellectual property through licence sales, development of new business streams or creation of spin-out ventures The uncertainty that exists over new technologies and markets may result in delays or failure to realise value from intellectual property The Group only invests in the development of intellectual property where it believes there is a substantial and realistic market opportunity for the technology and it undertakes a portfolio approach recognising that not all investments will be successful The performance of intellectual property realisation programmes is actively monitored to increase support for successful prospects and reduce expenditure where realisation appears less likely

Business review continued
Key performance indicators

To assess Group performance the Board uses a range of key performance indicators (KPIs) comprising both financial and non-financial metrics including

KPI	2007	2006	Comment
Organic revenue growth	2 3%	2 3%	The rate of organic growth in revenue
Proportion of revenue generated in North America	31 2%	23 6%	The Group aims to generate 50% of its revenue in the medium term from North America, through a combination of organic growth and acquisitions Organic growth in North American revenue was 14 2% in the year
Book to bill ratio	1 2 1	0 9 1	The ratio of orders to revenue to identify the rate of prospective growth in the business LTPA revenue is excluded from this calculation as no annual order is associated with this revenue The Group aims to achieve an average of at least 1 1 1 over the medium term
Backlog	£850 9m	£608 4m	The value of contractually funded future orders (excluding the LTPA) providing visibility over future revenues
Underlying operating profit margin	9 2%	8 6%	The percentage return on revenue achieved based on underlying operating profit The Group is targeting an underlying operating margin of 10 4% in the medium term
Underlying earnings per share growth	10 4%	16 3%	The rate at which underlying earnings per share increased over the prior year expressed as a percentage The entry point for Long-Term incentives provided under the QinetiQ Share Option Scheme equates to an average EPS growth rate of 7% per annum with full vesting achieved if the EPS growth rate equates to an average rate of 15% per annum
Total shareholder return	(2 3)%	n/a	The measure of total shareholder value creation (including dividends) each year expressed as a percentage of the value of the share price at the beginning of the year
Operating cash conversion	56%	84%	The percentage of underlying operating profit converted into underlying operating cash flow (after capital expenditure) The Group targets an underlying operating cash conversion rate of 80%
Health and safety of employees	3 47	3 85	Expressed as the number of RIDDOR (Reporting of Injuries, Diseases & Dangerous Occurrences) events in the UK in any period per 1 000 people Our target is to remain below the industrial average for all industries which was 5 63 for 2006 The average for Public Administration & Defence companies was 13 43 in 2006
Staff attrition rate	7 1%	5 8%	UK staff turnover (excluding redundancies) measured as the number of resignations expressed as a percentage of total headcount per annum

Group trading performance

Group summary

all figures in £ million	2007	2006	2005
Orders	1,214 0	816 7	668 3
Revenue	1,149 5	1,051 7	855 9
Underlying EBITDA[1]	140 5	124 5	104 3
Underlying operating profit[3]	106 0	90 7	65 2
Underlying operating margin	9 2%	8 6%	7.6%
Business divestments and investment impairment	4 6	–	17 1
Underlying profit before tax[4]	94 0	80 1	58 2
Net debt	300 8	233 0	176 6
Backlog[2]	850 9	608 4	572 0
Underlying effective tax rate	21%	23%	16%
Underlying earnings per share	11 3p	10 2p	8 8p
Dividend per share	3 65p	2 25p	nil

[1] Underlying EBITDA excluding IPO related items (2006) and restructuring (2005)

[2] Excluding remaining £4 8bn (2006 £5 0bn 2005 £5 2bn) in respect of LTPA contract

[3] Underlying operating profit is operating profit before acquisition amortisation IPO related items (2006) and restructuring (2005)

[4] Excluding business divestments investment impairment, disposal of non-current assets, acquisition amortisation IPO related items (2006) and restructuring (2005)

In February 2007 QinetiQ announced that it planned to create, from 1 April 2007, an EMEA (Europe, Middle East and Australasia) region to develop the Group's provision of its existing UK services globally The EMEA region comprises all of the Group's operations with the exception of QinetiQ North America and Ventures activities In order to identify the results covered by the EMEA region and to provide greater clarity on the development of commercial businesses from the defence technology base, the operating results of Ventures have been split out from within Security & Dual Use in the analysis below

Revenue

all figures in £ million	2007	2006	2005
Defence & Technology	657 9	669 6	664 9
Security & Dual Use	121 4	127 6	115 9
EMEA	779 3	797 2	780 8
QinetiQ North America	358 2	248 4	70 1
Ventures	12 0	6 1	5 0
Total	**1,149.5**	**1,051 7**	**855 9**

Group revenue increased 9 3% to £1,149 5m due primarily to acquisitions and organic growth in QNA. The overall level of organic growth in revenue in constant currency terms was 2 3% (2006 2 3%) The acquisitions of OSEC (May 2006) and Analex (March 2007) and the first time full year contributions from Apogen (September 2005) and PSI (September 2005) were complemented by organic growth in particular from Technology Supply (7 6%) within Defence & Technology (D&T) and from QNA (14%) at constant rates of exchange These increases in revenue more than offset the lower than anticipated reductions in MOD Research (8 4%), the non- recurrence of LCD patent royalty income in S&DU (£13m) and the effect of the weakening US dollar on the translation of the results of QNA (£28 9m compared to the level that would have been reported on a constant currency basis)

Orders

all figures in £ million	2007	2006	2005
Defence & Technology	650 8	420 7	472 6
Security & Dual Use	132 9	158 3	124 7
EMEA	783 7	579 0	597 3
QinetiQ North America	416 0	227 9	67 9
Ventures	14 3	9 8	3 1
Total	**1,214 0**	**816 7**	**668 3**

Backlog

all figures in £ million	2007	2006	2005
Defence & Technology[1]	520 0	366 6	410 0
Security & Dual Use	112 6	108 1	93 4
EMEA	632 6	474 7	503 4
QinetiQ North America	210 7	129 2	68 6
Ventures	7 6	4 5	–
Total[1]	**850 9**	**608 4**	**572 0**

[1] Excluding remaining £4 8bn (2006 £5 0bn, 2005 £5 2bn) in respect of LTPA contract

Orders have increased by 49% to £1 214 0m with strong performance from all sectors of the Group A 55% increase in orders was delivered within D&T, with the finalisation of the 20-year CATS contract (£104m) and the Typhoon support three year contract extension (£53m) particularly notable The continued high levels of funding for TALON® robots and robust funding for SETA work, together with the benefit of acquisitions in the prior and current year, has increased order levels in QNA by 97% in constant currency terms

The Group s strong orders performance has resulted in a book to bill ratio (excluding the LTPA) of 1 2 1 (2006 0 9 1)

Backlog increased by 40% from £608 4m to close at £850 9m LTPA backlog at 31 March 2007 stood at £4 8bn (2006 £5 0bn) The increase was primarily in D&T where the CATS contract added £104m to backlog and in North America where backlog has risen in all operating units There has also been an additional £44 6m of backlog added from the acquisitions of Analex and OSEC

Business review continued
Group trading performance continued

Underlying operating profit

all figures in £ million	2007	2006	2005
Defence & Technology	59 1	56 5	51 3
Security & Dual Use	13 9	17 2	15 9
EMEA	73 0	73 7	67 2
QinetiQ North America	39 9	24 5	8 0
Ventures	(6 9)	(7 5)	(10 0)
Total	**106 0**	**90 7**	**65 2**
Underlying operating profit margin	9 2%	8 6%	7 6%

Underlying operating profit has increased by 17% to £106 0m due to the benefit of the acquisitions noted above, organic growth in QNA and margin improvements within underlying operations, despite the impact of the weakening US dollar on the translation of QNA operating profits On a constant currency basis, using the average rate for the prior year QNA would have contributed an additional £2 9m of operating profit Underlying operating profit includes charges for UK rationalisation of £8 0m (2006 £9 4m)

Underlying operating margin has improved in the year by 60 basis points to 9 2% (2006 8 6%), driven by further improvements in existing business performance and benefiting from the increased contribution from QNA whose operations are typically higher margin than the EMEA businesses

Finance costs

Net finance costs increased by £1 4m to £12 0m (2006 £10 6m before IPO related MOD indemnity income) due to the increase in acquisition related debt partly offset by the proceeds from the IPO in February 2006 and the prior year redemption of high cost preference shares The interest cover ratio, measured as underlying EBITDA net finance costs was 11 7 times (2006 11 7 times before IPO related MOD indemnity income)

Profit before tax

Profit before tax, non-recurring items, disposals and acquisition amortisation increased by 17% from £80 1m to £94 0m The growth included the benefit of the acquisitions in the year of OSEC and Analex and a full year of trading results for Apogen, PSI and Verhaert The acquisitions made in the current year contributed £1 6m of profit before tax and the full year effect of acquisitions made in the prior year contributed an incremental £4 5m of profit before tax to the current year

Tax

The effective tax rate was 23% (2006 17%) The underlying effective tax rate for the year is 21% compared to 23% in the prior year The Group's effective rate continues to be below the statutory rates in the UK primarily due to the benefit of research and development relief The US effective rate is a little above the US statutory rate due to the US State tax mix The effective rate is expected to rise as an increasing proportion of taxable profits arise in the US This more than offsets the benefits from the March 2007 UK Budget which further enhanced research and development relief and reduced the UK corporation tax rate to 28% from April 2008

Profit for the year

The underlying performance of the Group, after allowing for non-recurring events and amortisation of acquired intangible assets, is shown below

all figures in £ million	2007	2006
Profit for the year	69 0	60 4
Minority interest	–	(2 3)
Profit for the year attributable to equity shareholders of the parent company	69 0	58 1
IPO related items	–	4 2
Gain on business divestments and unrealised impairment of investment	(4 6)	–
Profit on disposal of non-current assets	(3 3)	(8 9)
Amortisation of intangible assets arising from acquisitions	12 6	12 3
Tax impact of items above	0 4	(0 7)
Brought forward tax losses utilised	–	(5 4)
Underlying profit for the year attributable to equity shareholders of the parent company	**74 1**	**59 6**

Non-recurring items that have been excluded from underlying profit relate to gain on business divestments and investment impairment, costs associated with the IPO in the previous year and profit on disposal of non-current assets principally surplus property

Earnings per share

Underlying earnings per share increased by 10 4% to 11 3p compared to 10 2p in the prior year Basic earnings per share increased 5 3% from 10 0p to 10 5p

Dividend

The Board is recommending a final dividend of 2 45p per share bringing the total dividend for the year to 3 65p per share, with the final dividend increasing 8 9% from the 2 25p maiden final dividend paid in respect of the year ended 31 March 2006 The full year dividend per share is 3 1 times covered by underlying earnings per share

Outlook

The Group has maintained the strategy it outlined at IPO and performed in line with the Board's expectations The UK defence business is expected to show improved levels of growth in the coming year The Group will actively continue its strategy to commercialise appropriate elements of its intellectual property base and look to structures and resource allocations that will accelerate and enhance value creation from the portfolio Growth in QNA is anticipated both organically and from the recently completed acquisitions of Analex and ITS The Group continues to target selective acquisitions in its key markets to complement and expand its capabilities as a technology-rich defence and security services provider

EMEA – Defence & Technology

all figures in £ million	2007	2006	2005
Revenue			
MOD Research	150 5	164 3	188 8
Technology Supply	133 7	124 2	96 9
Procurement & Capability Support	182 6	197 3	182 3
Managed Services	191 1	183 8	196 9
Total	**657 9**	**669 6**	**664 9**
Underlying operating profit	59 1	56 5	51 3
Underlying operating margin	9 0%	8 4%	7 7%
Orders			
MOD Research	164 5	99 8	202 5
Technology Supply	153 0	137 3	98 3
Procurement & Capability Support	214 0	177 1	171 8
Managed Services	119 3	6 5	–
Total	**650 8**	**420 7**	**472 6**
Book to bill ratio	1 3 1	0 8 1	1 0 1
Backlog	520 0	366 6	410 0

Share of Group revenue

Share of Group underlying operating profit

Operations

Preferred bidder on DTR Package 1 and provisional preferred bidder on DTR Package 2 awarded to Metrix, a QinetiQ joint venture with Land Securities Trillium

Combined Aerial Target Service (CATS) contract signed Worth up to £308m over 20 years

Typhoon programme contract extension signed to provide £50m of defined technical support, advice and safety clearance activity, together with £2 5m allocated to sub-contracts and future emergent work over three years

World's first flight demonstration of a system capable of controlling and autonomously organising multiple unmanned aircraft The successful flight trial consisted of a package of self-organising unmanned aerial vehicles under the control of an operator flying in a fast jet.

Contract from Northrop Grumman's Remotec UK subsidiary to design and manufacture the command and control systems for the MOD CUTLASS robotics programme CUTLASS will provide the next generation of explosive ordnance disposal (EOD) unmanned ground vehicles

£9 5m MOD research contract to deliver the Vehicle Technology Integration Demonstrator programme The three-year programme will investigate and implement a layered protection approach to survivability for armoured vehicles to reduce their vulnerability to attack.

2,000th X-Net® vehicle arresting device sold in year X-Net® have generated revenue in excess of £3 5m

£10 5m weapons systems upgrade programme on the Philippine Navy's three Jacinto Class Patrol Vessels completed on time and to budget

QinetiQ Rail Limited sold resulting in a £2 8m profit

Financials

Revenue increased by 7 6% in Technology Supply broadly offsetting the continued impact of MOD Research opening to competition

Restructuring costs of £8 0m (2006 £4 4m) to align D&T capabilities with market requirements

Underlying operating profit margin improvement of 60 basis points to 9 0%.

Strong orders performance in year resulting in book to bill ratio of 1 3 1 (2006 0 8 1)

Backlog including remainder of LTPA £5 3bn (2006 £5 4bn)

Business review continued
EMEA – Defence & Technology continued

MOD Research
The MOD Research stream consists of customer-funded defence research revenues QinetiQ has retained its position as the leading independent provider of research services to the MOD and continued to win in excess of half of the competed MOD research bids in which it participated, resulting in a lower than expected 8 4% (2006 13 0%) decline in stream revenue to £150 5m Order flow into MOD Research has been stronger than expected at £164 5m including a number of awards for multi-year programmes The strong win rate has given rise to a book to bill ratio of 1 1 1 The MOD continues to increase competition in its research programme and by the end of 2008 new contracts available to industry will be fully open to competition Group revenue from MOD Research is therefore expected to continue to decline in the coming years

The Group also conducts elements of MOD Research through the divisions in the Security & Dual Use sector The total value of MOD research undertaken across the Group declined by 10 7% to £172 4m (2006 £193 1m)

Technology Supply
The Technology Supply business stream focuses on using intellectual property from customer-funded defence research to provide technology-based solutions to defence Original Equipment Manufacturers (OEMs), defence prime contractors, MOD and other UK Government agencies US DoD and a number of technology-driven civil industries QinetiQ has been successful in continuing to gain positions on new and existing major MOD programmes although delays by the MOD in placing major procurement contracts resulted in revenue growth lower than expected at 7 6% in year to £133 7m (2006 £124 2m) Order intake of £153 0m resulted in a book to bill ratio of 1 1 1, providing good visibility for continued future growth

On 5 March 2007 QinetiQ Rail Limited a subsidiary specialising in wireless broadband for the rail industry, was sold for consideration of £4 5m in shares in the acquiring company Nomad Holdings Limited (Nomad), representing an 8 6% shareholding in Nomad The transaction resulted in a net gain of £2 8m

Procurement & Capability Support
Procurement & Capability Support provides advice to the MOD in relation to the acquisition, effective sustainment and use of defence equipment together with systems engineering, integration and other support services and tasking services under the LTPA Revenue in year declined by 7 5% to £182 6m principally due to delays in commissioning work by the MOD and lower levels of Urgent Operational Requirements (UORs) This was partly offset by the high level of tasking work undertaken in the year which rose by 23% from £63 3m in 2006 to £77 6m in 2007 The order flow from the MOD was stronger in the final quarter of the year providing good order cover into the next year

Sensing success
QinetiQ sensor technology will enable UK forces to better detect, recognise, identify and engage the enemy in close combat through a £7 5m contract awarded by the MOD

Virtual training across the globe
MOD aircrews are trialling new flight simulator technology devised by QinetiQ and Boeing as part of a £7 8m project The technology could allow forces to train simultaneously in virtual reality around the world

Managed Services
Managed Services provides long-term technology-rich managed services to the MOD Currently this is principally through the LTPA whereby QinetiQ provides the UK's test and evaluation capabilities to the MOD The LTPA is QinetiQ's single largest current contract and is expected to provide revenues of up to £5 6bn (for the non-tasking services only) over the 25 years from its commencement in 2003 The LTPA operates under five-year periods with specific programmes, targets and performance measures set for each period As QinetiQ enters the fifth year of the contract it has again increased its performance score under the contract from 92% in 2006 to 94% in 2007 During the coming year QinetiQ and the MOD will finalise the nature of any refinements to the scope, specific changes to targets and agree relevant performance metrics and pricing for the next five year period which is due to commence in April 2008

During the year the Group reached financial close on the Combined Aerial Target Service (CATS) contract which is worth up to £308m over the next 20 years This contract enhances the service already provided under the LTPA and is expected to provide £104m of incremental revenue to the Group over the duration of the contract

Defence Training Rationalisation programme
In January 2007, the MOD announced that Metrix, QinetiQ's joint venture with Land Securities Trillium, had been selected as the preferred bidder for Package 1 and provisional preferred bidder for Package 2 of the 25-year DTR managed services contract to provide the UK Armed Forces with elements of their technical training programme Package 1 primarily comprises technical training, including aeronautical engineering and communications and information systems Package 2 incorporates logistics, joint personnel administration, security languages, intelligence and photography as well as supply training Negotiations are ongoing with the MOD to refine the scope of the packages to address customer affordability The target remains to agree the final scope by Autumn 2007, with financial close expected 12 to 18 months thereafter

Since attaining preferred bidder and provisional preferred bidder status bid costs have been capitalised Up to £25m of costs are expected to be capitalised during the next 12 months

EMEA – Security & Dual Use

all figures in £ million	2007	2006	2005
Revenue			
Security	26 8	27 2	22 1
Space	20 7	25 5	17 9
Technology Development & Exploitation	46 3	49 1	53 5
Managed Services	27 6	25 8	22 4
Total	**121.4**	**127 6**	**115 9**
Underlying operating profit	13 9	17 2	15 9
Underlying operating margin	11 4%	13 5%	13 7%
Orders			
Security	29 6	32 8	25 2
Space	20 1	18 7	12 5
Technology Development & Exploitation	51 6	66 4	55 9
Managed Services	31 6	40 4	31 1
Total	**132 9**	**158.3**	**124 7**
Book to bill ratio	1 1 1	1 2 1	1 1 1
Backlog – funded	112 6	108 1	93 4

Share of Group revenue

Share of Group underlying operating profit

Operations

Secured a two-year $5m research contract from the DARPA in support of its Large Area Coverage Optical Search While Track and Engage (LACOSTE) programme The concept is to develop a suite of sensors that can be operated at high altitude, possibly on an airship or long endurance UAV, that detect and simultaneously track large numbers of moving vehicles in dense urban areas with a high degree of accuracy, 24 hours a day

Won a £1 6m, three-year secure hosting contract for Aegate to keep sensitive information, generated as part of a drug authentication process, secure and confidential

Awarded a two-year contract extension worth £7m to continue the provision of technical support to the MOD's Defence Fuels Group (DFG) for fuels and lubricants

Announced as preferred bidder on a 10-year contract to operate an ESA tracking station

Partnered with Advantage West Midlands in a £20m advanced sensors project which will assist SMEs in the development and integration of advanced sensors

Financials

S&DU revenue declined slightly, following the completion of LCD patenxt royalty income in the prior year (£13m) Underlying growth excluding the LCD royalties was 5 9%

£2 8m of revenue was generated through a number of smaller transactions to licence or dispose of surplus intellectual property in the Group's portfolio

Underlying operating profit margin declined from 14% to 11% reflecting the cessation of LCD royalties, partially mitigated by the revenue generated from the smaller licence transactions and a £2 5m reduction in rental income following the sales of surplus property in recent years

The absolute margin continued to benefit from strong performance by the Estates division within Managed Services

The sector orders were strong at £132 9m and continued to support future growth with a book to bill ratio of 1 1 1

Orders won typically had an average value of around £0 1m complemented by approximately 30 contracts in excess of £1m each

Business review continued
EMEA – Security & Dual Use continued

Security
The Group's Security stream offers world-class capabilities in information security and assurance physical security, people screening, 24-hour monitoring of complex networks forensic work in law enforcement and specialised IT security and security technology Revenue in the year was broadly consistent with the prior year We have made certain management changes to drive a return to growth

Space
The Group's Space stream is a leading European player in the development of ion engines, small low cost, fast-to-launch satellites, and mission design and geospatial information systems The nature of the industry is one of large individual projects which in turn can result in an irregular sales profile which was evidenced in 2007 with a £4 8m reduction in revenue despite the inclusion of a full year contribution from Verhaert. The business is working an expanded pipeline of opportunities with customer decisions expected in the coming year

Technology Development & Exploitation
The Technology Development & Exploitation stream delivers research and development offerings from its leading Optronics, Materials and Energy technical capabilities In addition it facilitates the transition of intellectual capital generated from QinetiQ's funded technology research and development work into a viable range of products and solutions for the commercial marketplace Applications include optical devices and portable power units Revenue declined by only £2 8m despite the loss of the LCD royalty revenue, as a result of strong growth in Optronics and further sales of intellectual property not selected for internal exploitation generating £2 8m of licence revenue

Managed Services
Managed Services offers a portfolio of services in areas such as fuel and lubricant testing and analysis instrument calibration and supporting technical services together with real estate, facilities and equipment management services The Estates division continues to be a very strong profit generator for the sector from the rental income on surplus property The property disposal programme is leading to a reduction in rental and other property income with the disposals over the past two years resulting in a £2 5m reduction in rental income in year Actions are also underway to seek alternative tenants for part of the Group's Farnborough site as dstl a significant sub-tenant, has indicated that it intends to consolidate its operations elsewhere although no formal termination notice has been received

A foot in the US market
Stride Rite, the leading US children's footwear retailer and manufacturer, has placed an order for QinetiQ's 3D foot gauge, a system designed to produce highly accurate foot measurements Foot gauges were trialled in three Stride Rite stores in the Boston area in November 2006. The trial units were retained by the customer and an order was placed for further units in February 2007

Speeding security
A QinetiQ security system has been used to screen for explosive devices on passengers boarding the Staten Island Ferry at the St. George Terminal in Staten Island in New York SPO-20 is a security screening system designed to detect explosive devices concealed under people's clothing without asking passengers to slow their pace as they approach the point of entry

Thermal imaging
QinetiQ's thermal imaging work received a boost, as part of a team that won an £8 4m contract from the MOD to develop world-class high performance Thermal Imaging (TI) technology for a wide variety of military applications

QinetiQ North America

	2007 £m	2006 £m	2007 $m	2006 $m	Organic growth at constant currency[1] %
Revenue					
Technology	126 9	82 9	242 5	146 9	42 0%
SETA	98 5	105 3	188 3	187 5	(1 6)%
IT Services	128 5	60 2	246 1	105 3	0 4%
Mission Solutions	4 3	–	8 4	–	
Total	**358 2**	**248 4**	**685.3**	**439 7**	**14.2%**
Underlying operating profit	39 9	24 5	75 8	43 4	
Underlying operating margin	11 1%	9 9%	11 1%	9 9%	
Orders					
Technology	147 4	73 2	279 6	129 6	
SETA	128 0	97 4	244 5	172 6	
IT Services	140 6	57 3	269 6	100 2	
Total	**416 0**	**227 9**	**793 7**	**402 4**	
Book to bill ratio	1 2 1	0 9 1	1 2 1	0 9 1	
Backlog	210 7	129 2	413 0	223 5	

[1] Organic growth reflects the growth in businesses that were part of the Group at the start of the financial year

Share of Group revenue

Share of Group underlying operating profit

Operations

The MOD placed a $10m order for the supply of LAST® Armor for 85 Mastiff Protected Patrol Vehicles.

New $63 9m indefinite delivery/indefinite quantity (IDIQ) contract from NAVAIR for TALON® robots and spares of which $54m was funded in year An extra $77m of funding released against the six-year, $257m IDIQ contract from NAVSEA announced in September 2005

IT Services was awarded the Field Operations Authoring Support contract by the US Department of Commerce in support of the Census Bureau The $6 8m contract is to provide programming tools used in development of computer-assisted interviewing systems that enable the Census Bureau to conduct research for multiple federal agencies

IT Services was awarded three contracts worth a total of $11 3m with the Marine Corps System Command Acquisition Center for Support Services unit to provide engineering, technical, acquisition and logistics support services

Systems Engineering & Technology Assistance (SETA) won a contract to provide test support services to the US Army Aviation Technical Test Center under a five-year contract valued at more than $21m for planning, conducting, analysing and reporting on the development and airworthiness qualifications of aircraft, aviation systems, and associated equipment throughout their life cycles

In June 2006 Duane Andrews was appointed CEO of QNA. Duane was previously COO of SAIC and has also worked extensively for the US DoD

Three acquisitions were announced in year Ocean Systems Engineering Corporation (OSEC) ($53 7m – completed May 2006), Analex ($193 6m – March 2007) and ITS Corporation (ITS) ($80m – April 2007)

With the addition of Analex a fourth revenue stream of Mission Solutions has been established

Year end headcount has risen to 4,258 (2006 2,640) including 1,411 from the acquisitions of OSEC and Analex ITS added a further 700 staff in April 2007

Financials

Revenue increased 44% to £358 2m or 56% in constant currency to $685 3m 2007 included first time contributions from OSEC and Analex and full-year contributions from Apogen and PSI

Revenue growth from acquisitions was complemented by organic growth of 14 2% on a constant currency basis

The SETA stream without the contributions of Aerospace Filtration Systems (AFS) delivered organic revenue growth of 10%

Underlying operating margin, excluding business realisations, has improved 120 basis points to 11% primarily driven by the strong TALON® product sales in Technology

All QNA streams won orders significantly higher than the previous year and the sector book to bill ratio was 1 2 1

Business review continued
QinetiQ North America continued

Acquisitions and disposals
On 15 May 2006 the Group acquired San Diego based OSEC for a cash consideration, before acquisition costs and assumed net cash, of £28 2m ($53 7m) OSEC is a leading provider of research design development and integration of advanced information technology systems to key defence agencies in the US with some 340 staff OSEC has performed in line with expectations, and delivered £25 0m ($48 1m) of revenue and £2 1m ($4 1m) of operating profit since acquisition

On 14 March 2007 the Group acquired Analex for a cash consideration, before acquisition costs and assumed cash of £98 8m ($193 6m) Analex's 1,100 employees provide high technology professional services mainly to US Government agencies Analex has delivered £4 3m ($8 4m) of revenue and £0 6m ($1 1m) of operating profit since acquisition

Subsequent to the year end, on 16 April 2007, the Group acquired ITS for an initial cash consideration of £40 8m ($80 0m) ITS specialises in IT systems, business process management and operational support to federal government customers including the US Army, Navy and Department of Homeland Security

The Group disposed of its high performance engine inlet barrier AFS business on 28 February 2007 for £19 9m ($39 0m) to Donaldson Inc The disposal allowed the Group to realise the value from the AFS technology and business at an appropriate stage in its development A profit of £9 9m ($19 4m) has been recognised on disposal

Technology
The Technology stream provides high technology research services and defence and security related products to the US DoD, other government agencies and commercial customers in North America Specialisms in this stream include advanced materials, biomedical technology, robotics, electromagnetics, sensors, thermal systems, human performance, embedded software, non-destructive inspection & evaluation and diagnostics & prognostics

Revenue grew organically by 42% as the strong demand for TALON® robots continued and additional LAST® Armor orders were won During the year the Group recorded $111 6m of TALON® revenue and shipped 546 TALON® robots including the first to non-US customers A book to bill ratio of 1 2 1 supports a positive outlook for the coming year, albeit that the rate of growth is expected to moderate

Systems Engineering & Technical Assistance
The Systems Engineering & Technical Assistance stream provides independent support for the procurement, development, modification, fielding and sustainment of major army and missile defence equipment in North America

Revenue was flat on prior year due to the $19 2m fall in revenue from AFS to $11 8m (2006 $31 0m) The continuing business grew 10 1% primarily due to logistics services and the delivery of a number of aircraft flight simulation solution installations

IT Services
The IT Services stream offers high value-added capabilities including enterprise architecture software development and systems integration, network engineering and operations energy and environmental engineering and programme management to US Government agencies, particularly to the US DoD and DHS

Revenue growth occurred through the acquisition of OSEC and the full year contribution of Apogen Growth in Apogen, in common with others operating in the market was held back by delays in new staff receiving security clearance to work at the DHS, which has continued to delay the commencement of revenue generation from new contracted positions won in the year When combined with the expected loss of contracts previously awarded under US small business set aside rules, this resulted in Apogen s revenue being flat year on year The stream delivered a good order intake, resulting in a book to bill ratio of 1 1 1

Mission Solutions
Following the acquisition of Analex in March 2007 a new business stream, Mission Solutions, has been created comprising Analex and from 1 April 2007 elements of OSEC The business has capabilities principally in information technology, mission assurance and operations, system design, engineering and integration, system and programme security, intelligence and counter-intelligence support, enterprise systems engineering and integration and other consulting services requiring specialised customer or mission knowledge

Mission Solutions is focused on high margin/high growth markets such as intelligence and security with customers largely drawn from the US Government, particularly NASA and the DHS directly or through commercial subcontracts

In the year to 31 December 2006 Analex reported revenue of £78m and operating profit of £5 4m

TALON®
QinetiQ shipped over 500 TALON® explosive ordnance disposal (EOD) robots in the year bringing the total cumulative shipments to over 1,000 The first European order was received during the year from the Royal Netherlands Army for immediate deployment to Afghanistan

PADS
The Precision Airdrop System (PADS) is being successfully used in Afghanistan by the US Air Force to re-supply troops from high altitude drops with pinpoint accuracy

Ventures

all figures in £ million	2007	2006	2005
Revenue	12 0	6 1	5 0
Operating loss	(6 9)	(7 5)	(10 0)
Orders	14 3	9 8	3 1
Backlog	7 6	4 5	–

Sciemus

QinetiQ is to provide a new round of technical advice on spacecraft reliability and risk analysis to Sciemus, a UK based company, in which QinetiQ holds a 10% investment, that is revolutionising the space insurance market The contract covers the operation, licensing, maintenance and continued development of QinetiQ's Space Risk Assessment Tool (SpaceRAT™) and is worth £0 7m over three years

Building on its success in the satellite insurance market, Sciemus will also draw on QinetiQ's expertise to develop risk analysis models in cyber security power generation, UK property and other sectors where underwriters have traditionally faced significant challenges when assessing risk

Operations

Tarsier® runway foreign object detection system

- first installation at Vancouver International airport now operationally live,
- second installation at Dubai International airport delayed pending completion of groundworks but expected to be complete in the second quarter of the coming year,
- extended evaluations being installed at London Heathrow airport and with the FAA at Providence, Rhode Island airport, and
- winner of top award for defence to civil technology transfer at Defence Technology Exchange Awards

Licensed the ZephIR® laser anemometer technology for wind speed detection to Natural Power, a leading consultant to the international renewable energy industry, for £2 5m

Sale of 12% stake in Aurix to strategic licensing partner values Aurix at £9m

Successful fund raising round for ZBD Displays in March 2007 into which QinetiQ invested an additional £3 5m as part of the total £10 5m funding round QinetiQ increased its stake in the company by 1 2% to hold 32% following its total £4 4m investment in the year and saw the value of its investment increase by £6 1m

Extensive trials continuing with UK and European retailers Tesco, Dixons, Metro and PC World for ZBD displays

Omni-ID™ signed agreement with Crown Packaging to develop low cost RFID packaging solution

Initial export orders for Quintel mobile telephone antenna sharing equipment

Invested in development of new US focused product in Quintel

Financials

Ventures revenue has doubled as a number of the businesses and technologies progressed into initial revenue generating phases, including a strategic licensing agreement for ZephIR® and the initial Tarsier® revenue in respect of Vancouver

Stream losses temporarily decreased due to the ZephIR® licensing revenue offsetting increased marketing costs to push products to greater levels of customer awareness (principally Tarsier®) and further product development, particularly a new US focused product in Quintel

Investment in Ventures is expected to increase by up to £5m in the coming year to support accelerated development of promising opportunities such as Aurix and Omni-ID™

QinetiQ continues to explore a variety of routes to accelerate value creation from the ventures, with a drive to inject more management and financial resource, and to find valuable partners to help take products to market

This will allow greater management and investment focus on accelerating the growth of individual ventures while allowing the Group to focus on bringing forward new venture opportunities

Business review continued
Other financials

Cash flow
Cash inflow from operations before investing activities was £107 0m (2006 £107 6m) The UK business experienced delays in the award of contracts from the MOD during the year leading to a build in working capital at the year end of approximately £20m This position has reversed in the new financial year This contributed to an operating cash conversion of 56% compared to 84% in 2006 and the Group's long-term 80% target

Investment in acquisitions in the year amounted to £134 3m (2006 £202 5m) comprising £96 4m for Analex, £28 6m for OSEC and £9 3m of deferred consideration relating to prior year acquisitions, principally Westar, following the satisfaction of post acquisition performance criteria Other investments totalled £9 4m (2006 £1 2m) the most significant of which were further funding of £4 4m for ZBD £2 1m for Metalysis and £1 5m for Nomad £17 9m of proceeds were received from business realisations (primarily the AFS sale) and £8 6m from fixed asset disposals

The Group paid £3 3m of tax in the year, all in the US The payment was below the US statutory rate due to the utilisation of tax losses and higher than required payments on account in the prior year In the UK no cash tax was paid due to the availability of deductions for research and development relief and pension contributions made in the year to 31 March 2006

The Group expects that future tax payments in the US will broadly follow the US statutory rate In the UK the business is not expected to be in a tax paying position in the short to medium term as the Group continues to benefit from deductions for research and development relief and past pension contributions

Dividend payments of £22 7m were made in the year comprising the final dividend of £14 8m for the year ended 31 March 2006 (paid in August 2006) and an interim dividend of £7 9m (paid in February 2007)

Net debt and liquidity
At 31 March 2007 net debt was £300 8m representing an increase of £67 8m in the year Net debt was principally denominated in US dollars and consequently the 12% weakening of the US dollar sterling exchange rate in the year from $1 73 at the start of the year to $1 96 at 31 March 2007 resulted in a £30 2m exchange gain on the translation of net debt in the year

In August 2006 the Group extended its five year, £500m revolving credit facility (RCF) by a further year to August 2011 On 6 December 2006 the Group completed a private debt placement with US financial institutions to refinance $260m of existing debt This was secured at favourable interest rates and provides longer debt maturity profiles of 7 years for $135m and 10 years for $125m The Group had £319 9m of further borrowing capacity at 31 March 2007 on the basis of the unutilised element of the RCF The Group operated comfortably within its banking covenants during the year

Maturity profile of Group borrowings

Capital expenditure and fixed asset disposals
Property plant and equipment expenditure totalled £34 8m (2006 £45 0m), of which £16 9m (2006 £23 5m) related to assets which are funded as part of the LTPA contract The Group has future capital commitments of £13 2m (2006 £26 2m) largely in relation to planned capital expenditure under the LTPA Capital expenditure in the year ending 31 March 2008 is expected to be some £15 20m higher than in 2007 due to higher LTPA spend and new systems investment in the UK

Pensions
The Group provides both defined contribution and defined benefit pension arrangements The principal defined benefit scheme is the QinetiQ Pension Scheme

The majority of new entrants to QinetiQ in EMEA join the Defined Contribution Section of the QinetiQ Pension Scheme Pension benefits in QNA are provided on a defined contribution basis through 401k plans

A consolidated summary of the position of the defined benefit schemes is shown below

all figures in £ million	2007	2006
Schemes' assets	794 1	716 0
Schemes' liabilities	(884 9)	(884 4)
Schemes deficit before deferred tax	(90 8)	(168 4)
Deferred tax asset	27 1	50 4
Net pension liability	(63 7)	(118 0)

In the year the value of assets increased by 7 4%, close to the expected rate of return for the year of 7 7%, with the 46% reduction in net pension liability being principally driven by a reduction in the discount rate, partly offset by an increase in the inflation rate assumptions, used to value the scheme liabilities

The current investment policy of the QinetiQ Pension Scheme, as determined by the trustees in consultation with QinetiQ, is weighted towards equity investments The trustees believe this is appropriate at the current time due to the relative youth of the scheme, which is expected to be cash flow positive for approximately the next nine years

The funding of the defined benefit schemes is decided by the Group in conjunction with the trustees of the schemes and the advice of external actuaries The next full actuarial valuation is due as of 31 March 2008 and will be the first valuation under the new regulations for funding defined benefits

During the year the net pension cost charged to the income statement before curtailments for the defined benefit scheme represented 23% of pensionable pay and this compared to 21% in the year to 31 March 2006

The key assumptions used in the IAS 19 valuation are

Assumption	31 March 07	31 March 06
Discount rate	5 4%	4.9%
Inflation	3 1%	2.9%
Salary increase	4 6%	4 4%
Mortality male	86	86
Mortality female	89	89

The increase in the discount rate follows the movement in the 15-year AA bond yield at the year end dates

Each assumption is selected by management in consultation with the Company actuary and taking account of the industry practice amongst comparator listed companies The sensitivity of each of these key assumptions is shown in the table below and this illustrates how a small change in each assumption can have a material effect on the magnitude of the IAS 19 calculated deficit

Assumption	Change in assumption	Indicative effect on scheme liabilities
Discount rate	Increase/decrease by 0 1%	Decrease/increase by 2 6%
Inflation and salary increase	Increase/decrease by 0 1%	Increase/decrease by 2 5%
Life expectancy	Increase 1 year	Increase by 2 5%

Based on the assumptions prevailing at the year end the expected pension charge for the year to March 2008 will be lower than the current year, principally due to the impact of the higher bond rate at the year end

Research and development
Research and development (R&D) represents a significant focus for the Group with the majority of R&D related expenditure incurred on behalf of customers as part of specific funded research contracts from customers The costs and related income for this R&D is included in the relevant income statement cost category and revenue respectively In the year to 31 March 2007 the Group recorded £511 1m of customer funded R&D related expenditure up 1 3% on the prior year amount of £504 7m

£9 0m (2006 £5 6m) of internally funded R&D was charged to the income statement in the year and £3 2m (2006 £6 3m) of late stage development costs were capitalised, relating to development work on Tarsier® and Aurix £1 5m (2006 £0 5m) of capitalised development costs were amortised in the year

Financial risks
The Group Treasury Department operates within a framework of policies and procedures approved by the Audit Committee This includes strict control on the use of financial instruments and does not permit speculative trading activity in financial instruments

Interest rate risk management
The majority of the Group's debt is dollar denominated and consists of bank debt and private placement funds At 31 March 2007 80% (31 March 2006 87%) of the Group's bank and private placement borrowings are fixed or capped through a combination of interest rate swaps, collars and fixed rate debt

Business review continued
Other financials continued

Foreign exchange risk management

The principal exchange rate affecting the Group was the sterling to US dollar exchange rate

	2007	2006
£/US$ – average	1 92	1 78
£/US$ – closing rate	1 96	1 73
£/US$ – opening rate	1 73	1 89

The majority of the Group's income and expenditure is settled in the functional currency of the relevant Group entity, principally sterling or US dollar The Group s policy is to hedge all material transaction exposure at the point of commitment to the underlying transaction The Group does not typically hedge uncommitted future transactions The Group continues its practice of not hedging income statement translation exposure A one cent movement in the exchange rate causes an approximate £2m change in revenue and £0 2m change in operating profit on the translation of the QNA results

Credit risk

Credit risk arises because a counterparty may fail to perform its obligations The Group is exposed to credit risk on financial instruments such as liquid assets derivative assets and trade receivables Credit risk is managed by investing liquid assets and acquiring derivatives with high credit quality financial institutions The Group is not exposed to concentrations of credit risk on its liquid assets as these are spread over several financial institutions Trade receivables are subject to credit limits, control and approval procedures across the Group The nature of the Group's operations leads to concentrations of credit risk on its trade receivables The majority of the Group's credit risk is with the UK and US Governments

Insurance

The Group continually assesses the balance of risk arising from the operations undertaken against the insurance cover available for such activities and the associated premiums payable for such cover The Group has a policy of self-insurance through its captive insurance company on the first layer of specific risks with insurance cover above these levels placed in the external market with third party insurers

Employees

At 31 March	2007	2006	2005
Defence & Technology	6,651	6,791	6,905
Security & Dual Use	1,454	1 556	1 710
EMEA	8 105	8 347	8 615
QinetiQ North America	4,258	2,640	1 374
Ventures	82	87	80
Corporate	336	372	361
Group	12,781	11 446	10,430

Year end employee numbers have risen by 12% to 12 781 at 31 March 2007 The decline of 242 in EMEA headcount reflects the ongoing realignment of resources to the changing nature of the UK business, typified by a greater proportion of sub-contract effort in both the MOD Research and Technology Supply streams In North America there was an increase of 1,618 in staff numbers, with the acquisitions of OSEC and Analex adding 1,411 staff and an organic increase of 207 heads in other North American operating companies

Accounting standards

There have been no significant changes to accounting and financial reporting standards in the year and no impact on Group profit for the year This is the second year that QinetiQ has reported under International Financial Reporting Standards (IFRS) As required by IFRS 3 (Business Combinations) the formal valuation of goodwill and intangibles relating to acquisitions made in the prior year was completed in the year and is reflected in a restated balance sheet The adjustments were not significant and did not affect profit or net assets

Critical accounting estimates and judgements in applying accounting policies

A description and consideration of the critical accounting estimates and judgements made in preparing these financial statements is set out in Note 1 to the Group financial statements

Corporate Responsibility

The Group regards the management of social, environmental and ethical risk as fundamental to the sustainability of its business

QinetiQ recognises that Corporate Responsibility (CR) must be embedded at every level of its business The governance of CR is led by the Group's CEO on behalf of the Board He is supported in the implementation and monitoring of CR by the Corporate Responsibility Manager, Group Human Resources Director, Group Internal Audit Director and Group Health and Safety function

This year, QinetiQ has engineered stronger linkages between the governance of CR and Group Risk and has used this as a mechanism to engage key stakeholders more systematically in the management of its social and environmental position

Environment

QinetiQ is committed to embedding the principle of environmental sustainability across all of its business activities

The Group's key achievement this year has been in its energy management where QinetiQ in partnership with the Group s facilities management provider, has been awarded accreditation with the Carbon Trust for its energy management This reflects the culmination of a six-year drive towards greater energy efficiency

Across the year, employees were provided with advice on how best to conserve energy, enabling QinetiQ to reduce its UK energy consumption by 4 5%

The Group has also sought to address wider carbon footprint issues through investment in PhD research at Cardiff University that will provide a better understanding of how greenhouse gases released from aircraft gas turbine engines are formed, transported and in the longer term, can be mitigated through technological or regulatory means

QinetiQ UK CO_2 emissions from energy consumption

A number of the Group's sites focused on improving the level of recycling achieved in the year Employees at QinetiQ's Farnborough site recycled over half a tonne of plastic cups while Foster Miller's staff collected cans and bottles with the proceeds of redemption donated to the American Cancer Society

Environmental messaging has been embedded in the roll out of a new UK print strategy that helped meet a 16% reduction in paper wastage target and the Group has also successfully met its target of increasing video conferencing usage in the UK (as an alternative to travel) by 10%

Following a review of the Group's environmental management system, all business divisions that have a presence at the Farnborough and Malvern sites are now prepared for ISO14001 accreditation (which is expected later this year)

QinetiQ continues to look after 13 Sites of Special Scientific Interest (SSSI) across the UK This year, the SSSI in the Hebrides established its first formal conservation group comprising representatives from many of the islands while the Shoeburyness conservation group celebrated its 30th anniversary

Communities

Community support

QinetiQ through its staff, continues to distinguish itself as an organisation that is a responsible member of and active contributor to the local communities in which it operates across the UK and North America

QinetiQ sites continue to support a range of local causes and concerns in communities across the UK, from small sites such as Portland where the Group sponsored the development of the local swimming pool to large sites such as Boscombe Down where support was provided to the local hospital

The same principles are being applied by QinetiQ North America At Apogen Technologies the HR team received the Going Above and Beyond Excellence Award for employee support in the aftermath of Hurricane Katrina from the New Mexico Chapter of the Society for Human Resources

Charities

QinetiQ continued to support five 'priority' charities in the UK Cancer Research UK, RNLI, NSPCC, Soldiers, Sailors, Airmen and Families Association (SSAFA) and the Royal British Legion The Group matched donations raised by employees for these charities as well as continuing to provide a salary payroll giving service for those who wish to make regular monthly payments to charities of their choice

QinetiQ donated a total of £84,000 (2006 £136,000) to registered charities this year, of which £19 000 (2006 £54,000) was to UK registered charities

The Group continued to pursue 'payments in kind to charities through its people and technology For example, QinetiQ gave 131 hours of employee time to the Mines Advisory Group (MAG) a humanitarian charity in support of a de-mining project in Vietnam and Laos The QinetiQ team delivered technical support (scientific and engineering advice) to the MAG operating staff in the region, providing advice on the use and testing of detectors in the field and the design and modification of local machinery for demining operations

Business review continued
Corporate Responsibility continued

Landmine detection

Forgotten landmines and explosive remnants of warfare kill and maim thousands of people each year around the world QinetiQ's humanitarian demining research team has used its experience and expertise to help deal with this critical problem This has included the testing of a new UK mine detector, Minehound', which has been developed for field testing in minefields in Cambodia Bosnia and Angola

Education

The Group's approach to community engagement is principally focused on promoting science, technology, engineering and maths (STEM) both in education and among the wider public.

This year QinetiQ established a clear strategy for delivery of STEM outreach in the UK which proposes three foci school students at Key Stage 3 (11-14 year olds) and above, classroom influencers (teachers and career advisers) and the adult public With 100 QinetiQ employees now registered as Science and Engineering Ambassadors with Science, Engineering, Technology and Mathematics Network (SETNET), a considerable resource has been established with which to deliver on these objectives

The Group supports a mobile laboratory containing science experiments This 'Lab in a Lorry' programme was used by 3,400 school children across the UK The Group also provided bursaries for employees to deliver specific STEM projects to schools as part of its Schools Link Scheme

In taking STEM to the adult public, QinetiQ activity has focused on a series of public engagement lectures addressing topics such as 'Humans in extreme environments' and QinetiQ s solution to the asteroid threat to Earth' helping gain vital recognition for science and technology among the general public

QinetiQ continues to work in partnership with academia Through formal partnering with 12 UK universities, QinetiQ is maintaining an active involvement in leading-edge science and technology along with access to expertise, facilities and resources that complement and supplement those internal to QinetiQ A key feature of the partnerships is collaboration between teams of staff, students and researchers

In North America Foster-Miller has supported a number of initiatives such as the American Institute of Chemical Engineers ChemECar competition and the Society of Women Engineers' educational outreach programme Apogen sponsored the IT Excellence Award for Achievement in Information Technology in Education As part of this sponsorship, Apogen contributed to the New Mexico Supercomputing Challenge a non-profit programme committed to helping students in grades 7 to 12 solve real world problems using high-performance supercomputers Additionally, Planning Systems Inc co sponsors a scholarship in Uniontown, Pennsylvania as part of a programme designed to build a bridge between students in high school and the business community

Employees
Investing in people

QinetiQ recognises that it will retain a competitive edge by investing in its employees and in building and maintaining an environment where the best people do their best work

In addition to providing 313,349 hours of employee training in the UK (an average of 5 4 days per employee), 300 employees progressed through the QinetiQ Core Graduate Development Programme this year and a further 103 people achieved either chartered or fellowship status with professional institutions

The Group also launched an enhanced performance management and development system in the UK which provides employees with e-learning facilities to help manage their performance in its widest context and offered guidance on the setting of objectives, providing feedback and exploring career and personal development opportunities This was accompanied by a focus on talent planning which will lead to accelerated development for employees with high potential Leadership and management development programmes remain key to the Group's future success

QinetiQ's Fellowship Scheme recognises individuals who have achieved world class scientific, technological and intellectual status This year's round of Fellowship awards was presented by Sir David King, the Government's Chief Scientific Adviser at a ceremony in November 2006 The recipients were Malcolm Arthur, Ken Edwards, Marcus Harper, Matthew Angling, Lorraine Dodd, Nitin Bhakta Gavin Anthony, Steve Turner, Patrick Beasley, Rupert Anderton and Robert Lamb Chris Slinger was awarded Senior Fellow Status The Group also appointed its first visiting Fellow Professor Jonathan Chambers from Cardiff University

The Group's annual employee engagement survey in the UK continues to provide meaningful insights into employee attitudes and concerns The results of this annual survey are cascaded to team level where actions are taken to improve the way that we work

The QinetiQ Share Purchase Scheme provides employees with the opportunity to share in QinetiQ's success with the majority of employees now shareholders in QinetiQ. In recognition of this progress, QinetiQ won this year's ifsProshare Award which acknowledges excellence in employee share ownership amongst newly listed companies

The Group also recognises high achievement from employees through a range of internal awards The 'Make A Difference' Awards, for example recognise and reward employees for outstanding performance in satisfying customers, winning important new business or showing exceptional commercial acumen

Health and Safety

Improvements continued to be made on the already high standards of health and safety across the Group by achieving a 7 7% reduction in the lost time accident rate for the UK business which fell to 4,280 hours lost in the year The RIDDOR rate for QinetiQ's own UK staff was 3 47 accidents per 1 000 staff in 2006/7 compared with an all industries' rate of 5 63 in 2005/6

QinetiQ UK RIDDOR rate

Two major occupational health campaigns were rolled out to encourage eye testing and blood pressure testing to help prevent heart attacks and strokes In addition, the ongoing provision of the Group's Employee Assistance Programme offers help and assistance to employees across a wide range of personal and work-related issues

Ethics

QinetiQ's business ethics policy constitutes a set of business principles that underpin the Group's activities This is guided by our core values of integrity, excellence care, teamwork and commitment and with respect for the human rights and best interests of all employees The Group also respects the legitimate interests of those with whom it has a working relationship

This policy applies to all of the Group's companies and to their employees and contractors Where QinetiQ operates with third parties, or ventures where it has a significant interest, it seeks to promote the application of business practices that have a similar effect

Managers at all levels of the business ensure that these principles are understood and followed by all employees through appropriate communication, training, testing and performance management The QinetiQ Board requires that employees bring to its attention or that of senior management, any breach or suspected breach of our business principles, confidential reporting systems are in place to allow such reporting without fear of any retaliation

Responsible purchasing

Ensuring that QinetiQ s suppliers are providing goods and services procured from responsible sources remains a key priority for our purchasing team This year the Group has focused on making progress with three major suppliers Amey Accenture and the Compass Group, in systematically addressing key areas of social, environmental and ethical impact

Amey this year focused on the extension of paper recycling across all major QinetiQ sites, more than doubling the recycling rate as a result Together with QinetiQ, Amey also identified a number of areas where energy savings could be made by means of small investments, an example of which is automatic light controls

Accenture and QinetiQ worked to reduce the electricity consumed by employees leaving PCs on overnight or over weekends Accenture utilises its IT network management applications to identify PCs that have been left on and then worked with the relevant business area to confirm if this was necessary This approach has led to further reductions in energy consumption on many of the Group's sites

The Group also opened a range of new facilities further improving the physical working environment including a new cafe, restaurant and conference facilities at the Tom Elliot Centre in Malvern QinetiQ worked closely with Compass our catering provider, to delivery healthy, balanced eating options to employees across a range of QinetiQ sites

Future objectives

The Group's specific corporate responsibility targets for the coming year, include

- **Not exceeding current levels of UK CO_2 emissions from energy consumption relative to business output**
- **Major campaigns aimed at generating behavioural change across the business on key areas of environmental impact such as travel and waste**
- **9,000 students having experienced 'Lab in a Lorry' by 2009**
- **Retaining our status as 'top quartile' investor in employee learning and development**
- **Ensuring that the Group's RIDDOR Injury Accident Rate remains below the Health and Safety Executive's (HSE) industry benchmark**
- **Establishing a clear set of corporate responsibility criteria with which to engage all QinetiQ suppliers**

Our Board of Directors

1 Sir John Chisholm[a, b]
Chairman (Non-executive Director)
Sir John Chisholm (60), the Non-executive Chairman of QinetiQ, was Chief Executive Officer of QinetiQ (previously DERA) from 1991 to 2005 transforming it into a successful trading fund and developing its commercial business Until October 2006 he was the Executive Chairman of QinetiQ Previously Sir John was UK Managing Director of Sema Group plc and prior to that he was a director of CAP Group plc. In 1979 he founded and became Managing Director of CAP Scientific Ltd After a degree at Cambridge in Mechanical Sciences, Sir John s work experience included periods at General Motors and Scicon Ltd part of BP Sir John was formerly President of the Institution of Engineering and Technology and is currently Chairman of the Medical Research Council He is also a Fellow of the Royal Academy of Engineering, the Royal Aeronautical Society and the Institute of Physics The Board considers Sir John s extensive knowledge of Defence and Security Technology markets and his unrivalled experience of QinetiQ s business gained whilst Chief Executive Officer to be a valuable asset to the Board in terms of decision making and understanding the strategic issues affecting the Group

2 Graham Love[a]
Chief Executive Officer (Executive Director)
Graham Love (53) is the Chief Executive Officer of QinetiQ, having previously been Chief Financial Officer Prior to rejoining DERA in 2001 he was Chief Executive of Comax Secure Business Services Ltd, leading it through its privatisation in 1997 before its sale to Amey plc in 1999 Before that, Graham was Finance Director of DERA from 1992 to 1996 After a degree in English at Cambridge his career included management roles with Ernst & Young, KPMG and Shandwick plc as well as several years in international consulting He is a Fellow of the Institute of Chartered Accountants in England and Wales

3 Doug Webb
Chief Financial Officer (Executive Director)
Doug Webb (46) is the Chief Financial Officer of QinetiQ Doug was appointed to the Board in September 2005 having previously been Group Financial Controller He joined QinetiQ in June 2003 from LogicaCMG where he had most recently been the Regional Finance Director for Continental Europe During his eight years with Logica, Doug spent the period from 1995 to 2000 in the US in various management roles at its US subsidiary including Chief Operating Officer Chief Financial Officer and Executive Vice President Telecoms Division He trained as an accountant with Price Waterhouse where as a senior audit manager he focused on IT companies and stock exchange listed clients Doug is a Fellow of the Institute of Chartered Accountants in England and Wales

4 Sir David Lees[a, b, c]
Deputy Chairman (Senior Independent Non executive Director)
Sir David Lees (70) joined the Board of QinetiQ in August 2005 Sir David is currently Chairman of Tate & Lyle plc He has also been a member of the UK Panel on Takeovers and Mergers since June 2001 Sir David joined GKN plc in 1970 and became Group Finance Director in 1982 He was appointed Group Managing Director in 1987 and Chairman and Chief Executive in 1988 before becoming Non executive Chairman in 1997 until his retirement in May 2004 Other notable roles include being a member of the National Defence Industries Council between 1995 and 2004, Chairman of Courtaulds plc from 1996 to 1998 a Non executive Director of the Bank of England between 1991 and 1999 and Chairman of the CBI Economic Affairs Committee from 1988 until 1994 as well as being a member of the CBI President s Committee from 1988 to 1996 From 2001 to 2006 he was Non executive Joint Deputy Chairman of Brambles Industries plc and Brambles Industries Limited Sir David is currently a Non-executive Director of the Royal Opera House and Chairman of the governing body of Shrewsbury School He is also a Fellow of the Institute of Chartered Accountants in England and Wales The Board considers that Sir David's detailed understanding of the Defence sector coupled with his extensive experience of corporate governance and the City and its institutions, significantly enhances the operation of the Board, particularly in the context of Sir David's dual role of Deputy Chairman and Senior Independent Non-executive Director

5 Nick Luff[c]
Non-executive Director
Nick Luff (40) joined the Board of QinetiQ in June 2004 and serves as an independent Non executive Director Nick was appointed Finance Director of Centrica plc in March 2007 having previously served as CFO of the P&O Group He trained as a chartered accountant with KPMG and is a member of the Institute of Chartered Accountants in England and Wales Nick joined P&O in 1991 and held various finance roles before joining the board as Finance Director in 1999 In October 2000 he became Chief Financial Officer of P&O Princess Cruises plc on its demerger from the P&O Group and returned as Chief Financial Officer of P&O in May 2003 Nick has also served as a Non executive Director on the board of Royal P&O Nedlloyd NV, the Dutch-listed international container shipping company The Board considers that Nick's experience of operating as Chief Financial Officer/Finance Director with P&O and Centrica coupled with his extensive exposure to a variety of industrial sectors provides the rigorous financial and commercial scrutiny required of a FTSE-listed company at the Board level particularly in the context of his role as Chairman of the Audit Committee

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- [a] Member of Compliance Committee
- [b] Member of Nomination Committee
- [c] Member of Audit Committee
- [d] Member of Remuneration Committee
- [*] Chair of Committee

6 Dr Peter Fellner[b,c,d*]
Non-executive Director
Dr Peter Fellner (63) joined the Board of QinetiQ in September 2004 Peter is Executive Chairman of Vernalis plc, and is also Chairman of Acambis plc, and the privately held biotechnology company Astex Therapeutics Limited In addition he serves as a Director of two European biotechnology companies, UCB SA and Evotec AG and is also a Director of Bespak plc and Isis Innovation Limited He is also a member of the Medical Research Council Peter previously served as Chairman of Celltech Group plc from 2003 to July 2004 having been Chief Executive Officer from 1990 onwards Before joining Celltech he was Chief Executive of Roche UK from 1986 to 1990 having previously been a Director of Roche UK Research Centre The Board considers that Peter s detailed understanding of the commercialisation of innovative technologies and his experience of bringing high technology businesses to the public markets, are a valuable asset to the Board in terms of the development of QinetiQ s portfolio of leading technologies and the evolution of QinetiQ s remuneration policies particularly in the context of his role as Chairman of the Remuneration Committee.

7 Noreen Doyle[c,d]
Non-executive Director
Noreen Doyle (58) was appointed to the Board of QinetiQ in October 2005 and serves as an independent Non executive Director She also sits on the Board and Risk Committee of Credit Suisse Group (Zurich) and is a Non executive Director of Newmont Mining Corporation (Denver) and Rexam PLC In August 2005 Noreen completed her four-year term as First Vice President of the European Bank for Reconstruction and Development (EBRD) where she chaired the EBRD's Operations Committee and was a member of the Executive Committee Prior to her appointment as First Vice President Noreen was firm-wide head of Risk Management She joined the EBRD in 1992 to establish its syndications functions Before joining the EBRD, Noreen had a distinguished career at Bankers Trust Company (now Deutsche Bank) in corporate finance and leveraged financing with a concentration in oil gas and mining Noreen has a BA from the College of Mount Saint Vincent, Riverdale New York and an MBA from Tuck School at Dartmouth College The Board considers that Noreen s extensive international business experience, particularly in the areas of corporate finance risk management and banking, to be of significant benefit to the Board as QinetiQ continues its strategy of developing new business opportunities outside its traditional UK market particularly in North America

8 George Tenet
Non-executive Director
George Tenet (54) was appointed to the Board of QinetiQ in October 2006 and serves as an independent Non executive Director Having been sworn into office in July 1997 George was one of the longest serving directors of the US Central Intelligence Agency (CIA), a position he held until his resignation in 2004 George is Board Director of Granahan McCourt Acquisition Corp Guidance Software Inc and L-1 Identity Solutions sits on the advisory board of The Analysis Corporation and is a professor at Georgetown University in Washington DC Prior to his directorship of the CIA, he held various roles in federal government, including staff director of the Senate Committee on Intelligence A holder of the Presidential Medal of Freedom the US s highest civilian honour George has also been awarded with numerous foreign decorations including the Egyptian Order of Merit (First Class) the first American to receive this honour The Board considers that George's unparalleled exposure to Defence Security and Intelligence communities worldwide coupled with his extensive understanding of the working of Government, particularly in the US significantly enhances the operation of the Board as QinetiQ continues to pursue its strategy of growing its US platform in the Defence and Security Technology domain

9 Colin Balmer[a]
Non-executive Director
Colin Balmer (60) was appointed to the Board of QinetiQ in February 2003 He served as Managing Director of the Cabinet Office from 2003 until his retirement in 2006 Previously, Colin was Finance Director of the MOD, with responsibility for QinetiQ's privatisation and the subsequent investment by Carlyle as part of the PPP Transaction He has extensive experience across the MOD including periods as Private Secretary of two Ministers for Defence Procurement a secondment to the UK Delegation to the North Atlantic Treaty Organisation (NATO) and as a Minister for Defence Materiel in Washington DC United States Colin was formerly a member of the Independent Financial Reporting Advisory Board and the Advisory Council of Partnerships UK and is currently a member of the Foreign and Commonwealth Office's Audit and Risk Committee and is on the Board of the Royal Mint, chairing their Audit Committee The Board considers that Colin s extensive knowledge of the development of QinetiQ throughout its public-private partnership and his in depth understanding of the working of Government, particularly the UK MOD provides the Board with a unique insight into the issues facing Government in delivering its procurement objectives and partnering with industry suppliers

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Statement of Corporate Governance

Corporate Governance – introduction
QinetiQ's commitment to maintaining the highest standards of corporate governance is fundamental to the Group's operations, not only in terms of ensuring compliance with the Combined Code on Corporate Governance as revised by the Financial Reporting Council in June 2006 ('the Combined Code') but more generally in the way the Group conducts its day-to-day business affairs The concept of good corporate governance is by no means new to QinetiQ – the Company has been guided by the letter and spirit of the Combined Code since its creation in 2001, a process which was formalised at the time of QinetiQ's Initial Public Offering (IPO) in February 2006 Since then, QinetiQ's governance systems have continued to evolve to meet best practice, both at a Board and operational level, and in terms of the Group's interaction with its key stakeholders, as described in more detail in this Statement of Corporate Governance, together with the Report of the Remuneration Committee on page 50

Combined Code
On appointment as Chairman, Sir John Chisholm was not regarded as independent under the Combined Code as he was formerly QinetiQ's Chief Executive Officer The Combined Code recommends that a company's chairman be independent on appointment and that its chief executive officer should not become chairman of the same company The Board considered that departure from the Combined Code in this area was appropriate and gave its reasons for non compliance both in the IPO documentation and the 2006 Annual Report On 1 October 2006, Sir John handed over all executive responsibilities to the Chief Executive Officer in accordance with the Board's previously announced intentions

The Board considers Sir John's extensive knowledge and experience of QinetiQ's business an invaluable asset following its transition to a publicly listed company The Board continues to believe that Sir John remains the most appropriate person to lead it as the new organisation, both in the US and the UK becomes fully established and as it continues to oversee the development of QinetiQ s strategy The Company operates in a critical environment involving national security and defence and engages with a highly complex range of external stakeholders on both sides of the Atlantic. Sir John brings a unique set of skills and experience to bear in this challenging area The Board is convinced that this is a suitable departure from the recommendation of the Combined Code The Deputy Chairman, Sir David Lees, confirms that Sir John continues to perform effectively both as Chairman and a member of the Board and demonstrates commitment to both roles

As stated on page 54 it is proposed that with effect from 1 August 2007 Sir John s term of appointment will be on a 12 month rolling basis The Board intends that all Directors including Sir John, should stand for re election annually Each member of the Board will be put forward for re election at the Annual General Meeting of the Company in 2007

Save as stated above, QinetiQ has complied with the provisions of the Combined Code throughout the last financial year

The Board – governance, processes and systems
Composition of the Board
Sir John Chisholm is the Non-executive Chairman of QinetiQ, having transferred all of his executive responsibilities to Graham Love, the Chief Executive Officer on 1 October 2006 The roles of Chairman and Chief Executive Officer are separate, with their responsibilities having been clearly articulated by the Board in writing The Chairman is responsible for the effective operation of the Board and ensures that all Directors are enabled and encouraged to play their full part in Board activities The Chief Executive Officer is responsible to the Board for directing and promoting the profitable operation and development of the Group consistent with enhancing long-term shareholder value, which includes the day-to-day management of the Group, formulating, communicating and executing Group strategy and the implementation of Board policies

The Board comprises a Non-executive Chairman, six Non-executive Directors and two Executive Directors, namely the Chief Executive Officer and the Chief Financial Officer, with the objective of achieving a balance of Executive and Non executive Directors The Board considers its overall size and composition to be appropriate, having regard in particular to the independence of character and integrity of all the Directors and the experience and skills which they bring to their duties which prevents any individual or small group from dominating the Board's decision-making

The Senior Independent Non-executive Director is Sir David Lees Sir David is also Deputy Chairman of the Board and serves as an additional point of contact for shareholders should they feel that their concerns are not being addressed through the normal channels Sir David is, furthermore, available to fellow Non-executive Directors either individually or collectively, should they wish to discuss matters of concern in a forum that does not include the Chairman, the Executive Directors or the senior management of QinetiQ

The Shareholder Relationship Agreement entered into between QinetiQ and MOD at IPO entitles the MOD to nominate one Non-executive Director to the Board, for so long as the MOD does not dispose of any further ordinary shares in the Company, and thereafter for so long as it holds at least 10% of QinetiQ's issued ordinary share capital

Directors' independence
Of the existing Directors of the Company, the Board considers Sir David Lees Nick Luff, Dr Peter Fellner Noreen Doyle and George Tenet to be independent of QinetiQ's executive management and free from any business or other relationships that could materially interfere with the exercise of their independent judgement Of the remaining Non-executive Directors, the Board considers that both Sir John Chisholm and Colin Balmer are not independent for Combined Code purposes, Sir John on the basis that he was formerly QinetiQ's Chief Executive Officer and exercised certain executive responsibilities until 1 October 2006, and Colin as he is a nominee of the MOD, which is the largest shareholder on QinetiQ's share register

In October 2006 George Tenet was appointed as an additional independent Non-executive Director, the Board having concluded that Mr Tenet's unparalleled exposure to Defence, Security and Intelligence communities worldwide coupled with his extensive understanding of the workings of Government particularly in the US, would enhance the operation of the Board as QinetiQ continues its strategy of growing its US platform in the Defence and Security Technology domain

In February 2007, Glenn Youngkin resigned as a Non-executive Director when Carlyle sold its remaining shareholding in QinetiQ Mr Youngkin had not previously been considered by the Board to be an independent Non executive Director for Combined Code purposes, on the basis that he was a representative of Carlyle which was (until February 2007) a significant shareholder in QinetiQ

Based on the above the Board considers that at least half of its members (excluding the Chairman) were independent Non-executive Directors throughout the last financial year and that at the date of this report, five out of nine members of the QinetiQ Board are independent Non executive Directors for Combined Code purposes

Board structure
QinetiQ's IPO in February 2006 was a key stage in the Company's transformation from a government agency to an international commercial enterprise The IPO also had a significant impact at Board level, it being recognised that the majority of Non-executive Directors were appointed in anticipation of the Company's IPO As a consequence, the headline strategies described in the Company s prospectus issued at IPO – namely the continuation of QinetiQ s focus on its MOD customer base, the further penetration into defence markets, the application of technologies and services to adjacent non-defence markets, the focus on the development of the QNA business and selective acquisitions – have guided the Board in its decision-making throughout QinetiQ's first full year as a publicly listed company It is the Board's belief that the skills and experience of individual members of the Board, particularly in the areas of UK Defence and Security, the commercialisation of innovative technologies, corporate finance and mergers and acquisitions, have been fundamental in QinetiQ's pursuit of these growth strategies In addition the quoted company experience available to members of the Board in a variety of industry sectors has also been invaluable to the Company in its first year's trading as a public company The Board s knowledge and experience has been enhanced in the last financial year by the appointment of George Tenet as a Non-executive Director

Although the Company's IPO has set the framework for the Board's objectives in the last financial year, the Board evaluation process (which is described in more detail later in this report) has presented an opportunity to refine further the Board's key targets resulting in the creation of a detailed set of Board objectives which build upon the key corporate objectives put in place at IPO

Operation of the Board
The Board is responsible for managing the Group's operations and in this capacity determines the Group's strategic and investment policies The Board also monitors the performance of the Group s senior management team The following is a summary of the approach taken by the Board to corporate governance in the financial year ended 31 March 2007

- The Board took the decision during the last financial year to extend the length of time devoted to each Board meeting in order to allow members of the Board to consider key strategic decisions in greater depth, this has resulted in the number of Board meetings being reduced from ten to eight in the financial year commencing 1 April 2007 Members of the Board are also invited to attend a dinner on the occasion of each Board meeting, which assists in the process of relationship building and ensuring that key strategic initiatives are properly discussed In the last financial year the Board met on 10 separate occasions, two of these meetings were unscheduled and were convened to allow the Board to consider the merits of two separate acquisition opportunities in the US The Board held one of its scheduled meetings in the US in the past year, which gave members of the Board an opportunity to meet with senior management within QinetiQ North America It is proposed that in 2007/08, two Board meetings will be held in the US to allow members of the Board greater opportunity to interact with this fast growing part of the Group's business
- The Board receives written reports from the CEO and CFO each month during the course of the financial year which are considered at each meeting of the Board, together with a separate report on investor relations (which is prepared in consultation with QinetiQ's brokers) and a report produced by the Company Secretary on key legal and regulatory issues affecting the Group The Board also considers reports from the respective Chairmen of the Committees of the Board at the next scheduled Board meeting following the date on which each such Committee Meeting was held The CEO's monthly report addresses the key strategic initiatives impacting the Group since the last meeting of the Board and focuses in particular on the performance of each of the EMEA, QNA and Ventures businesses Other key areas of focus include health, safety, environmental, staff and organisational issues the status of key account management/customer relationship initiatives and the pipeline of potential acquisitions disposals and investments Of particular significance in the last financial year was the consideration given to a number of acquisition opportunities in the US (which culminated in the execution of the Analex and ITS acquisitions), reorganisation activity in relation to the UK sectors (which resulted in restructuring within D&T in the early part of the financial year and the creation of the EMEA Sector in April 2007) and the consideration of the bidding process in respect of the award of both the Combined Aerial Targets System and Defence Training Rationalisation programmes (conducted through Metrix) in the year Any proposed acquisitions, disposals and investments which exceed the CEO's delegated authority are considered by the Board in the context of the CEO's report
- The CFO s monthly report addresses the financial performance of the Group and each of the Sectors, both on a monthly and year-to-date basis, with the key performance indicators analysed being those identified on page 24 in the Business Review The Group Risk Register also forms part of the CFO's report on a quarterly basis and highlights the 10 to 12 principal risks having a potential impact at a Group level, the materiality of each risk, the assumptions underlying each such risk, the actions required to manage the risk and the relevant key performance indicators for each headline risk The risks covered by the Group Risk Register cover a range of financial and non-financial items, based on the

Statement of Corporate Governance continued

Principal risks and uncertainties' identified on pages 22 and 23 of the Business Review The CFO also reports on a monthly basis, as part of his investor relations report, on the key issues raised by shareholders potential investors and other important stakeholders on QinetiQ's performance and key strategic initiatives This process provides an opportunity for the Executive Directors to take soundings from the Non-executive Directors on matters which are considered important from an investor relations perspective

- At each scheduled meeting, either the Sector heads or the Managing Director of QinetiQ Ventures, gives a presentation to the Board on the key strategic, operational and performance issues impacting their businesses The Board also receives updates from the CEO s key functional reports (such as the Group Director of Human Resources on Pensions Strategy) on an as needed' basis throughout the financial year The Board devotes one entire meeting each year to consider strategy and planning issues impacting the Group, from which the five-year corporate plan is generated, a key part of this process involves the Board having the opportunity to question the Sector heads and the Executive Directors in relation to the formulation of the corporate plan at Sector level and the impact of these plans on the Group strategy as a whole The Non executive Directors also have an opportunity to meet with other members of staff within the QinetiQ Group (including, but not limited to, other members of the senior management team) at lunch-time events which are scheduled to coincide with Board meetings, during the last financial year two such events were held in Malvern and Washington DC
- The Board operates through a comprehensive set of processes which define the schedule of matters to be considered by the Board and its Committees during the yearly business cycle, the level of delegated authorities (both financial and non-financial) available to both Executive Directors and other layers of management within the business, and QinetiQ s Business Ethics, Risk Management and Health, Safety and Environmental processes The Board also has a clearly articulated set of matters which are specifically reserved to it for consideration, which include reviewing the annual budgets, raising indebtedness, granting security over Group assets approving Group strategy and the corporate plan, approval of the annual and interim report and accounts, approval of significant investment, bid, acquisition and divestment transactions, approval of HR policies (including pension arrangements) reviewing material litigation and monitoring the overall system of internal controls, including risk management
- In 2006 QinetiQ became a member of the UK Defence Industry Anti-corruption Forum which has the primary objective of promoting 'the prevention of corruption in the international defence markets' In furtherance of this objective, QinetiQ has enhanced its existing internal procedures which are designed not only to comply with, but to exceed international best practice in this area This is facilitated by the engagement of an independent, internationally recognised organisation known as TRACE (Transparent Agents and Contracting Entities) which conducts anti bribery due diligence reviews and compliance training on behalf of the Group, particularly in circumstances in which QinetiQ is planning to engage third party agents overseas

Performance of the Board

During the financial year ended 31 March 2007, the Board undertook the first formal evaluation of its performance, and that of its Committees and individual Directors since the Company's IPO in February 2006 In the first half of the financial year the Board consulted widely in considering the range of options available to it in conducting such an evaluation exercise and decided that the review process would be based on a detailed self-assessment questionnaire, covering issues ranging from 'value creation' and 'strategic planning' through to the operation of the Board/its Committees and risk management' The evaluation process was led by the Chairman, who supplemented the detailed responses derived from the self-assessment' questionnaire with a series of meetings held individually with each of the Directors, at which the performance of the Board as a whole, as well as the Committees and individual Board members were discussed In addition, Sir David Lees, in his capacity as the Senior Independent Non-executive Director, met with individual members of the Board to evaluate the performance of the Chairman The overall conclusion of the evaluation process which was characterised by commonality of views expressed by individual members of the Board, was that the Board conducts its business in an extremely positive and open manner with the Board possessing the requisite skills and diversity to fulfil its leadership role and having a detailed understanding of its stewardship responsibilities The Board agreed that the evaluation process had been an extremely worthwhile exercise and had highlighted very few weaknesses in terms of its method of operation, although the Board did suggest that improved performance benchmarking as against QinetiQ s peers, improved objective setting for the Board and increased Board contribution to management succession planning as areas which could merit further development Each of the suggested areas for improvement arising out of the Board evaluation process have either been remedied or are in the process of being resolved in particular a new Board objectives paper has been approved by the Board, which focuses in particular on the added value the Board brings to the Group

As a separate exercise, the Chairman held meetings with the Non-executive Directors on three separate occasions in the last financial year, without the Executive Directors present, in order to review both the operation of the Board and the performance of the Executive Directors In addition, the Executive Directors were appraised as part of the annual salary review process, which was overseen by the Remuneration Committee, which reviewed the performance of the Executive Directors in detail as against their personal objectives set at the start of the financial year

Directors' induction, training and information

All newly appointed Directors participate in an induction programme, which is tailored to meet their needs in relation to information on the Group This induction programme includes an induction pack which is refreshed to ensure it contains the most up-to date information available on the Group Any changes made to the information contained in the induction packs (for example, amendments to the Group Directors' and Officers insurance policy) are made available to the entire Board

All Directors are encouraged to visit QinetiQ's principal sites and to meet a wide cross-section of QinetiQ's employee base During the last financial year the Board held one of its meetings in Washington DC, which allowed members of the Board to better appreciate the business dynamics of QinetiQ's newly acquired Apogen, PSI and Ocean Systems businesses, the Board also held one of its meetings at QinetiQ s Malvern site, during which a site tour was undertaken which provided members of the Board with exposure to a range of QinetiQ technologies (including 3D imaging, low power microchips and millimetre wave detection technologies), as well as a commentary on the key stages of a successful MOD bid

Training is also available to the Board on key business issues or developments in policy, regulation or legislation on an as needed' basis, by way of example the Board was provided with an overview of the Companies Act 2006 during the last financial year which will be supplemented with additional training as the various parts of the Act are implemented Each of the Directors has access to the services of the Company Secretary, and there is also an agreed procedure for the Directors to seek independent advice at the Company s expense

Directors' responsibilities
Statements explaining the Directors' responsibilities for preparing the Group s financial statements and the auditors' responsibilities for reporting on those statements are set out on pages 58 and 59

Other Directors' information
Details of Executive Directors service contracts and the Non-executive Directors' letters of appointment are set out in the Report of the Remuneration Committee Copies of Directors service contracts and letters of appointment will be available for inspection at the Company's Annual General Meeting

In October 2006, Sir John Chisholm, was appointed Chairman of the Medical Research Council which is a non-fee paying role

Committees of Directors
The Board has established four principal committees, being the Audit Committee, the Remuneration Committee, the Nominations Committee and the Compliance Committee each of which operates within written terms of reference approved by the Board, details of which are set out in the Investor Relations section of QinetiQ's website (www QinetiQ com) Each of the Chairmen of the Board Committees reports on the key issues discussed, and decisions taken, at the next meeting of the Board following the Committee meeting in question

Details of each of these Committees are summarised below

Audit Committee
Each member of the Audit Committee is an independent Non-executive Director The Committee is chaired by Nick Luff, who has been a member of the Institute of Chartered Accountants in England and Wales since 1991 and the Board considers him to have recent and relevant financial experience given his former roles as CFO of P&O and P&O Princess Cruises and his current position as Finance Director of Centrica The other members of the Committee are Dr Peter Fellner and Noreen Doyle The Audit Committee meets as necessary and at least four times a year During the financial year ended 31 March 2007, the Committee met on four occasions The external auditors have the right to request that a meeting of the Audit Committee be convened During the past financial year the Committee met with QinetiQ's external auditors on two separate occasions without Executive Directors present to discuss the audit process, and the Committee Chairman also met with the Group internal audit function on the same basis Except where not permitted to attend, the Group Chairman, Chief Executive Officer, Chief Financial Officer, Group Financial Controller Head of Internal Audit and a representative of the external auditors normally attend Audit Committee meetings

During the last financial year, QinetiQ's first as a listed company the principal areas of focus for the Audit Committee were to oversee the audit process for the full year and interim results The Committee also conducted a detailed review of the QinetiQ internal audit function in year, which resulted in the approval of a detailed 12 month work programme for the function, the adoption of a balanced scorecard approach to measure internal audit objectives and the appointment of the Group's first head of internal audit for the QNA region in 2006 In the context of the Group's North American business, the Committee also reviewed the application of internal controls in respect of the proxy regime through which the majority of QinetiQ's North American business is operated (see below under the heading Management and control of US subsidiaries) and KPMG s approach to auditing the newly acquired US businesses As part of its regular review of internal controls, the Committee paid particular attention to the effectiveness of QinetiQ's whistleblower policies in year as well as those areas of internal audit review which had failed to achieve at least a satisfactory' rating, these were limited in number and principally related to the development of certain software systems for customers and the conduct of certain project management activity As part of the regular reporting process, the Committee also viewed the activities of the treasury, tax, and insurance functions, as well as overseeing the level of KPMG's audit fees, as part of this process, the Committee conducted a detailed review of the Group Treasury policy in year and introduced certain changes, related principally to the Group's attitude to risk in conducting foreign exchange/hedging activity

In order to safeguard auditor independence, the Committee ensures that any other advisory/consulting services provided by the auditors do not conflict with their statutory audit responsibilities and are conducted through entirely separate working teams, such advisory/consulting services only generally cover regulatory reporting, tax and mergers and acquisitions work Any non-audit services conducted by the auditors require the consent of the Chief Financial Officer or the Chairman of the Audit Committee before being initiated with any such services exceeding £50,000 in value requiring the consent of the Audit Committee as a whole In the last financial year, the only non-audit activity conducted by KPMG on behalf of QinetiQ which exceeded this £50,000 threshold related to the provision of taxation advice and services to the Group which the Committee concluded did not create any conflict of interest issues which might compromise the independence of KPMG audit work It is also QinetiQ s policy that no KPMG employee may be appointed into a senior position within the QinetiQ Group without the prior approval of the Chief Financial Officer The Committee s policy regulating the award of non-audit work to its auditors was reviewed during the course of the last financial year, with the only material change being to allow the Chairman of the Audit Committee (as well as the Chief Financial

Statement of Corporate Governance continued

Officer) to approve non-audit fees below the £50,000 threshold The cost of non-audit work undertaken by the auditors was reviewed by the Committee on several occasions during the last financial year, this process allows the Committee to take corrective action if it believes that there is a risk of the auditors independence being undermined through the award of such work.

The members of the Audit Committee have declared themselves satisfied with the performance of KPMG as the Company s auditors in the last financial year There will be a rotation of KPMG's lead audit partner during the forthcoming financial year It is anticipated that the incoming lead audit partner will continue in the role for a maximum term of five years

Remuneration Committee
Each member of the Remuneration Committee is an independent Non-executive Director The Committee is chaired by Dr Peter Fellner The other members of the Remuneration Committee are Sir David Lees and Noreen Doyle The Committee meets as necessary although normally not less than three times a year During the financial year ended 31 March 2007, the Remuneration Committee met on four occasions Although not members of the Committee the Group Chairman the Chief Executive Officer, the Group Head of Human Resources and the Head of Performance and Reward normally attend Committee meetings Executive Directors are not present when their own remuneration is being discussed

During the last financial year, the Remuneration Committee focused its attention in particular on reviewing the long-term share incentive arrangements for Executive Directors, senior management and the wider employee base, to ensure, as far as possible, that QinetiQ's existing incentive arrangements are competitive with its external comparator group This review exercise has culminated in the proposed adoption of the Performance Share Plan and Deferred Annual Bonus Plan described in detail in the notes set out in the Notice of AGM In addition, the Committee approved the salary and benefit arrangements for the Executive Directors and the CEO's direct management reports in year as well as approving the Group level targets under the Leadership Incentive Scheme pursuant to which senior management receives cash bonus awards based on the attainment of Group level turnover, EBIT and cash targets, as well as tailored personal objectives which were also approved by the Committee

The Company continued to engage the services of Deloitte & Touche as remuneration consultants in the past financial year to assist the Remuneration Committee and the Board in framing the remuneration and benefits policies for the Executive Directors, members of the senior management team and employees throughout the Group Deloitte & Touche have provided additional consultancy services to the Company during the course of the past financial year in areas such as taxation, albeit through entirely separate teams of advisers, none of whom have any other connection with the Company

Nominations Committee
The Nominations Committee consists of the Committee Chairman, Sir David Lees, together with Dr Peter Fellner and Sir John Chisholm A majority of the Committee throughout the year were Non-executive Directors The Committee meets as necessary and when called by its Chair During the financial year ended 31 March 2007, the Committee met on two separate occasions

The principal focus of the Committee s activity during the financial year ended 31 March 2007 was to select an independent Non-executive Director with experience of the US Defence, Security and Intelligence community, which culminated in the appointment of George Tenet to the Board in October 2006 The Committee was responsible for initiating this recruitment process using external recruitment agents, at the beginning of the financial year and retained responsibility for finalising the terms of Mr Tenet s engagement through to completion of his appointment Other activities undertaken by the Nominations Committee in the last financial year included consideration of the appointment of Clive Richardson as COO of the newly created EMEA region as well as reviewing QinetiQ's succession planning processes at both the Executive Director level and for other key management positions within the Group, which the Committee considered in terms of need to plan for immediate cover in respect of key roles, as well as succession planning to cover vacancies arising over a two to five year timeframe

Compliance Committee
QinetiQ s breadth of technical knowledge and its depth of understanding of the defence operating environment allows it to serve the interests of the MOD in two distinct ways It is able to partner with other manufacturers in the defence supply chain to develop and deliver capabilities that give an operational advantage to the armed forces and also to provide advice to the MOD during the entire procurement cycle

However, these distinct offerings may lead to conflict of interest, which, if unmanaged could bring into question the MOD s ability to be able to rely on impartial advice during any competitive evaluation of a procurement where QinetiQ wishes to operate on both the buy' and the supply sides To give MOD customers confidence that QinetiQ is able to perform these activities, QinetiQ is required by its Articles of Association to implement a Compliance Regime, which was established on its creation out of DERA. Central to this Regime is the requirement for QinetiQ to seek permission from the MOD prior to providing commercial defence services to others where there is potential for a conflict of interest with the services that QinetiQ provides to the MOD

In designing the Compliance Regime the MOD and QinetiQ sought to achieve a balance between meeting the needs of the procurement customers within the MOD (principally Defence Equipment and Support (DE&S) and the need to allow QinetiQ flexibility to exploit research into the supply chain and pursue its planned commercial activities without compromising the defence or security interests of the UK The Compliance Regime is largely self-policing, in that it is applied by QinetiQ in respect of its activities without extensive intervention or oversight by the MOD Since the inception of the Compliance Regime, over 97% of the requests to the MOD to allow QinetiQ to operate on the supply side of the commercial defence market have been approved

Oversight of the operation of the Regime is provided by the Compliance Committee, chaired by Sir David Lees Colin Balmer, a Non-executive Director, is a member of the Committee and the Group Chairman Chief Executive Officer and Compliance Audit Director are also members The Board nominates two senior executives to act as Compliance Implementation Director and Compliance Audit Director currently the Compliance Audit Director is Dr Graham Coley and the Compliance Implementation Director is Neville Salkeld

QinetiQ's Compliance Committee meets on four occasions each year to monitor the operation of the Regime It receives a report from the Company's Compliance Implementation Director which describes the permissions which have been sought and granted since the last meeting of the Committee, and the status of projects where the potential conflicts of interest are being managed The Committee also receives from the Compliance Audit Director a report on the effectiveness of the controls that are in place to ensure that the Regime is operated correctly The Committee reviews the systems that support the Compliance Regime and those that may impact it, directing changes if appropriate The Committee is the forum that would address any issues arising out of QinetiQ's failure to comply with the requirements of the Regime

One innovation during the year has been the introduction of a web-hosted Computer Based Training (CBT) package This training package has been developed for UK staff, based on the MOD Compliance Regime and its implementation within the UK business The objective has been to implement a CBT package that will inform, train and test staff on the fundamental principles of the Compliance Regime and its implementation within QinetiQ via their desktop computer A key element of the training has been the necessary focus on individual accountability and responsibilities at the different stages of QinetiQ's business development process within the compliance framework All staff whose activities may impinge on the Compliance Regime will complete the test annually

The MOD reviews the operation and effectiveness of the Compliance Regime, through its right to have an observer at the Compliance Committee meetings

During the year, a total of 13 new permissions were sought from the MOD under the Compliance Regime where potential conflicts of interest were identified by QinetiQ, with a further four permission requests outstanding from the previous year Of these 17 requests 13 were approved, three were not pursued, none were rejected and one was outstanding at the end of March 2007 At the end of the year, 37 firewalls were in place, with 14 being established and 12 being closed down during the year Since vesting in 2001, a total of 105 firewalls have operated with 67 now closed No breaches of the MOD Compliance Regime have been noted during the year A firewall is a series of rules and procedures governing written and oral communication between staff contributing to products in an MOD competition with industry (outside the wall) and staff assessing those products for MOD (inside the wall)

The Compliance Committee also provides oversight of QinetiQ's activities that fall within the scope of the Helsinki Protocol covering trials involving human volunteers and those other activities that are inherently hazardous

Attendance at Board and Committee meetings April 2006 – March 2007

	Board	Remuneration Committee	Audit Committee	Compliance Committee	Nomination Committee
Colin Balmer	9/10			3/3	
Sir John Chisholm	10/10			3/3	2/2
Noreen Doyle	8/10	3/4	4/4		
Dr Peter Fellner	7/10	4/4	4/4		2/2
Sir David Lees	9/10	4/4		3/3	2/2
Graham Love	10/10			3/3	
Nick Luff	10/10		4/4		
George Tenet[1]	3/4				
Doug Webb	10/10				
Glenn Youngkin[2]	10/10				

[1] George Tenet was appointed to the Board on 24 October 2006
[2] Glenn Youngkin resigned from the Board on 8 February 2007

Statement of Corporate Governance continued

Going concern
The Directors are of the opinion that the Group has adequate resources to continue to operate for the foreseeable future and have prepared the accounts on a going concern basis

Communication with shareholders
The Company attaches significant importance to the effectiveness of its communications with shareholders During the last financial year, the Company has initiated regular dialogue with institutional shareholders and the financial community, which has included presentations of the full-year and interim results (including investor 'road shows held in the UK, Europe and US) regular meetings with major shareholders and industry analysts participation in stockbrokers' seminars and shareholder site visits held at Farnborough and Malvern In addition, each member of the Board attended the Company's Annual General Meeting in July 2006 and a number of Non-executive Directors attended key shareholder events in the last financial year, including the full year and interim results presentations at which they were available to take questions from shareholders All shareholders and potential shareholders can gain access to the Annual Report, presentations to investors and other significant information about the QinetiQ Group on the Company s website at www QinetiQ com

Holders of ordinary shares may attend the Company s AGM at which the Company highlights key business developments during the year and at which the shareholders have an opportunity to ask questions The chairmen of the Audit, Remuneration, Nominations and Compliance Committees will be available to answer any questions on the work of the Committees The Company confirms that it will send the AGM notice and relevant documentation to all shareholders at least 20 working days before the date of the AGM For those shareholders who have elected to receive communications electronically, notice is given of the availability of documents on the Investor Relations section of the Group s website All shareholders will be entitled to vote on the resolutions put to the AGM and, to ensure that all votes are counted, a poll will be taken on all the resolutions in the Notice of Meeting The results of the votes on the resolutions will be published on the Company's website

Responsibility for maintaining regular communications with shareholders rests with the Executive Team, led by the Chief Executive Officer, assisted by an investor relations function which reports to the Chief Financial Officer The Board is informed on a regular basis of key shareholder issues, including share price performance, the composition of the shareholder register and City expectations The Chairman, the Senior Independent Director and Non-executive Directors make themselves available to meet with shareholders as required

Management and control of US subsidiaries
QinetiQ's US subsidiaries, Apogen, Foster-Miller Planning Systems, Westar, Ocean Systems, Analex and ITS are currently required by the US National Industrial Security Program to maintain facility security clearances and to be insulated from foreign ownership, control or influence To comply with these requirements, QinetiQ North America Operations, LLC (a wholly-owned subsidiary of QinetiQ in the US) and the US DoD have entered into a proxy agreement that regulates the ownership, management and operation of these companies Pursuant to this proxy arrangement, QinetiQ appointed three US citizens holding requisite US security clearances as proxy holders to exercise the voting rights of QinetiQ North America Operations, LLC's shares in the US subsidiaries The proxy holders are also appointed as directors of the relevant US subsidiaries and in addition to their powers as directors, have power under the proxy arrangements to exercise all prerogatives of share ownership of QinetiQ North America Operations, LLC The proxy holders agree to perform their role in the best interests of QinetiQ North America Operations, LLC and consistent with the national security concerns of the United States QinetiQ does not have any representation on the boards of Apogen, Foster-Miller Planning Systems, Westar Ocean Systems, Analex or ITS and does not have the right to attend board meetings QinetiQ may not remove the proxy holders except for acts of gross negligence or wilful misconduct or for breach of the proxy agreements (with the consent of the US Defense Security Service)

Internal controls
The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness in safeguarding the shareholders' interests and the Company's assets However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable and not absolute assurance against material misstatement or loss QinetiQ managers are responsible for the identification and evaluation of significant risks applicable to their areas of business together with the design and operation of suitable internal controls to ensure effective mitigation These risks, which are related to achievement of business objectives, are assessed on a continual basis and may be associated with a variety of internal and external events, including control breakdowns competition disruption, regulatory requirements and natural and other catastrophes

A process of hierarchical self-certification has been established within the organisation which provides a documented and auditable trail of accountability for the operation of the system of internal control This process is informed by a rigorous and structured self assessment that addresses all of the guidance cited in the Combined Code The process provides for successive assurances to be given at increasingly higher levels of management and, finally to the Board The process is informed by the Internal Audit function, which also provides a degree of assurance as to the operation and validity of the system of internal control Planned corrective actions are independently monitored for their timely completion

The managers report on risks (which are recorded at corporate, sector and divisional level of profit and loss as well as within all customer-facing projects) and how these are managed on a monthly basis to the QinetiQ Executive Team and the Board, formally, on a quarterly basis

The QinetiQ Executive Team reviews on a monthly basis the risk management and control process and considers

- the authority, resources and co-ordination of those involved in the identification, assessment and management of significant risks faced by the organisation,
- the response to the significant risks which have been identified by management and others,
- the monitoring of reports from Group management
- the maintenance of a control environment directed towards the proper management of risk

The centrally provided internal audit programme is structured to address the risks identified by the Company and is integrated across all business and functional dimensions, thereby reducing issues of overlap or gaps in coverage These risks are identified dynamically and the Board is involved in this process as well as the QinetiQ Executive Team

The Chief Financial Officer provides to the Board monthly information that includes key performance and risk indicators Where areas for improvement in the system of internal control are identified, the Board considers the recommendations made by the QinetiQ Executive Team the Audit Committee and the Compliance Committee The Audit Committee reviews, on behalf of the Board the key risks inherent in the business and the system of internal control necessary to manage such risks and presents its findings to the Board Internal Audit independently reviews the risk identification and control processes implemented by management and reports to the Audit Committee

The Audit Committee also reviews the assurance process, ensuring that an appropriate mix of techniques is used to obtain the level of assurance required by the Board It presents its findings to the Board on a regular basis The Board has reviewed the effectiveness of the system of internal control that has been in operation during the financial year ended 31 March 2007 In particular it has reviewed and updated the process for the identification and evaluation of significant risks affecting the business and the processes by which these are managed However the Board routinely challenges the management to ensure that the systems of internal control are constantly improving to maintain their continuing effectiveness

Report of the Remuneration Committee

The following Report of the Remuneration Committee has been approved by the Board for submission to shareholders

The report covers the remuneration for Directors and includes specific disclosures relating to their emoluments shares and other interests This report has been produced in accordance with the Directors' Remuneration Report Regulations 2002

Role of the Remuneration Committee
The Remuneration Committee ('the Committee') has delegated authority from the Board for determining Executive Directors' remuneration and reviewing proposals in respect of other senior executives In addition, the Committee determines annual performance targets and performance criteria for related share schemes operated by the Group

The Board has delegated the following responsibilities to the Committee

- agreeing the overall remuneration policy for senior executives,
- determining and recommending to the Board individual remuneration packages for the Executive Directors and the Chairman,
- agreeing employee share based incentive schemes together with the appropriate performance criteria
- recommending to the Board any awards under executive share plans (and any other incentive arrangements involving the issue or transfer of shares in the Company, other than all-employee schemes) (share based schemes) and any other short- and long-term incentive arrangements operated from time to time for Executive Directors and senior management The Committee will also oversee the administration and operation of these schemes,
- approving any contract of employment or related contract for Executive Directors and the next most senior category of executives, and
- determining and approving remuneration including bonus arrangements and awards for the next most senior category of executives

The full Terms of Reference of the Committee can be found on the QinetiQ website (www QinetiQ com) and copies are available on request

Committee membership
The Committee is composed of the following independent Non-executive Directors

- Dr Peter Fellner (Committee Chairman),
- Sir David Lees, and
- Noreen Doyle

The Committee met four times during the year

Advisers to the Committee
During the year the Committee received independent advice on matters relating to executive remuneration and share schemes from Deloitte & Touche LPP (Deloitte') Towers Perrin and Monks Partnership provided market information Deloitte also provided other tax and consulting services during the year

Sir John Chisholm (Chairman) Graham Love (CEO), Stephen Luckhurst (Group Human Resources Director) and John Leighton-Jones (Group Head of Reward & Performance) provided material assistance to the Committee, other than for their own remuneration

Directors' remuneration policy
The Committee recommends to the Board a remuneration framework for Executive Directors and determines the remuneration arrangements for individual Executive Directors The Committee aims to maintain a remuneration policy, consistent with the Company's business objectives, which

- attracts, retains and motivates individuals of high calibre,
- is responsive to both company and personal performance,
- is based on information from independent remuneration sources and other publicly available information for companies of a comparable size (based on revenue and market capitalisation) and complexity, and
- is compatible with the principles for establishing remuneration for the Company as a whole (based on market comparators and individual performance)

The remuneration policy is built on the following philosophy

- remuneration packages will be structured in order to support business strategy whilst conforming to current best practice,
- constituent elements of each Executive Director's remuneration package will be evaluated on the basis of total rewards,
- total rewards are achieved through the attainment of stretching performance targets based around measures which are consistent with the short- medium- and long-term interests of shareholders, and
- a significant element of the executive's remuneration package will be performance related

Activities in the year

During the year the following activities were undertaken by the Committee

- evaluation of Executive Director and senior management performance in relation to determining salaries and prior year bonus payments,
- review of Executive Directors' and senior managers' total remuneration,
- determining remuneration package for newly appointed COO EMEA,
- operation of Group Share Option Scheme including determining appropriate grant levels coupled with performance criteria
- policy and overall operation of Share Incentive Plan,
- setting parameters and performance targets for annual bonus plans, and
- review of long-term incentive arrangements, as outlined below

Executive Directors' remuneration

The components of the remuneration package for Executive Directors, which are reviewed annually by the Committee, are as follows

Basic salary

Basic salary for each Director is determined by assessment of the Director's performance, experience and responsibility and relevant benchmarks Salaries are reviewed annually in the context of all other remuneration elements Factors taken into account are performance, personal contribution, responsibilities and market pressures For market comparison purposes account is taken of company type sector and measures of company size in terms of complexity, market capitalisation and revenue

Annual bonus

Executive Directors have annual cash bonus arrangements, which are non-pensionable Bonuses are linked to Group and personal targets The maximum annual bonus opportunity for the Executive Directors is 100% of salary

The 2006/07 bonus scheme was structured around an 'on target annual bonus of 50% of basic salary The bonuses for all three Executive Directors (Executive Chairman applicable for 6 months only) were measured against the same three key performance indicators (KPIs) Group revenue earnings before interest, tax and amortisation (EBITA) and cash generation An entry level is defined for each KPI and no payment will be made against that KPI unless the entry level performance is achieved The entry level is always set to represent incremental growth over the prior year performance Performance against the KPIs is measured independently However, if the underlying EBITA is not satisfied, the Committee has the discretion to reduce any bonus

For performance in excess of the entry threshold, bonus elements for each KPI accrue on a straight-line basis up to the target level If there is over-achievement against one or more KPIs then the proportion of bonus increases linearly such that twice the on target bonus is payable if 125% or more of the target is achieved

Each Executive Director also has personal supporting objectives which may be used to moderate the financial element up or down The Committee considers annually the choice of performance measures and approves bonus targets

Benefits

Benefits include a pension or contribution in lieu, as appropriate, plus car allowance health insurance and membership of the Group's employee Share Incentive Plan which is open to all UK employees none of which are pensionable The Company also pays an insurance premium in respect of death in service cover

In response to the new UK pensions legislation which took effect on 6 April 2006, it was decided to permit executives whose benefits are likely to exceed the Lifetime Allowance to opt out of the QinetiQ Pension Plan In such cases, the individual will be paid a salary supplement in lieu of pension contributions

Long-term incentives

QinetiQ Share Option Scheme (QSOS)

The Company currently provides long-term incentives in the form of share options The objective is to align the rewards of Executives with the returns to shareholders by providing a focus on increasing the share price over the medium to longer term Under the scheme annual share option awards with a value up to 300% of salary can be made

It was determined by the Committee that due to option grants taking place in close proximity to the IPO in February 2006, no further executive grants would be made in the year ended 31 March 2007 The 2006 award is subject to two performance measures which have equal weighting underlying earnings per share ('EPS') and total shareholder return ('TSR') measured against the FTSE 250 index Performance is measured over three years and there is no re-testing of performance

The EPS measure was selected to ensure that the scheme includes a performance measure which provides a clear line of sight for the participants reflecting the business strategy For the EPS proportion of the award to start to vest, EPS growth of at least 22 5% must be achieved over the performance period 25% of the award vests at that level of performance with full vesting for achieving 52% EPS growth For EPS performance between these two points straight-line vesting applies

Under the TSR element, there is no vesting for performance below the median with full vesting for achieving TSR performance which positions the Company in the upper quartile of the FTSE 250 At median, 30% of the award vests with straight-line vesting between median and the upper quartile

Report of the Remuneration Committee continued

Proposed Discretionary Share Plans
The Company is focused on delivering value to shareholders and growing the Company's operations and profitability The Committee now feels that this is an appropriate time to review the remuneration structures to ensure that these support this focus and align our plans with other quoted companies of similar size and business interests QinetiQ will seek shareholder approval for the establishment of the following new share plans at the forthcoming Annual General Meeting

- 2007 Performance Share Plan (2007 PSP), and
- 2007 Deferred Annual Bonus Plan (2007 DAB)

These new arrangements are intended to become the medium for long-term incentivisation The new plans will replace the current share option plan for Executives albeit the QSOS will be kept for awards in exceptional circumstances such as recruitment and retention

Fundamentals of 2007 Performance Share Plan
The 2007 PSP has taken account of changes in best practice amongst comparator companies Accordingly the fundamentals of the 2007 PSP will be

- conditional share awards will be made annually to Executive Directors and other senior executives,
- awards will vest three years from date of grant
- vesting is subject to continued employment and performance conditions being met,
- in line with the QSOS, awards will be based on a combination of relative total shareholder return (TSR') performance and absolute underlying earnings per share (EPS') growth with 50% of the award vesting based on relative TSR and 50% of the award vesting based on underlying EPS performance
- the TSR part of the award will be measured against the constituents of a comparator group initially consisting of the following peer group of companies Babcock International plc, BAE Systems plc BBA Aviation plc, Bodycote International plc, Capita Group plc, Chemring Group plc, Cobham plc, Cookson Group plc, Detica Group plc, Enodis plc, FKI plc, GKN plc, Halma plc, IMI plc Invensys plc, LogicaCMG plc, Meggitt plc, The Morgan Crucible Company plc, Rolls-Royce Group plc, Serco Group plc, Tomkins plc, Ultra Electronic Holdings plc, Victrex Group plc, VT Group plc and WS Atkins plc,
- the TSR part of the award will vest only if relative TSR performance is at least at median against the comparator group over a three year performance period 30% of the TSR part of the award will vest for achieving median rising on a straight-line basis to full vesting for upper quartile performance TSR will be calculated by an independent third party,
- for initial awards, the EPS part of the award will require at a minimum, absolute EPS growth of 22 5% over the three year performance period, for which 25% of the EPS part of the award would vest This will increase on a straight-line basis to full vesting if EPS growth of 52% is achieved,
- individual participants' award levels will be determined by the Remuneration Committee from year to year, with due regard to seniority as well as business and individual performance It is anticipated that for the initial awards Executive Directors will receive awards with a face value of up to 100% of base salary, with awards for other participants not exceeding 75% of base salary,
- on leaving employment with QinetiQ, awards will normally lapse In the case of of ill health death, or as a result of the participant's employing company ceasing to be a part of the QinetiQ Group, any unvested portion of the award will vest pro-rata for time and performance, and
- in the event of a change of control (other than a reorganisation) awards will generally vest pro-rata for time and performance Alternatively the Committee may seek agreement from the Company that has obtained control to offer participants replacement awards over shares in the controlling company

Fundamentals of 2007 Deferred Annual Bonus Plan
The Deferred Annual Bonus Plan is designed to align the interests of management with shareholders', and to aid retention of key individuals, in a way that is closely linked to Company performance Accordingly the fundamentals of the 2007 DAB will be

- for 2007, individuals will be invited to defer up to 50% of their pre tax annual bonus and in the future the Remuneration Committee will have the discretion to require up to 50% of participants' annual bonus to be deferred into shares (Deferred Shares'),
- Deferred Shares will be matched in the form of a 'Matching Award of free shares which will vest subject to performance The annual individual limit of the Matching Award will be 100% of the value of the Deferred Shares (i e the equivalent of 50% of a participant's annual bonus)
- deferral levels will be determined by the Remuneration Committee from year to year, with due regard to seniority as well as business and individual performance,
- where an individual participates in the Deferred Annual Bonus Plan and also participates in the PSP, he/she will not receive awards which, in aggregate, exceed 150% of his/her base salary in any one year,
- performance conditions have been selected which are relevant to the earnings performance of the Group, while ensuring that participants will have a line of sight of the performance targets,

- awards will be subject to absolute underlying earnings per share ('EPS') growth,
- for initial awards minimum underlying EPS growth of at least 22 5% must be achieved over the three year performance period, for which the match would be half a share for each share deferred rising to a match of a full share for each share deferred if EPS growth of 52% is achieved
- participants will be entitled to dividends or dividend equivalents (paid at the end of the deferral period) on the Deferred Shares and on the Matching Award to the extent this vests
- if a participant ceases employment as a result of ill health, death, or as a result of the participant's employing company ceasing to be a part of the QinetiQ Group, any unvested portion will vest pro-rata for time and performance, and
- the Remuneration Committee will determine the proportion of a Matching Award that will vest, and intends to apply the following in the event of a change of control (other than a reorganisation)
  - Matching Awards will generally vest pro-rata for time and performance
  - Alternatively the Committee may seek agreement from the company that has obtained control to offer participants replacement awards over shares in the controlling company to the extent that performance conditions have been satisfied up to the change in control

Shareholding requirement

Executives are encouraged to maintain equity interests in the Group Given the current levels of executive equity interests, coupled with the current lock in arrangements which control the Executive Directors' ability to sell shares over a three year period post the IPO, the Committee does not consider it necessary to introduce a further formal shareholding requirement for the Executive Directors and other executives at this stage

Dilution limits

There is a ceiling of 10% of issued share capital over a 10-year period on the use of new issue shares in connection with the Group's all employee share schemes In relation to discretionary schemes there is a 5% ceiling In the year ended 31 March 2007, all outstanding awards under the QinetiQ Group Share Option Scheme represented 1 6% of the issued share capital

In July 2003, all employees were granted share options under the QinetiQ Share Option Plan Dilution limits do not include rights to shares relating to options granted prior to the IPO

Performance graph

The graph below compares the Company's Total Shareholder return over the period from flotation to 31 March 2007 with the FTSE 250 and FTSE 350 Aerospace & Defence sector Total Return Indices over the same period

Non-executive Directors' terms, conditions and fees

The executive members of the Board review the fees of the Non-executive Directors and make recommendations to the Board Non executive Directors receive additional fees as agreed by the Board for the chairmanship of Board committees The Chairman's remuneration is determined by the Remuneration Committee and is approved by the Board The fees take account of the responsibilities of the role The level of fees paid in UK organisations of a similar size and complexity to QinetiQ are considered in setting remuneration policy for Non-executive Directors The fees are neither performance related nor pensionable Non executive Directors are not eligible to participate in bonus, profit sharing or employee share schemes The annual fees are due for review in October 2007

Report of the Remuneration Committee continued

Service agreements

The Chairman's contract as an Executive continued until 30 September 2006 after which he became a Non executive It is proposed that from 1 August 2007, the Chairman's term of appointment be on a 12 month rolling basis Further detail on this is provided in the Governance section of the report The date of most recent reappointment is shown below

	Notice to be given by the Company	Date of most recent service agreement	Date of appointment
Non-executives			
Sir John Chisholm	–	1 October 2006	February 2003
Sir David Lees	–	16 February 2006	August 2005
Nick Luff	–	16 February 2006	June 2004
Dr Peter Fellner	–	16 February 2006	September 2004
Noreen Doyle	–	16 February 2006	October 2005
Colin Balmer	–	16 February 2006	February 2003
George Tenet	–	24 October 2006	October 2006
Executives			
Graham Love	12 months	1 December 2005	February 2003
Doug Webb	12 months	1 October 2005	September 2005

Non executive Directors contracts are renewed on a rolling 12 month basis subject to re-appointment at the Annual General Meeting with no notice period There are no provisions in their contracts for compensation on early termination The service agreements/letters of appointment were reviewed and updated in preparation for IPO and the Board received advice on current best practice from its legal advisers Herbert Smith LLP Consequently, the Board believes that the current contracts are in line with best practice

External appointments

It is QinetiQ's policy to permit Executive Directors to broaden their knowledge and experience by becoming Non-executive Directors of other companies Appointments are approved by the Board or Committee on the basis that there is no conflict of interest or deterioration in the Executive's performance Fees are normally retained by the individual During the year ended 31 March 2007, no Executive Director held such an appointment at a public company

Audited information

The information on Directors' remuneration and Directors' interests on pages 54 to 56 has been audited Where Executive Directors were appointed or resigned during the year, but have been employees of QinetiQ for the whole year, the sums shown reflect the elements of their remuneration over the period of their directorship

all figures in £	Salary/fees	Bonus[a]	Benefits[b]	Total 2007	Total 2006
Executive Directors					
Graham Love	299,916	170,000	74,983[c]	544 899	561,112
Doug Webb	259,250[d]	140,000	16,029[e]	415,279	208,637[f]
Non-executive Directors					
Sir John Chisholm[g]	247,500	85,000	56,153[h]	388,653	561,015
Sir David Lees	50,000	–	–	50,000	28,333
Nick Luff	40 000	–	–	40 000	35,833
Dr Peter Fellner	40,000	–	–	40 000	33,593
Noreen Doyle	35,000	–	–	35,000	13,826
Colin Balmer	35,000	–	–	35,000	2,917
George Tenet[i]	47,754	–	–	47,754	–
Former Directors					
Glenn Youngkin[j]	–	–	–	–	–
	1,054,420	395,000	147,165	1,596,585	1,445,266

[a] Performance bonuses were earned but not paid in the financial period
[b] Benefits apart from pensions
[c] Includes car allowance and payment in lieu of pension contributions
[d] Before deductions to basic salary for SMART pensions (salary sacrifice arrangement)
[e] Includes car allowance life assurance and health insurance benefits
[f] Part year from appointment as Executive Director
[g] Includes fees as an Executive Chairman from 1 April to 30 September 2006
[h] Includes life assurance health insurance company car benefit and a payment in respect of tax on pension contributions
[i] Appointed 24 October 2006
[j] Resigned from the Board 8 February 2007

Pensions

The Group's policy is to offer all UK employees membership of the QinetiQ Pension Scheme as described in note 39 to the financial statements This Scheme contains both defined benefit and defined contribution sections Sir John Chisholm was a member of the defined benefit section until 30 September 2006 Doug Webb is a member of the defined contribution section

Disclosures in respect of Sir John Chisholm

Disclosure in relation to defined benefits

Details of the value of individual pension entitlements and information relating to defined benefits available to Sir John Chisholm under the QinetiQ Pension Scheme, as required under the Companies Act 1985 are shown below

	Additional accrued pension earned in the period (including inflation) £ p.a	Additional accrued lump sum earned in the period (including inflation) £	Accrued pension entitlement at 31 March 2007 £ p a	Accrued lump sum entitlement at 31 March 2007 £	Transfer value at 31 March 2007 £	Transfer value at 31 March 2006 £	Increase in transfer value less Director's contributions £
Sir John Chisholm	913[1]	2,738[1]	6 570[2]	–	135 861[2]	155,628	(24,088)

The additional information required under the FSA's Listing Rules is given below

	Additional accrued pension earned in the year (excluding inflation) £ p a	Additional accrued lump sum earned in the year (excluding inflation) £	Transfer value of increase in accrued benefits (excluding inflation) at 31 March 2007 less Director s contributions £
Sir John Chisholm	672[1]	2,016[1]	11,592

Notes to pension benefits

[1] The member retired from the scheme on 30 September 2006 with an accrued pension of £7 602 p a The member was also entitled to a separate lump sum of £22 806 The additional accrued pension in the above tables reflects the increase in accrued pension between 31 March 2006 and 30 September 2006

[2] On retirement, the member opted to commute pension for an additional lump sum The total lump sum paid was £43,799 The pension commencing on retirement at 30 September 2006 (after commutation of pension for additional lump sum) was £6 570 p a The transfer value at 31 March 2007 reflects the value of this pension in payment.

[3] The transfer values have been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11

[4] Members of the scheme have the option to pay Additional Voluntary Contributions neither the contributions nor the resulting benefits are included in the above table

As required under IAS 24, the value of individual pension entitlements relating to defined benefits available to Sir John Chisholm under the QinetiQ Pension Scheme for the six months to 30 September 2006, less member contributions, valued on the IAS 19 basis were £15,092

Disclosure in relation to defined contributions

Details of the contributions payable to the Sir John Chisholm Retirement Benefits Scheme, as required under Schedule 7A Section 12(3) of the Companies Act 1985 LR 9 8 8(11) of the FSA's Listing Rules and IAS 24 are shown below

The Company contributions payable in respect of the year to 31 March 2007 were £17 319 This contribution was prepaid on 21 February 2006

Disclosures in respect of Doug Webb

Details of the contributions payable to the Defined Contribution section of the QinetiQ Pension Scheme, as required under Schedule 7A Section 12(3) of the Companies Act 1985, LR 9 8 8(11) of the FSA s Listing Rules and IAS 24 are shown below

The Company contributions payable in respect of the year to 31 March 2007 were £27 233 These represent notional payments before SMART pension arrangements

Directors' interest under Share Incentive Plan

The company operates a UK all employee Share Incentive Plan in which Executive Directors are eligible to participate
Details of their interests in this scheme are given below

Name	Interest as at 31 March 2006	Partnership shares acquired during year	Matching shares appropriated during year	Dividend shares allocated during year	Interest as at 31 March 2007
Sir John Chisholm	250	nil	nil	4	254
Graham Love	250	750	250	13	1,263
Doug Webb	250	750	250	13	1,263

Report of the Remuneration Committee continued

Directors' interests

The interests of the Directors in office at 31 March 2007 in the shares of QinetiQ Group plc, including shares held under the Share Incentive Plan, were as follows

Name	Number of 1p ordinary shares held at 1 April 2006	Number of 1p ordinary shares held at 31 March 2007
Sir John Chisholm	12,989,048	13 001 004
Graham Love	10,676,548	7,779,513
Doug Webb	616,165	619,130
Sir David Lees	17,000	17,000
Nick Luff	17,000	27,000
Dr Peter Fellner	17 000	17,000
Noreen Doyle	17,000	17,000
Colin Balmer	–	–
George Tenet	–	–

	Grant date	Number at 1 April 2006	Granted in year	Exercised in year[1]	Lapsed in year	Number at 31 March 2007	Exercise price	Earliest exercise date	Expiry date
Sir John Chisholm									
All-employee share option plan	25 07 03	1 702	–	1,702	–	–	2 3p	–	–
Total		**1,702**	–	**1,702**	–	–	–	–	–
Graham Love									
All-employee share option plan	25 07 03	1,702	–	1,702	–	–	2 3p	–	–
Total		**1,702**	–	**1,702**	–	–	–	–	–
Doug Webb									
QinetiQ Share Option Scheme (approved)[2]	22 02 06	14 043	–	–	–	14,043	208p	22 02 09	22 08 09
QinetiQ Share Option Scheme (unapproved)[2]	22 02 06	230,769	–	–	–	230,769	208p	22 02 09	22 08 09
All-employee share option plan	25 07 03	1,702	–	1,702	–	–	–	–	–
Total		**246,514**	–	**1,702**	–	**244,812**	–	–	–

[1] Sir John Chisholm Graham Love and Doug Webb exercised 1 702 options each under the all-employee share option plan on 10 August 2006, 27 July 2006 and 25 July 2006 respectively The share prices on these dates were 161 75p 164p and 164 75p respectively

[2] These shares are subject to an EPS performance condition such that no options will vest unless growth of underlying EPS is at least 22 5% over the performance period Full vesting will occur only where underlying EPS grows by a minimum of 52% over the performance period

[3] The mid-market price for the Company s shares at 31 March 2007 was 187 25p The highest and lowest share price during the year ended 31 March 2007 were 218.5p (23 January 2007) and 160 75p (15 August 2006) respectively

By Order of the Board

Dr Peter Fellner
Chairman of the Remuneration Committee
QinetiQ Group plc
31 May 2007

Report of the Directors

The Directors present their report and the audited financial statements for the year to 31 March 2007

Principal activity
The Group s principal activity is the supply of scientific and technical solutions and services

Business review
The profit of the Group before tax was £89 3m (2006 £72 5m)

A description of the Group's performance during the year and the likely future developments is contained in the reports of the Chairman and Chief Executive Officer on pages 2 to 6 and in the Business Review on pages 20 to 39

Principal risks and uncertainties
A description of the Group's principal risks and uncertainties is contained in the Business Review on pages 22 to 23

Principal changes to the Group
The Group made a number of acquisitions and disposals in the year which are disclosed in detail in note 13 on pages 80 to 81

Research and development
One of the Group's principal business streams is the provision of funded research and development for customers The Group also invests in the commercialisation of promising technologies across all areas of business Further description of the Group's research and development activity is contained in the Business Review on pages 20 to 39

Proposed dividend
The Directors recommend the payment of a final dividend of 2 45p per ordinary share (2006 2 25p) During the year the Group paid an interim dividend of 1 2p per share (2006 £nil) During the prior year the Group paid a preference share dividend of £8 9m on the redemption of the outstanding Cumulative Preference Shares

Policy and practice on payment of suppliers
The policy of the Group is to agree terms of payment prior to commencing trade with a supplier and to abide by those terms based on the timely submission of satisfactory invoices At 31 March 2007 the trade creditors of the Group represented 31 days of annual purchases (2006 31 days)

Principal financial instrument risks and uncertainties
The Group's principal risks in relation to the use of financial instruments arise on contracting with customers in foreign currencies and through the use of interest rate swaps and caps to manage interest rate exposure on the Group's borrowings A more detailed description of the Group's principal risks and uncertainties and policies related to the use of financial instruments is contained in the Business Review on pages 20 to 39

Directors and Directors' interests
The Directors in office at the date of this report and details of the Board Committees on which they sit are detailed on pages 40 and 41 The dates of Director appointments can be found on page 54 Details of the Directors' emoluments and interests are shown in the Report of the Remuneration Committee on pages 50 to 56

Employees
The Group is an equal opportunities employer, upholds the principles of the UK Employment Service's 'Two Ticks symbol and is accredited by Investors in People Every possible consideration is given to applications for employment, regardless of gender, religion, disability or ethnic origin, having regard only to skills and competencies This policy is extended to existing employees and any change which may affect their personal circumstances The policy is supported by strategies for professional and career development

QinetiQ seeks to utilise a range of communication channels to employees in order to involve them in the running of the organisation This is done using various media including in house magazines, intranet, regular newsletters, bulletins, management briefings, trade union consultation and widespread training programmes

Environment
Details of the Group's policy and practice in relation to the environment is detailed in the Corporate Responsibility report, contained in the Business Review on pages 37 to 39

Political and charitable contributions
The Group s policy is not to make political contributions Donations during the year to UK charities amounted to £19,000 (2006 £54,000)

Corporate Governance
The Company's application of the principles of good governance in respect of the Combined Code, as revised by the Financial Reporting Council June 2006, is described in the Statement of Corporate Governance on pages 42 to 49

Report of the Directors continued

Share Capital
At 31 May 2007 being the latest practicable date prior to the issuance of this report the Group had been notified of the following shareholdings of at least 3% in the ordinary share capital of the Group

UK Ministry of Defence	18 9%
Lansdowne Partners Ltd	9 1%
BlackRock, Inc	6 0%
Fidelity International Ltd	5 2%
Allianz SE	3 1%

Post balance sheet event
On 16 April 2007 the Group completed the acquisition of Washington based ITS Corporation through its subsidiary QinetiQ North America Operations LLC for an initial cash consideration of £40 8m ($80 0m) On 23 April 2007 the Group announced the agreement to purchase Applied Perception, Inc and Automatika, Inc both providers of robotics technologies, for up to £4 7m ($9 2m) each

Statement of disclosure of information to auditors
The Directors who held office at the date of approval of this directors report confirmed that so far as the Directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and the Directors have taken all the steps they reasonably ought to have taken as Directors to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information

Statement of Directors' responsibilities in respect of the Annual Report and the financial statements
The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements, in accordance with applicable law and regulations

Company law requires the Directors to prepare Group and parent company financial statements for each financial year Under that law they are required to prepare the Group financial statements in accordance with IFRS as adopted by the EU and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards

The Group financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position and performance of the Group the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company In preparing each of the Group and parent company financial statements, the Directors are required

- to select suitable accounting policies and then apply them consistently,
- to make judgements and estimates that are reasonable and prudent,
- to state for the Group financial statements, whether they have been prepared in accordance with IFRS as adopted by the EU, and
- to state for the parent company financial statements, whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985 They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with the law and those regulations

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

Annual General Meeting
The Company's Annual General Meeting will be held on 26 July 2007

By order of the Board

Lynton Boardman
Company Secretary
85 Buckingham Gate
London SW1E 6PD
31 May 2007

Independent Auditors' Report to the members of QinetiQ Group plc

We have audited the Group and parent company financial statements (the 'financial statements') of QinetiQ Group plc for the year ended 31 March 2007 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group Cash Flow Statement, Group Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein We have also audited the information in the Report of the Remuneration Committee that is described as having been audited

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors
The Directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU, and for preparing the parent company financial statements and the Report of the Remuneration Committee in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' responsibilities on page 58.

Our responsibility is to audit the financial statements and the part of the Report of the Remuneration Committee to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Report of the Remuneration Committee to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation We also report to you whether in our opinion the information given in the Report of the Directors is consistent with the financial statements The information given in the Report of the Directors includes that specific information presented in the Business Review that is cross referenced from the Report of the Directors We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed

We review whether the Statement of Corporate Governance reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any other information

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Report of the Remuneration Committee to be audited It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Report of the Remuneration Committee to be audited are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Report of the Remuneration Committee to be audited

Opinion
In our opinion

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the Group's affairs as at 31 March 2007 and of its profit for the year then ended,
- the parent company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 March 2007,
- the financial statements and the part of the Report of the Remuneration Committee to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements Article 4 of the IAS Regulation, and
- the information given in the Report of the Directors is consistent with the financial statements.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered auditor
London
31 May 2007

Consolidated income statement

for the year ended 31 March

all figures in £ million	note	2007 Before acquisition amortisation	2007 Acquisition amortisation	2007 Total	2006 Before IPO related items and acquisition amortisation	2006 IPO related items and acquisition amortisation	2006 Total
Revenue	2 3	**1,149 5**	**–**	**1,149 5**	**1,051 7**	**–**	**1,051 7**
Employee costs	9	(513 4)	–	(513 4)	(492 0)	(6 8)	(498 8)
Third-party project costs		(258 7)	–	(258 7)	(230 8)	–	(230 8)
Other operating costs excluding depreciation and amortisation		(246 7)	–	(246 7)	(217 5)	(2 1)	(219 6)
Share of post-tax loss of equity accounted joint ventures and associates	18	(1 2)	–	(1 2)	(0 4)	–	(0 4)
Other income	2	11 0	–	11 0	13 5	–	13 5
EBITDA (earnings before interest, tax, depreciation and amortisation)		**140 5**	**–**	**140 5**	**124 5**	**(8.9)**	**115 6**
Depreciation of property, plant and equipment	14	(31 7)	–	(31 7)	(32 7)	–	(32 7)
Amortisation of intangible assets	4	(2 8)	(12 6)	(15 4)	(1 1)	(12 3)	(13 4)
Group operating profit	3	**106 0**	**(12 6)**	**93.4**	**90 7**	**(21 2)**	**69 5**
Gain on business divestments and unrealised impairment of investment	5a	4 6	–	4 6	–	–	–
Profit on disposal of non current assets	5b	3 3	–	3 3	8 9	–	8 9
Finance income	6	4 2	–	4 2	8 4	4 7	13 1
Finance expense	6	(16 2)	–	(16 2)	(19 0)	–	(19 0)
Profit before tax	4	**101 9**	**(12 6)**	**89 3**	**89 0**	**(16 5)**	**72 5**
Taxation expense	7	(25 0)	4 7	(20 3)	(16 6)	4 5	(12 1)
Profit for the year		**76 9**	**(7 9)**	**69 0**	**72 4**	**(12 0)**	**60 4**
Profit attributable to							
Equity shareholders of the parent company	33	76 9	(7 9)	69 0	70 1	(12 0)	58 1
Minority interest	33	–	–	–	2 3	–	2 3
		76 9	**(7 9)**	**69 0**	**72 4**	**(12 0)**	**60 4**
Earnings per share							
Basic	10			10 5p			10 0p
Diluted	10			10 3p			9 8p
Underlying	10			11 3p			10 2p

Consolidated balance sheet

as at 31 March

all figures in £ million	note	2007	2006 Restated
Non-current assets			
Goodwill	11	373 1	314 9
Intangible assets	12	65 0	57 1
Property, plant and equipment	14	341 5	340 3
Investment property	15	–	5 8
Financial assets	16	18 8	22 1
Investments	17	28 5	1 3
Investments accounted for using the equity method	18	0 3	0 6
Deferred tax asset	25	11 0	11 8
		838 2	**753 9**
Current assets			
Inventories	19	39 5	25 4
Financial assets	16	4 0	3 0
Trade and other receivables	20	401 2	332 6
Cash and cash equivalents	21	20 0	58 9
Investments	22	4 0	11 2
Non-current assets classified as held for sale		1 8	3 6
		470 5	**434 7**
Total assets		**1,308 7**	**1,188 6**
Current liabilities			
Trade and other payables	23	(339 4)	(300 1)
Current tax		(6 9)	(2 6)
Provisions	24	(1 1)	(17 3)
Financial liabilities	26	(15 9)	(6 6)
		(363 3)	**(326 6)**
Non-current liabilities			
Retirement benefit obligation (gross of deferred tax)	39	(90 8)	(168 4)
Deferred tax liability	25	(30 9)	(8 2)
Provisions	24	(13 1)	(9 2)
Financial liabilities	27	(327 7)	(310 4)
Other payables		(5 5)	(2 9)
		(468 0)	**(499 1)**
Total liabilities		**(831 3)**	**(825 7)**
Net assets		**477 4**	**362 9**
Capital and reserves			
Ordinary Shares	32	6 6	6 5
Capital redemption reserve	33	39 9	39 9
Share premium account	33	147 6	147 5
Own shares	33	(0 1)	–
Hedging and translation reserve	33	(13 1)	4 9
Retained earnings	33	296 4	164 7
Capital and reserves attributable to shareholders of the parent company		**477 3**	**363 5**
Minority interest	33	0 1	(0 6)
Total shareholders' funds		**477 4**	**362 9**

The financial statements were approved by the Board of Directors and authorised for issue on 31 May 2007 and were signed on its behalf by

Graham Love
Chief Executive Officer

Doug Webb
Chief Financial Officer

Consolidated cash flow statement

for the year ended 31 March

all figures in £ million	note	2007	2006
Profit for the year		**69 0**	**60 4**
Taxation expense		20 3	12 1
Net finance costs		12 0	5 9
IPO costs		–	8 9
Gain on business divestments and unrealised impairment of investment		(4 6)	–
Profit on disposal of non current assets		(3 3)	(8 9)
Depreciation of property, plant and equipment		31 7	32 7
Amortisation of intangible assets		15 4	13 4
Share of post tax loss of equity accounted joint ventures and associates		1 2	0 4
Increase in inventories		(15 5)	(9 9)
(Increase)/decrease in receivables		(33 9)	42 2
Increase/(decrease) in payables		27 0	(31 8)
Decrease in provisions		(12 3)	(17 8)
Cash inflow from operations		**107 0**	**107.6**
Tax paid		(3 3)	(4 4)
Interest received		4 2	3 4
Interest paid		(13 8)	(12 8)
Preference share interest paid		–	(10 5)
Net cash inflow from operating activities		**94 1**	**83 3**
Purchase of intangible assets		(12 1)	(8 5)
Purchase of property, plant and equipment		(34 8)	(45 0)
Sale of property plant and equipment		8 6	111 5
Investments in associate undertaking and other investments		(9 4)	(1 2)
Purchase of subsidiary undertakings		(134 3)	(202 5)
Sale of interest in subsidiary undertakings		17 9	–
Net cash outflow from investing activities		**(164 1)**	**(145 7)**
Net (costs)/proceeds from IPO		(2 0)	136 2
Cash outflow from repayment of loans		(79 2)	(75 4)
Cash outflow from repayment of loan notes		(1 4)	(45 9)
Cash inflow from loans received		131 3	198 9
Cash inflow from loan notes		1 3	–
Payment of deferred finance costs		(0 4)	–
Preference share repayment		–	(37 5)
Equity dividends paid		(22 7)	–
Receipt of MOD indemnity		–	45 3
Additional pension contributions		–	(106 4)
Capital element of finance lease rental payments		(5 9)	(2 2)
Capital element of finance lease rental receipts		3 5	3 0
Net cash inflow from financing activities		**24 5**	**116 0**
(Decrease)/increase in cash and cash equivalents	29	**(45 5)**	**53 6**
Effect of foreign exchange changes on cash and cash equivalents		(0 5)	–
Cash and cash equivalents at beginning of year		58 6	5 0
Cash and cash equivalents at end of year		**12 6**	**58 6**
Cash and cash equivalents	21	20 0	58 9
Overdrafts	30	(7 4)	(0 3)
Cash and cash equivalents at end of year		**12 6**	**58 6**

Consolidated statement of recognised income and expense

for the year ended 31 March

all figures in £ million	note	2007	2006
Net loss on hedge of net investment in foreign subsidiary	33	(14 4)	(2 0)
(Decrease)/increase in fair value of hedging derivatives	33	(5 6)	4 9
Movement in deferred tax on hedging derivatives	33	2 0	(1 5)
Gain/(loss) on available for sale financial assets	33	10 0	(1 6)
Actuarial gains/(losses) recognised in the defined benefit pension schemes	33	85 8	(105 4)
(Decrease)/increase in deferred tax asset due to movement in pension deficit	33	(17 9)	8 7
Net income recognised directly in equity		**59 9**	**(96 9)**
Profit for the year		69 0	60 4
Total recognised income and expense for the year		**128 9**	**(36 5)**
Attributable to			
Equity shareholders of the parent company		128 9	(38 8)
Minority interest		–	2 3
		128 9	**(36 5)**

Notes to the financial statements

1 Significant accounting policies

Accounting policies
The following accounting policies have been applied consistently to all periods presented in dealing with items which are considered material in relation to the Group's financial statements Certain comparatives have been restated following the finalisation during the year of the fair values of acquisitions completed in the prior year Further details on the restatements are provided in note 40

Basis of preparation
The Group financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU ('IFRS') The Company has elected to prepare its parent company financial statements in accordance with UK GAAP, these are presented on pages 107 to 109

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities (including derivative financial instruments at fair value through the income statement) Non current assets held for sale are held at the lower of historic cost and fair value The Group is domiciled in the United Kingdom The Group's functional currency is sterling and unless otherwise stated the financial statements are rounded to the nearest hundred thousand

Basis of consolidation
The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings up to 31 March 2007 The purchase method of accounting has been adopted Under this method, the results of 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)

A subsidiary is an entity over which the Group has the power to govern financial and operating policies in order to obtain benefits An associate is an undertaking over which the Group exercises significant influence (usually from 20% to 50% of the equity voting rights) 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 up to the date of disposal 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

Revenue
Revenue (net of value added and other sales taxes) represents the value of work performed for customers, measured on the following bases

- revenue from fixed price contracts is recognised in proportion to the value of the work performed and includes attributable profit Depending on the nature of the contract revenue is recognised as contractually agreed-upon milestones are reached, as units are delivered or as the work progresses,
- revenue on cost plus and time and materials contracts is recognised as work is performed,
- royalty revenue is recognised on the earlier of the date on which the income is earned and measurable with reasonable certainty or cash is received and
- revenue from sales of products and licensing of technology is recognised on acceptance by the customer and when the amount of revenue can be measured reliably

Third party project costs
Third party project costs primarily consist of subcontracted research and development costs and purchased materials incurred on behalf of customers as part of funded projects, together with direct material costs used in product manufacture

Profit recognition
Profit on the supply of professional services on cost plus or time and materials contracts is recognised as the work is performed Profit on fixed price contracts is recognised on a percentage of completion basis once the contract's ultimate outcome can be foreseen with reasonable certainty The principal estimation method used by the Group in attributing profit on contracts to a particular accounting period is the preparation of forecasts on a contract by contract basis These focus on the costs to complete and enable an assessment to be made of the most likely final out-turn of each contract Consistent contract review procedures are in place in respect of contract forecasting. Losses on completion are recognised in full as soon as they are foreseen

Segmental information
Segmental information is presented in two formats the primary format reflects the Group's management structure and markets in which the Group operates, whereas the secondary format is based on geography (i e location of customers) The principal activities of the Group are managed through four sectors organised according to the distinct markets the Group operates in

- Defence & Technology which primarily delivers technology solutions and managed services that support the armed forces of the UK,
- Security & Dual Use Core which primarily delivers security and technology solutions and consultancy to civil and government customers
- Security & Dual Use Ventures which primarily comprises commercial product businesses and business venturing activities, and
- QinetiQ North America which primarily provides technology and services to the US Government.

Segment results represent the contribution of the different segments to the profit of the Group Corporate expenses are allocated to the corresponding segments Unallocated items comprise mainly profit on disposal of non-current assets, business divestments and unrealised impairment of investments, IPO costs financing costs and taxation Eliminations represent inter-company trading between the different segments

Segment assets comprise property plant and equipment, goodwill and other intangible assets, trade and other receivables, inventories and prepayments and accrued income Unallocated assets represent mainly corporate assets, including property, cash and cash equivalents and deferred tax asset balances Segment liabilities comprise trade and other payables, accruals and deferred income and debt specifically used to finance activities and acquisitions Unallocated liabilities represent mainly corporate liabilities, including retirement benefit obligations, current and deferred tax liabilities and bank and other borrowings Segment assets and liabilities are as at the end of the year

Research and development expenditure
Research and development costs incurred on behalf of a customer as part of a specific project are chargeable to the customer on whose behalf the work is undertaken The costs and the related income are included in their relevant income statement cost category and revenue respectively

Internally funded development expenditure is capitalised in the balance sheet where there is a clearly defined project the expenditures are separately identifiable the project is technically and commercially feasible, all costs are recoverable by future revenue and the resources exist to complete the project Such capitalised costs are written off over the forecast period of sales resulting from the development All other research and development costs are written off to the income statement in the period in which they are incurred If the research phase cannot be clearly distinguished from the development phase, the respective project-related costs are treated as if they were incurred in the research phase only and expensed

Financing
Financing represents the financial expense on borrowings accounted for using the effective rate method and the financial income earned on funds invested Exchange differences on financial assets and liabilities and the income or expense from interest hedging instruments that are recognised in the income statement are included within interest income and expense in financing

Taxation
The taxation charge is based on the profit for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes

Deferred taxation is the tax attributable to the temporary differences that appear when taxation authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated financial statements The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using rates enacted or substantively enacted at the balance sheet date Any change in the tax rates are recognised in the income statement unless related to items directly recognised in equity Deferred tax liabilities are recognised on all taxable temporary differences excluding non-deductible goodwill Deferred tax assets are recognised on all deductible temporary differences provided that it is probable that future taxable income will be available against which the asset can be utilised Deferred tax assets and liabilities are only offset where there is a legally enforceable right to offset and there is an intention to settle balances net

Goodwill
Business combinations are accounted for under the purchase accounting method All identifiable assets acquired and liabilities and contingent liabilities incurred or assumed are recorded at fair value at the date control is transferred to QinetiQ, irrespective of the extent of any minority interest The cost of a business combination is measured at the fair value of assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition Any excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised is capitalised as goodwill Goodwill is subject to annual impairment reviews (see below) If the cost of an acquisition is less than the fair value of the net assets acquired, the difference is immediately recognised in the Consolidated Income Statement

Intangible assets
Intangible assets recognised on business combinations are at fair value which is calculated as the present value of future cash flows expected to be derived from those assets Internally generated intangible assets are recorded at cost, including labour, directly attributable overhead and any third party expenses Purchased intangible assets are recognised at cost less amortisation Intangible assets are amortised over their respective useful lives on a straight line basis as follows

Intellectual property rights	2-8 years
Development costs	Useful economic life or unit of production method subject to a minimum amortisation of no less than straight line method over economic life of 1-4 years
Other	1-5 years

Property, plant and equipment
Property plant and equipment are stated at cost less depreciation Freehold land is not depreciated Other tangible non-current assets are depreciated on a straight line basis over their useful economic lives to their estimated residual value as follows

Freehold buildings	20-25 years
Leasehold land and buildings	Shorter of useful economic life and the period of the lease
Plant and machinery	3-10 years
Fixtures and fittings	5-10 years
Computers	3-5 years
Motor vehicles	3-5 years

Assets under construction are included in property, plant and equipment on the basis of expenditure incurred at the balance sheet date In the case of assets constructed by the Group, the value includes the cost of own work completed, including directly attributable overheads but excluding interest

Notes to the financial statements continued

The useful lives depreciation methods and residual values applied to property, plant and equipment are reviewed annually and if they change significantly depreciation charges for current and future periods are adjusted accordingly If the carrying amount of any asset exceeds its recoverable amount an impairment loss is recognised immediately in the income statement

Investment property
The Group accounts for investment property using the cost model Investment property is recorded on balance sheet at cost less any accumulated depreciation and any accumulated impairment losses The fair value of investment property is reviewed annually by management or expert valuers where appropriate

Impairment of tangible, intangible and held for sale assets
The Group assesses at each reporting date whether there is an indication that an asset may be impaired In addition, goodwill is tested for impairment annually irrespective of any indication of impairment If the carrying amount exceeds the recoverable amount, the respective asset or the assets in the cash generating unit are written down to their recoverable amounts The recoverable amount of an asset or a cash generating unit is the higher of its fair value less costs to sell and its value in use The value in use is the present value of the future cash flows expected to be derived from an asset or cash generating unit calculated using an appropriate discount rate Impairment losses are expensed to the income statement

Inventories
Inventory and work-in-progress (including contract costs) are stated at the lower of cost and net realisable value Work-in-progress and manufactured finished goods are valued at production cost. Production cost includes direct production costs and an appropriate proportion of production overheads A provision is established when the net realisable value of any inventory item is lower than its cost

Bid costs
Costs incurred in bidding for work are normally expensed as incurred In the case of large multi year government contracts the bidding process typically involves a competitive bid process to determine a preferred bidder and then a further period to reach financial close with the customer In these cases, the costs incurred after announcement of the Group achieving preferred bidder status are deferred to the balance sheet within work-in-progress from the point financial close is reached and amortised over the life of the contract If an opportunity for which the Group was awarded preferred bidder status fails to reach financial close the costs deferred to that point will be expensed in the income statement immediately it becomes likely that financial close will not be achieved

Amounts recoverable on contracts and payments received on account
Amounts recoverable on contracts are included in trade and other receivables and represent revenue recognised in excess of amounts invoiced Payments received on account are included in trade and other payables and represent amounts invoiced in excess of revenue recognised

Cash and cash equivalents
Cash and cash equivalents comprise cash at bank and short-term deposits that are readily convertible into cash In the cash flow statement overdraft balances are included in cash and equivalents

Current and non-current liabilities
Current liabilities include amounts due within the normal operating cycle of the Group

Interest-bearing current and non-current liabilities are recognised at fair value and then stated at amortised cost with any difference between the cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis

Provisions
A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation If the effect is material, provisions are determined by discounting the expected cash flows at the Group's weighted average cost of capital

Financial instruments
Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument The derecognition of a financial instrument takes place when the Group no longer controls the contractual rights that comprise the financial instrument, which is normally the case when the instrument expires or is sold terminated or exercised

Leased assets
Assets held under finance leases are capitalised and included in property, plant and equipment at the lower of the present value of minimum lease payments and fair value at the inception of the lease Assets are then depreciated over the shorter of their useful economic lives or the lease term Obligations relating to finance leases, net of finance charges arising in future periods are included under creditors Rentals payable under operating leases are charged to the income statement on a straight line basis over the term of the lease

Non-current assets held for sale
Where the carrying value of an asset will be recovered principally through a sale transaction rather than continuing use the asset is classified as held for sale Held for sale assets are held at the lower of net book value and net realisable value Deprecation is not charged on assets classified as held for sale

Investments in debt and equity securities
Investments held by the Group are classified as either a current asset or as a non current asset and being available for sale are stated at fair value with any resultant gain or loss being recognised directly in equity, except for impairment losses When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in the income statement

The fair value of financial instruments is their quoted bid price at the balance sheet date where available

The fair value of unquoted equity investments is measured in accordance with British Venture Capital Association (BVCA) guidelines The Group s unlisted investments are usually held at fair value based upon the price of the most recent investment by the Group or a third party less any impairment

Derivative financial instruments
Derivative financial instruments are initially recognised at cost and thereafter held at fair value being the market value for quoted instruments or valuation based on models and discounted cash flow calculations for unlisted instruments

Hedging – fair value
Changes in the fair value of fair value hedges of currency risk or the interest rate risk are recognised in the income statement The hedged item is held at fair value with respect to the hedged risk with any gain or loss recognised in the income statement

Hedging – cash flow
Changes in the fair value of derivatives designated as a cash flow hedge that are regarded as highly effective are recognised in equity The ineffective portion is recognised immediately in the income statement Where a hedged item results in an asset or a liability, gains and losses previously recognised in equity are included in the cost of the asset or liability Gains and losses previously recognised in equity are removed and recognised in the income statement at the same time as the hedged transaction

Hedging – net investment
The changes in fair value of derivatives used to hedge the net investment in a foreign entity are recognised in equity until the net investment is sold or disposed Any ineffective portion is recognised directly in the income statement

Loan issue costs
Costs associated with the arrangement of bank facilities or the issue of loans are capitalised and deducted from the associated liability presented in the balance sheet Capitalised issue costs are released over the estimated life of the facility or instrument to which they relate using the effective interest rate method If it becomes clear that the facility or instrument will be redeemed early, the amortisation of the issue costs will be accelerated

Foreign currencies
Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction Monetary assets and liabilities in foreign currencies are translated at period end rates Any resulting exchange differences are taken to the income statement Gains and losses on designated forward foreign exchange hedging contracts are matched against the foreign exchange movements on the underlying transaction

Assets and liabilities of overseas subsidiaries and associated undertakings and joint ventures, including any related goodwill, are translated to sterling at the rate of exchange at the balance sheet date The results and cash flows of overseas subsidiaries and associated undertakings and joint ventures are translated to sterling using the average rates of exchange during the period Exchange adjustments arising from the re-translation of the opening net investment and the results for the period to the period-end rate are taken directly to equity and reported in the Statement of Recognised Income and Expense

Post-retirement benefits
The Group provides both defined contribution and defined benefit pension arrangements The liabilities of the Group arising from defined benefit obligations, and the related current service cost, are determined using the projected unit credit method Valuations for accounting purposes are carried out half yearly for the largest plans and on a regular basis for other plans Actuarial advice is provided by external consultants For the funded defined benefit plans, the excess or deficit of the fair value of plan assets less the present value of the defined benefit obligation are recognised as an asset or a liability respectively

For defined benefit plans the actuarial cost charged to the income statement consists of current service cost interest cost, expected return on plan assets and past service cost All of these elements are charged as a component of employee costs in the income statement Actuarial gains and losses are recognised in full immediately through the Statement of Recognised Income and Expense

Contributions to defined contribution plans are charged to the income statement as incurred

Share-based payments
The Group operates share-based payment arrangements with employees The fair value of equity settled options for share-based payments is determined on grant and expensed straight line over the period from grant to the date of earliest unconditional exercise The fair value of cash settled options for share-based payments is determined each period end until exercised or they lapse The value is expensed straight line over the period from grant to the date of earliest unconditional exercise The fair value of both equity settled and cash settled share options is calculated by a binomial option pricing model The charges for both equity and cash settled share based payments are updated annually for non-market based vesting conditions

Notes to the financial statements continued

Restatement of prior periods for finalisation of fair values arising on acquisitions
The fair values of the net assets of acquired business are finalised within 12 months of the acquisition date, with the exception of certain deferred tax balances All fair value adjustments are recorded with effect from the date of acquisition and consequently may result in the restatement of previously reported financial results (see note 40)

Recent accounting developments
IFRIC 7, Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies (effective for annual periods beginning on or after 1 March 2006) IFRIC 7 provides guidance on how to apply the requirements of IAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period As none of the Group entities has a currency of a hyperinflationary economy as its functional currency, IFRIC 7 is not relevant to the Group's operations

The following new standards or interpretations to existing standards have been published and are mandatory for the Group's future accounting periods They have not been early adopted in these financial statements

IAS 1 (Amendment), Presentation of Financial Statements (effective for annual periods commencing on or after 1 January 2007) The amendment to IAS 1 introduces new Capital Disclosures for an entity regarding an entity's objectives policies, processes and regulation of its capital and quantitative disclosure about what the entity regards as capital The Group will apply the amendment to IAS 1 from April 2007 but does not consider that this will have a significant impact on the Group's relevant disclosures

IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009) IFRS 8 requires an entity to report financial and descriptive information about its reportable segments The Group will apply IFRS 8 from 1 April 2009 but it is not expected to have any significant impact on the Group's financial statements

IAS 23 (Amendment), Borrowing Costs (effective for qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009) The amendment to IAS 23 requires borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale to be capitalised as part of the cost of such assets The Group has reviewed the potential impact of this amendment and does not consider it would have any material impact on the Group's financial statements based on its current operations

IFRS 7, Financial instruments Disclosures This new standard incorporates the disclosure requirements of IAS 32 which it supersedes, and adds further quantitive disclosures in relation to financial instruments The Group will apply IFRS 7 from 1 April 2007, which will impact the Group's relevant disclosures

IFRIC 8, Scope of IFRS 2 (effective for annual periods beginning on or after 1 May 2006) IFRIC 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS 2 The Group will apply IFRIC 8 from 1 April 2007

IFRIC 9, Reassessment of embedded derivatives (effective for annual periods beginning on or after 1 June 2006) IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required IFRIC 9 is not relevant to the Group's operations because none of the terms of the Group s contracts have been changed

IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006) IFRIC 10 prohibits the impairment losses recognised in an interim period on goodwill and investments in equity instruments and in financial assets carried at cost to be reversed at a subsequent balance sheet date The Group will apply IFRIC 10 from 1 April 2007

IFRIC 12, Service Concession Agreements (effective for annual periods beginning on or after 1 January 2008) IFRIC 12 requires that certain elements of service concession agreements may be treated as either a financial asset or an intangible asset The Group has reviewed its long-term managed services agreements and does not consider that IFRIC 12 is relevant to any of its operations

Critical accounting estimates and judgements in applying accounting policies
The following commentary is intended to highlight those policies that are critical to the business based on the level of management judgement required in their application, their complexity and their potential impact on the results and financial position reported for the Group The level of management judgement required includes assumptions and estimates about future events which are uncertain, the actual outcome of which may result in a materially different outcome from that anticipated

Revenue and profit recognition
The estimation process required to evaluate the potential outcome of contracts and projects requires skill, knowledge and experience from a variety of sources within the business to assess the status of the contract, costs to complete, internal and external labour resources required and other factors This process is carried out continuously throughout the business to ensure that project and contract assessments reflect the latest status of such work.

Business combinations

Intangible assets recognised on business combinations have been valued using established methods and models to determine estimated value and useful economic life with input, where appropriate, from external valuation consultants Such methods require the use of estimates which may produce results that are different from actual future outcomes

The Group tests annually whether goodwill and identified intangible assets have suffered any impairment. This process is reliant on the use of estimates of the future profitability and cash flows of its cash generating units which may differ from the actual results delivered

Post-retirement benefits

The Group s defined benefit pension obligations and net income statement costs are based on key assumptions including return on plan assets, discount rates, mortality, inflation and future salary and pension increases Management exercise their best judgement, in consultation with actuarial advisers, in selecting the values for these assumptions that are the most appropriate to the Group Small changes in these assumptions, individually or collectively may result in significant changes in the size of the deficit or the net income statement costs

Research and development expenditure

Internally-funded development expenditure is capitalised when criteria are met and is written off over the forecast period of sales resulting from the development Management decides upon the adequacy of future demand and market for such new products in order to justify capitalisation of internally funded development expenditure which can be difficult to determine when dealing with such innovative technologies Actual product sales may differ from these estimates

Income taxes

In determining the Group s provisions for income tax and deferred tax it is necessary to consider transactions in a small number of key tax jurisdictions for which the ultimate tax determination is uncertain To the extent that the final outcome differs from the tax that has been provided, adjustments will be made to income tax and deferred tax provisions held in the period the determination is made

Unquoted equity investments

The Group usually judges the fair value of unquoted equity investments using the valuation ascribed to the investment by a third party funding round or similar valuation event for that investment In determining the value of an investment the Group may use information from funding rounds, business plans and forecasts market projections and other estimation techniques as a guide These valuation techniques require estimates of the business future performance The actual business performance of investments may differ from these estimates

Notes to the financial statements continued

2. Revenue

Revenue and other income is analysed as follows

all figures in £ million	2007	2006
Sales of goods	133 5	73 2
Services	1,009 1	962 2
Royalties	6 9	16 3
Revenue	**1,149 5**	**1,051 7**
Property rental income	**11 0**	**13.5**

3. Segmental analysis

Business segments
Year ended 31 March 2007

all figures in £ million	Defence & Technology	Security & Dual Use	Ventures	QinetiQ North America	Eliminations	Consolidated
Revenue						
External sales	657 9	121 4	12 0	358 2	–	1 149 5
Internal sales[1]	5 3	10 8	–	0 6	(16 7)	–
	663 2	132 2	12 0	358 8	(16 7)	1,149 5
Other information						
EBITDA before share of equity accounted associates	81 0	21 2	(3 6)	43 1	–	141 7
Share of equity accounted associates	–	–	(1 3)	0 1	–	(1 2)
EBITDA	**81 0**	**21.2**	**(4 9)**	**43 2**	**–**	**140 5**
Depreciation of property, plant and equipment – own equipment	(13 9)	(6 9)	(0 7)	(3 2)	–	(24 7)
Depreciation of property, plant and equipment – LTPA funded	(7 0)	–	–	–	–	(7 0)
Amortisation of purchased or internally developed intangible assets	(1 0)	(0 4)	(1 3)	(0 1)	–	(2 8)
Group operating profit/(loss) before amortisation of intangible assets arising from acquisitions	**59 1**	**13 9**	**(6 9)**	**39 9**	**–**	**106 0**
Amortisation of intangible assets arising from acquisitions	(0 8)	(1 1)	–	(10 7)	–	(12 6)
Group operating profit/(loss)	**58 3**	**12 8**	**(6 9)**	**29 2**	**–**	**93.4**
Gain on business divestments and unrealised impairment of investment						4 6
Profit on disposal of non-current assets						3 3
Net finance expense						(12 0)
Profit before tax						**89.3**
Taxation expense						(20 3)
Profit for the year						**69 0**

[1] Inter segment sales are priced at fair value and treated as an arm s length transaction

3 Segmental analysis continued

Year ended 31 March 2006

all figures in £ million	Defence & Technology	Security & Dual Use	Ventures	QinetiQ North America	Eliminations	Consolidated
Revenue						
External sales	669 6	127 6	6 1	248 4	–	1,051 7
Internal sales[(1)]	9 8	11 3	–	–	(21 1)	–
	679 4	138 9	6 1	248 4	(21 1)	1,051 7
Other information						
EBITDA before IPO costs and share of equity accounted joint ventures and associates	79 0	25 0	(6 2)	27 1	–	124 9
Share of equity accounted joint ventures and associates	–	–	(0 4)	–	–	(0 4)
EBITDA before IPO costs	**79.0**	**25 0**	**(6 6)**	**27 1**	**–**	**124 5**
Depreciation of property plant and equipment – own equipment	(13 2)	(7 3)	(0 9)	(2 5)	–	(23 9)
Depreciation of property, plant and equipment – LTPA funded	(8 8)	–	–	–	–	(8 8)
Amortisation of purchased or internally developed intangible assets	(0 5)	(0 5)	–	(0 1)	–	(1 1)
Group operating profit/(loss) before IPO costs and amortisation of intangible assets arising from acquisitions	**56 5**	**17 2**	**(7 5)**	**24 5**	**–**	**90.7**
Amortisation of intangible assets arising from acquisitions	(2 0)	(0 7)	–	(9 6)	–	(12 3)
Group operating profit/(loss) before IPO costs	**54 5**	**16 5**	**(7 5)**	**14 9**	**–**	**78 4**
IPO costs						(8 9)
Group operating profit						**69 5**
Profit on disposal of non current assets						8 9
Net finance expense						(5 9)
Profit before tax						**72 5**
Taxation expense						(12 1)
Profit for the year						**60 4**

[(1)] Inter segment sales are priced at fair value and treated as an arm's length transaction

The segmental analysis has been modified from the prior year to align with the operational change in the year in which the Ventures are now separately reported from the rest of the Security & Dual Use sector

Notes to the financial statements continued

3 Segmental analysis continued

Year ended 31 March 2007

all figures in £ million	Defence & Technology	Security & Dual Use	Ventures	QinetiQ North America	Unallocated	Consolidated
Segment assets+	535 7	145 0	33 0	547 4	4 8	1,265 9
Segment liabilities+	(175 2)	(60 3)	(5 2)	(77 8)	(78 4)	(396 9)
Unallocated net debt					(300 8)	(300 8)
Unallocated retirement benefit obligation					(90 8)	(90 8)
Net assets	**360 5**	**84 7**	**27 8**	**469 6**	**(465 2)**	**477 4**
Other information						
Capital expenditure – own equipment*	12 7	12 3	0 9	4 1	–	30 0
Capital expenditure – LTPA funded*	16 9	–	–	–	–	16 9
Impairment losses recognised in income statement or equity	–	–	(8 8)	–	–	(8 8)

Year ended 31 March 2006

all figures in £ million	Defence & Technology	Security & Dual Use	Ventures	QinetiQ North America	Unallocated	Consolidated
Segment assets+	463 5	142 0	15 2	449 8	34 1	1,104 6
Segment liabilities+	(143 7)	(72 6)	(3 0)	(53 4)	(67 6)	(340 3)
Unallocated net debt					(233 0)	(233 0)
Unallocated retirement benefit obligation					(168 4)	(168 4)
Net assets	**319 8**	**69 4**	**12 2**	**396 4**	**(434 9)**	**362 9**
Other information						
Capital expenditure – own equipment*	8 3	16 6	0 8	4 3	–	30 0
Capital expenditure – LTPA funded*	23 5	–	–	–	–	23 5
Impairment losses recognised in income statement or equity	–	–	(0 5)	–	–	(0 5)

+ Segment assets and liabilities exclude retirement benefit obligation and net debt

* Capital expenditure is defined as cash paid for property plant and equipment additions and purchased and internally developed intangible assets
For Security & Dual Use this includes spend on UK estates and UK corporate information systems as these UK functions are managed within this sector

3. Segmental analysis continued

Geographical segments

Revenue by customer location

all figures in £ million	Turnover	
	2007	**2006**
United Kingdom	729.9	733.9
North America	385.7	268.7
Other	33.9	49.1
Total	**1,149.5**	**1,051.7**

Assets/(liabilities) by location

all figures in £ million	Gross assets		Gross liabilities	
	2007	**2006**	**2007**	**2006**
United Kingdom	743.7	733.5	(614.1)	(767.9)
North America	557.1	449.8	(213.5)	(53.4)
Other	7.9	5.3	(3.7)	(4.4)
Total	**1,308.7**	**1,188.6**	**(831.3)**	**(825.7)**

Capital expenditure by location

all figures in £ million	**2007**	**2006**
United Kingdom	42.8	49.2
North America	4.1	4.3
Total	**46.9**	**53.5**

4. Profit before tax

The following items have been charged in arriving at profit before tax

all figures in £ million	note	**2007**	**2006**
Fees payable to the auditor			
– Statutory audit		0.7	0.6
– Other services supplied pursuant to legislation		0.2	0.1
– Other services relating to taxation		0.2	0.1
– Other services		0.1	0.1
Total auditor's remuneration*		**1.2**	**0.9**
Inventories recognised as an expense		74.6	33.5
Depreciation of property, plant and equipment			
– Owned assets		29.6	29.8
– Under finance lease		2.1	2.9
Research and development expenditure costs under customer funded contracts		511.1	504.7
Research and development expenditure costs – Group funded		9.0	5.6
Amortisation of intangible assets			
– Acquisition intangible asset amortisation	12	12.6	12.3
– Other intangible amortisation	12	2.8	1.1
		15.4	13.4

* In the year to 31 March 2006 the Group also incurred £3.7m for reporting accountant's and due diligence services from its auditor related to the IPO. This amount was charged to the share premium account.

Notes to the financial statements continued

5a. Gain on business divestments and unrealised impairment of investment

all figures in £ million	2007	2006
Gain on business divestments	13 4	–
Unrealised impairment of investment	(8 8)	–
	4 6	–

On 28 February 2007 Aerospace Filtration Systems, Inc., was sold to Donaldson Inc for £19 9m ($39 0m) resulting in a profit on disposal of £9 9m ($19 4m) Included in the proceeds was £3 1m ($6 0m) of cash held in escrow for a period of two years from the transaction date which has been recorded as a financial asset

On 5 March 2007 QinetiQ Rail Limited was sold to Nomad Holdings Limited (Nomad) in exchange for an 8 6% shareholding in Nomad valued at £4 5m resulting in a profit on disposal of £2 8m At the transaction date QinetiQ also purchased £1 5m of initially zero coupon preference shares in Nomad and these have been recorded at their fair valued at 31 March 2007 of £1 2m

On 3 August 2006 a 12% stake in Aurix Limited was sold to a strategic licensing partner for cash consideration of £1 1m and resulting in a profit on disposal of £0 7m

The unrealised impairment of investment relates to an £8 8m charge to the income statement in respect of the impairment in the carrying value of the quoted pSivida investment (see note 22 for further details)

5b. Profit on disposal of non-current assets

all figures in £ million	2007	2006
Profit on disposal of non-current assets	**3 3**	**8 9**

Current year disposals

On 29 March 2007 the Group unconditionally exchanged on the contract to dispose of its Bedford site resulting in the recognition of £2 5m of profit on disposal net of costs Initial proceeds of £1 8m were received on exchange of contracts The sale completed on 13 April 2007 and a further £15 7m was received at that date The disposal was to a company which was, at the date of the transaction, 50% owned by the Carlyle group of companies From the start of the year through to 14 February 2007, when they disposed of their entire shareholding, Carlyle was a related party of the Group by virtue of its 10 2% interest in the ordinary share capital of QinetiQ Group plc The transaction was completed on an arm s length basis as part of a competitive bidding process

Other disposals in the year generated a net profit of £0 8m of which £0 7m came from property disposals

Prior year disposals

In the year to 31 March 2006 the Group disposed of fixed assets for proceeds of £121 6m with £6 0m of these proceeds due in the following financial year There was a net profit of £8 9m recognised on these disposals

6 Finance income and expense

all figures in £ million	2007	2006
Receivable on bank deposits	2 1	3 8
Finance lease income	2 1	2 4
Release of discount on MOD indemnity	–	2 2
Finance income	**4 2**	**8 4**
Amortisation of recapitalisation fee	(0 2)	(1 6)
Payable on bank loans and overdrafts	(12 3)	(13 3)
Payable on US$ private placement debt	(1 6)	–
Finance lease expense	(1 9)	(1 0)
Amortisation of discount on financial liability	(0 2)	–
Preference share interest	–	(3 1)
Finance expense	**(16.2)**	**(19.0)**
Net finance costs before IPO related items	**(12 0)**	**(10 6)**
Release of remaining discount on MOD indemnity	–	4 7
Net finance expense	**(12 0)**	**(5 9)**

7. Taxation expense

all figures in £ million	2007	2006
Analysis of charge		
UK corporation tax at 30%	–	–
Overseas corporation tax in respect of prior years	(0 2)	–
Overseas corporation tax	13 9	7 4
Total corporation tax	**13 7**	**7 4**
Overseas withholding tax	–	2 4
Deferred tax	6 6	7 7
Deferred tax in respect of prior years	–	(5 4)
Taxation expense	**20 3**	**12 1**
Factors affecting the tax charge in year		
The principal factors reducing the Group's current year tax charge below the UK statutory rate are explained below		
Profit before tax	89 3	72 5
Tax on profit before tax at 30%	**26 8**	**21 8**
Effect of		
Expenses not deductible for tax purposes, research and development relief and non taxable items arising on consolidation	(10 3)	(8 4)
Unprovided tax losses of subsidiaries	1 0	1 3
Overseas withholding tax	–	2 4
Tax in respect of prior years	0 2	(5 4)
Effect of different rates in overseas jurisdictions	3 0	0 4
Taxation expense	**20 3**	**12 1**

Factors affecting future tax charges

The effective tax rate continues to be below the statutory rate in the UK primarily as a result of the benefit of research and development relief in the UK The effective rate is expected to remain below the UK statutory rate in the medium term but is expected to rise as an increasing proportion of taxable profits are generated from the US where the effective rate is broadly in line with the US statutory rate

Notes to the financial statements continued

8. Dividends

During the year to 31 March 2007 the Group has declared and paid equity dividends of £22 7m comprising a 2 25 pence per ordinary share final dividend in respect of the year ended 31 March 2006 paid in August 2006 and a 1 2 pence per ordinary share interim dividend in respect of the year ended 31 March 2007 paid in February 2007 (year to 31 March 2006 £nil) On 31 May 2007 the Directors proposed a dividend of 2 45 pence per ordinary share payable on 31 August 2007

9 Analysis of employee costs

The largest component of operating expenses is employee costs The year end and average monthly number of persons employed by the Group including Directors analysed by business segment, was

	Year end		Monthly average	
	2007 number	2006 number	2007 number	2006 number
Defence & Technology	6,651	6 791	6 773	6 883
Security & Dual Use	1,454	1,556	1,512	1 612
Ventures	82	87	85	83
QinetiQ North America	4,258	2,640	3,154	2 083
Corporate	336	372	346	363
Total	**12,781**	**11,446**	**11,870**	**11,024**

The aggregate payroll costs of these persons were as follows

all figures in £ million	note	2007	2006
Wages and salaries		414 9	408 4
Social security costs		36 4	35 2
Other pension costs		61 0	48 3
Cost of share based payments	34	1 1	0 1
Employee costs before IPO costs		**513 4**	**492 0**
IPO costs	43	–	6 8
Total employee costs		**513 4**	**498 8**

10. Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. For the year ended 31 March 2006 this is presented on an adjusted basis to reflect the share restructuring that took place at IPO. For diluted earnings per share the weighted average number of shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares arising from share options granted. Underlying earnings per share figures are presented below as the Directors believe this to be a good measure of recurring business performance. Underlying earnings per share reflect adjustments for the impact of non-recurring and other items on basic earnings per share.

Year ended 31 March 2007

	Earnings £m	Weighted average number of shares million	Per share amount pence
Basic	69.0	656.6	**10.51**
Effect of dilutive securities – options		11.0	(0.17)
Diluted	69.0	667.6	**10.34**

Underlying earnings per share

	Earnings £m	Weighted average number of shares million	Per share amount pence
Basic	69.0	656.6	**10.51**
Amortisation of intangible assets arising from acquisitions	12.6		1.92
Gain on business divestments and unrealised impairment of investment	(4.6)		(0.70)
Profit on disposal of non current assets	(3.3)		(0.50)
Tax impact of items above	0.4		0.06
Underlying	74.1	656.6	**11.29**

Year ended 31 March 2006

	Earnings £m	Weighted average number of shares million	Per share amount pence
Basic	58.1	582.4	**9.98**
Effect of dilutive securities – options		12.4	(0.21)
Diluted	58.1	594.8	**9.77**

Underlying earnings per share

	note	Earnings £m	Weighted average number of shares million	Per share amount pence
Basic		58.1	582.4	**9.98**
IPO related items	43	4.2		0.72
Amortisation of intangible assets arising from acquisitions		12.3		2.11
Profit on disposal of non-current assets		(8.9)		(1.53)
Tax impact of items above		(0.7)		(0.12)
Brought forward unprovided tax losses utilised in year		(5.4)		(0.93)
Underlying		59.6	582.4	**10.23**

Notes to the financial statements continued

11. Goodwill

all figures in £ million	note	2007	2006
Cost			
At 1 April – restated	40	315 4	132 0
Acquisitions – restated	13	101 7	163 8
Disposals		(7 1)	–
Foreign exchange		(36 4)	19 6
At 31 March – restated		**373 6**	**315 4**
Impairment			
At 1 April and 31 March		0 5	0 5
Net book value at 31 March – restated		**373 1**	**314 9**

Net book value of goodwill at 31 March 2005 amounted to £131 5m

Goodwill at 31 March 2007 was allocated to cash generating units (CGUs) including Apogen £124 9m, Analex £77 4m, FMI £57 3m Westar £52 6m, OSEC £20 6m and PSI £15 0m No other allocations of goodwill are considered significant to the Group's total goodwill The Group tests goodwill for impairment annually and uses value in use as the recoverable amount The Group has made a number of assumptions in determining the value in use of goodwill allocated to a cash generating unit It is assumed that cash generating units perform to the five-year corporate plan This is consistent with the current and prior performance of the cash generating units and current UK and US defence and security spending forecasts The estimates of the long-term growth rates for the CGUs is based on macro economic assumptions and does not exceed the long-term estimate for the sectors in which CGUs operate The Group has assumed that effective tax rates continue after allowing for stated tax rate changes Future cash flows have been discounted at a post tax discount rate of 8% Sensitivity analysis has indicated that no reasonably foreseeable changes in the key assumptions in the impairment model would result in significant impairment charges being recorded in the financial statements

12. Intangible assets

Year ended 31 March 2007

all figures in £ million	note	Acquired intangible assets*	Development costs	Other intangible assets	Total
Cost					
At 1 April 2006 – restated	40	63.7	8.6	2.9	75.2
Additions – internally developed		–	3.2	3.5	6.7
Additions – purchased		–	–	5.4	5.4
Additions – recognised on acquisitions	13	17.6	–	–	17.6
Disposals		(1.2)	(1.3)	(0.7)	(3.2)
Transfers to plant, property and equipment		–	(0.4)	–	(0.4)
Foreign exchange		(6.4)	–	–	(6.4)
At 31 March 2007		**73.7**	**10.1**	**11.1**	**94.9**
Amortisation and impairment					
At 1 April 2006		16.8	0.5	0.8	18.1
Amortisation charge for the year		12.6	1.5	1.3	15.4
Disposals		(0.7)	(1.3)	(0.1)	(2.1)
Foreign exchange		(1.5)	–	–	(1.5)
At 31 March 2007		**27.2**	**0.7**	**2.0**	**29.9**
Net book value at 31 March 2007		**46.5**	**9.4**	**9.1**	**65.0**

Year ended 31 March 2006

all figures in £ million	note	Acquired intangible assets*	Development costs	Other intangible assets	Total
Cost					
At 1 April 2005		38.7	2.3	0.7	41.7
Additions – internally developed		–	6.3	–	6.3
Additions – purchased		–	–	2.2	2.2
Additions – recognised on acquisitions – restated	13, 40	21.7	–	–	21.7
Foreign exchange		3.3		–	3.3
At 31 March 2006 – restated	40	**63.7**	**8.6**	**2.9**	**75.2**
Amortisation and impairment					
At 1 April 2005		4.2	–	0.2	4.4
Amortisation charge for the year		12.3	0.5	0.6	13.4
Foreign exchange		0.3	–	–	0.3
At 31 March 2006		**16.8**	**0.5**	**0.8**	**18.1**
Net book value at 31 March 2006 – restated	40	**46.9**	**8.1**	**2.1**	**57.1**
Net book value at 31 March 2005		34.5	2.3	0.5	37.3

* Acquired intangible assets principally consist of the value of orders backlogs and certain customer relationships, technology and patents/licences No value is attributed to customer relationships where short term contracts are held that are subject to regular re-competes

Notes to the financial statements continued

13. Business combinations

In the year to 31 March 2007 the Group made two principal acquisitions, both in North America, Ocean Systems Engineering Corporation (OSEC) and Analex Corporation (Analex) If these acquisitions had been completed at 1 April 2006 Group revenue for the year ended 31 March 2007 would have been £1,228 1m and Group profit before tax would have been £92 3m

US acquisitions

On 15 May 2006 the Group acquired the whole of the trade and assets of OSEC for cash consideration before acquisition costs, of £28 2m ($53 7m) On 14 March 2007 the Group acquired the whole of the share capital of Analex for consideration before acquisition costs, of £98 8m ($193 6m) Summary profit and loss accounts for the two acquisitions in the year, OSEC and Analex, prior to acquisition are shown below These results are extracted from the audited financial statements for the relevant periods, which were prepared under US GAAP The results have been converted into sterling at the exchange rates ruling at that time and have not been adjusted to IFRS

OSEC

all figures in £ million	Period from 1 January 2006 to 14 May 2006	Year from 1 January 2005 to 31 December 2005	Year from 1 January 2004 to 31 December 2004
Income statement			
Revenue	5 1	24 6	16 5
Operating income	0 5	2 3	1 9
Profit before taxation	0 5	2 3	1 9
Taxation expense	(0 2)	(0 9)	(0 8)
Profit after tax	**0 3**	**1.4**	**1.1**

Analex

all figures in £ million	Period from 1 January 2007 to 13 March 2007	Year from 1 January 2006 to 31 December 2006	Year from 1 January 2005 to 31 December 2005
Income statement			
Revenue	16 3	78 4	72 0
Operating income	1 1	5 4	4 6
Profit before taxation	0 6	3 0	2 6
Taxation expense	(0 3)	(1 4)	(1 6)
Profit after tax	**0 3**	**1 6**	**1 0**

Set out below are the allocations of purchase consideration, assets and liabilities of the North American acquisitions made in the period and the adjustments required to the book values of the assets and liabilities of the businesses acquired in order to present the net assets of these businesses at fair value and in accordance with Group accounting policies In the case of Analex allocations and adjustments are provisional

		OSEC			Analex		
all figures in £ million	note	Book value	Fair value adjustment	Fair value at acquisition	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets		–	4 1	4 1	–	12 8	12 8
Property plant and equipment		0 6	–	0 6	1 4	–	1 4
Trade and other receivables		6 4	–	6 4	20 3	–	20 3
Trade and other payables		(4 1)	–	(4 1)	(9 4)	–	(9 4)
Cash and cash equivalents		0 1	–	0 1	2 8	–	2 8
Deferred taxation	25	–	–	–	(1 0)	(5 1)	(6 1)
Net assets acquired		**3 0**	**4 1**	**7 1**	**14 1**	**7 7**	**21.8**
Goodwill				21 6			77 4
				28 7			**99.2**
Consideration satisfied by							
Cash				28 2			98 8
Total consideration				**28 2**			**98.8**
Related costs of acquisition				0 5			0 4
				28.7			**99 2**

The OSEC fair value adjustment of £4 1m relates to the recognition of acquired intangible assets From the date of acquisition to 31 March 2007 OSEC has contributed revenue of £25 0m and operating profit of £2 1m

The Analex fair value adjustment of £7 7m relates to the recognition of £12 8m of acquired intangible assets less the recognition of a deferred tax liability of £5 1m in relation to these intangible assets From the date of acquisition to 31 March 2007 Analex has contributed revenue of £4 3m and an operating profit of £0 6m

Other acquisitions and disposals in year to 31 March 2007
On 3 May 2006 the Group purchased the remaining 19 9% minority interest in Aurix Limited for £nil consideration resulting in goodwill on acquisition of £2 0m

On 28 March 2007 the Group acquired the remaining 10% minority interest share in Verhaert Design and Development NV for £0 6m (€0 95m), resulting in additional goodwill on acquisition of £0 6m

There was a net increase of £0 6m in goodwill in relation to the adjustment of deferred tax on the following acquisitions Planning Systems, Inc reduction of £0 3m ($0 5m), Apogen Technologies, Inc an increase of £0 5m ($1 0m) and SimAuthor, Inc. an increase of £0 4m ($0 8m) These adjustments followed the finalisation of the estimated deferred tax made at the time of the acquisitions

On 28 February 2007 Aerospace Filtration Systems Inc., was sold to Donaldson Inc. for £19 9m ($39 0m) resulting in a profit on disposal of £9 9m ($19 4m) This transaction resulted in the disposal of £7 1m ($14 0m) of goodwill

On 5 March 2007 QinetiQ Rail Limited was sold to Nomad Holdings Limited (Nomad) in exchange for an 8 6% shareholding in Nomad valued at £4 5m, resulting in a profit on disposal of £2 8m There was no goodwill associated with this disposal

On 3 August 2006 a 12% stake in Aurix Limited was sold to a strategic licensing partner for cash consideration of £1 1m resulting in a profit on disposal of £0 7m There was no change in goodwill associated with this disposal

Update in respect of acquisitions made in the year ended 31 March 2006
At the date of acquisition of Planning Systems, Inc provision was made for additional consideration payable on the achievement of certain performance criteria in the 12 months ended 31 December 2005 of £0 9m and £0 8m for the performance criteria in the 12 months to 31 December 2006 The performance criteria for the 12 months to December 2005 was paid in full, however the criteria for the 12 months to 31 December 2006 were not met and consequently the accrual was released resulting in a reduction in goodwill of £0 8m in the year to 31 March 2007

In the year to 31 March 2007 additional goodwill of £1 0m ($1 9m) was recognised in relation to the acquisition of Apogen as additional contingent consideration was paid as specific post-acquisition criteria were met

During the year the Group paid deferred consideration amounting to £4 8m £1 4m and £0 6m in respect of the acquisitions of Westar Verhaert and Graphics Research Corporation respectively

The previously estimated fair value of assets and liabilities on the acquisitions of Apogen Inc Planning Systems, Inc and SimAuthor, Inc were finalised during the year The goodwill on the SimAuthor acquisition was reduced by £0 7m ($1 3m) as the previously estimated fair value of intangibles was finalised following receipt of an external valuation report partially offset by a £0 4m ($0 7m) increase in deferred tax liabilities The Group recognised £0 5m ($1 0m) of additional goodwill on the acquisition of Apogen on finalisation of deferred tax liabilities Goodwill on the acquisition of Planning Systems, Inc. was reduced by £0 3m ($0 6m) on finalisation of deferred tax liabilities

Notes to the financial statements continued

14. Property, plant and equipment

Year ended 31 March 2007

all figures in £ million	Land and buildings	Plant, machinery and vehicles	Computers and office equipment	Assets under construction	Total
Cost					
At 1 April 2006	299 4	87 3	26 4	25 7	438 8
Additions	0 3	3 3	3 3	27 9	34 8
Acquisition of subsidiaries	–	–	2 0	–	2 0
Disposals	(3 4)	(0 6)	(2 6)	(0 5)	(7 1)
Disposals as a result of disposal of businesses	–	–	(0 4)	–	(0 4)
Transfers from development costs	–	–	–	0 4	0 4
Transfers	8 2	15 5	4 5	(28 2)	–
Foreign exchange	(0 5)	(0 6)	(1 3)	(0 1)	(2 5)
At 31 March 2007	**304 0**	**104 9**	**31 9**	**25 2**	**466 0**
Depreciation					
At 1 April 2006	33 5	51 9	13 1	–	98 5
Charge for the year	11 3	10 6	9 8	–	31 7
Disposals	(1 1)	(0 6)	(2 3)	–	(4 0)
Disposals as a result of disposal of businesses	–	–	(0 1)	–	(0 1)
Foreign exchange	(0 4)	(0 3)	(0 9)	–	(1 6)
At 31 March 2007	**43.3**	**61 6**	**19 6**	**–**	**124 5**
Net book value at 31 March 2007	**260 7**	**43 3**	**12 3**	**25 2**	**341.5**

Year ended 31 March 2006

all figures in £ million	Land and buildings	Plant machinery and vehicles	Computers and office equipment	Assets under construction	Total
Cost					
At 1 April 2005	341 0	67 2	19 6	10 3	438 1
Additions	2 4	3 2	4 6	34 8	45 0
Acquisition of subsidiaries	–	0 4	1 5	–	1 9
Disposals	(40 2)	(2 3)	–	(0 2)	(42 7)
Transfers	–	18 7	0 5	(19 2)	–
Transfer to disposal group*	(3 9)	–	–	–	(3 9)
Foreign exchange	0 1	0 1	0 2	–	0 4
At 31 March 2006	**299 4**	**87 3**	**26 4**	**25 7**	**438.8**
Depreciation					
At 1 April 2005	24 9	39 1	6 2	–	70 2
Charge for the year	12 6	13 2	6 9	–	32 7
Disposals	(3 7)	(0 5)	–	–	(4 2)
Transfer to disposal group	(0 3)	–	–	–	(0 3)
Foreign exchange	–	0 1	–	–	0 1
At 31 March 2006	**33 5**	**51 9**	**13.1**	**–**	**98 5**
Net book value at 31 March 2006	**265 9**	**35.4**	**13.3**	**25 7**	**340 3**
Net book value at 31 March 2005	316 1	28 1	13 4	10 3	367 9

* At 31 March 2006 certain property was presented as held for sale and transferred to a disposal group

Assets held under finance leases, capitalised and included in computers and equipment, have
- a cost of £5 7m (31 March 2006 £5 2m)
- aggregate depreciation of £5 0m (31 March 2006 £2 9m), and
- a net book value of £0 7m (31 March 2006 £2 3m)

Under the terms of the Business Transfer Agreement with the MOD, certain restrictions have been placed on freehold land and buildings, and certain plant and machinery related to them These restrictions are detailed in note 36 'Transactions with the MOD'

15 Investment property

all figures in £ million	2007	2006
Cost and net book value		
At 1 April	5 8	6 6
Disposals	(5 8)	(0 8)
At 31 March	**–**	**5 8**

all figures in £ million	2007	2006
The following amounts have been credited/(charged) in arriving at Group operating profit.		
Rental income from investment property	0 7	0 7
Direct operating expenses arising on investment property generating rental income	(0 2)	(0 2)

On 29 March 2007 the Group unconditionally exchanged on the contract to dispose of its Bedford property which was classified as an investment property Further details are shown in note 5b All investment property generated income in the year

16. Financial assets

all figures in £ million	2007	2006
Net investment in finance lease	14 1	15 0
Escrow financial assets	3 1	–
Derivative financial instruments	1 6	7 1
Total non-current financial assets	**18.8**	**22 1**
Derivative financial instruments	1 0	–
Net investment in finance lease	3 0	3 0
Total current financial assets	**4 0**	**3 0**
Total financial assets	**22 8**	**25 1**

17. Non-current investments

all figures in £ million	2007	2006
Available for sale investments	**28 5**	**1 3**

The Group holds a 1 7% interest in Last Mile Communications Limited acquired for £0 2m During the year further funding of £4 7m was advanced by the Group resulting in a total investment carrying value of £4 9m at 31 March 2007

On 14 December 2005 the Group sold certain intellectual property to Metalysis Limited and received settlement for the sale in the form of a 10% interest in the ordinary share capital of the company The investment was held at fair value of £0 8m at 1 April 2006 In February 2007 as part of a third-party funding round QinetiQ invested a further £2 1m and increased its interest in Metalysis Limited to 16 3% The funding round established the new fair value of QinetiQ s holding as £6 4m and this resulted in a revaluation gain of £3 5m being recorded

At 31 March 2007 the Group held a 10 0% interest in Sciemus Limited which was acquired on 14 September 2004 The investment continued to be held at its written down value of £nil at 31 March 2007

On 23 March 2006 the Group sold certain intellectual property to Stingray Geophysical and received a 19 9% interest in Stingray Geophysical During the year this investment was revalued and resulted in an £0 6m increase in the investment value to a closing value of £0 9m at 31 March 2007 The Group s interest in Stingray Geophysical may increase upon satisfaction of certain performance criteria to the extent that the Group could receive up to 30% of the proceeds of a sale of the business

In September 2006 the Group's investment in ZBD Displays Limited (ZBD) was re-classified from an associate to an investment following a reduction in the level of influence exercised by QinetiQ in the management of ZBD, following the resignation of the QinetiQ appointed director from the board of the company This resulted in £0 6m of assets being reclassified from an equity accounted investment to a non-current asset investment Cash investments totalled £4 4m with the Group's holding increasing to 31 6% at 31 March 2007 (2006 30 4%)

Notes to the financial statements continued

In addition the investment was revalued upwards by £6 1m following the valuation of shares from current year funding rounds by external investors This resulted in the closing investment value of £10 5m at 31 March 2007

On 5 March 2007 the Group acquired an 8 6% investment in Nomad Holdings Limited valued at £4 5m in consideration for the sale of its subsidiary QinetiQ Rail Limited In addition the Group acquired £1 5m of preference shares in Nomad which have been discounted by £0 2m to reflect the zero coupon rate of interest on the preference shares in the first 3 4 years This results in a total investment carrying value of £5 8m

18. Equity accounted investments

Year ended 31 March 2007

all figures in £ million	Associates financial results	Group net share of associates
Revenue	6 1	2 0
Loss after tax	**(3 1)**	**(1 2)**
Non current assets	0 5	0 1
Current assets	2 8	0 6
	3 3	**0 7**
Current liabilities	(3 0)	(0 4)
Non current liabilities	(11 0)	–
	(14 0)	**(0 4)**
Net assets	**(10 7)**	**0 3**

Year ended 31 March 2006

all figures in £ million	Associates financial results	Group gross share of associates	Restructuring of Group's funding of associates	Group net share of associates
Revenue	4 2	1 4	–	1 4
Loss after tax	**(4 1)**	**(1 5)**	**1 1**	**(0.4)**
Non current assets	1 2	0 3	–	0 3
Current assets	1 8	0 7	(0 2)	0 5
	3 0	**1 0**	**(0 2)**	**0 8**
Current liabilities	(2 7)	(1 2)	1 0	(0 2)
Non-current liabilities	(0 7)	(0 3)	0 3	–
	(3 4)	**(1 5)**	**1 3**	**(0 2)**
Net assets	**(0 4)**	**(0 5)**	**1 1**	**0 6**

Details of the Group's associates are set out in note 44

The unrecognised share of losses of associates at 31 March 2007 was £nil (31 March 2006 £1 1m) The prior year amount represented the associate losses the Group had no obligation to fund following the restructuring of the funding arrangements for QS4 Limited

During the year ended 31 March 2007 sales of £nil (year ended 31 March 2006 £1 2m) were made to associates and at 31 March 2007 associates and joint ventures had an outstanding debtor balance of £nil (31 March 2006 £1 0m)

19. Inventories

all figures in £ million	2007	2006
Raw materials	3 5	3 6
Work in progress	17 7	5 6
Finished goods	18 3	16 2
	39 5	**25 4**

20. Trade and other receivables

all figures in £ million	2007	2006
Trade debtors	250 7	194 8
Amounts recoverable under contracts	106 3	94 7
Current tax	–	3 6
Other debtors	21 8	17 8
Prepayments	22 4	21 7
	401 2	**332 6**

Included within amounts recoverable under contracts is £nil (31 March 2006 £7 8m) due after one year Trade debtors include a provision for doubtful debts of £2 5m (31 March 2006 £4 2m)

21. Cash and cash equivalents

all figures in £ million	2007	2006
Cash	**20 0**	**58 9**

At 31 March 2007 £12 7m (31 March 2006 £10 6m) of cash is held by the Group s captive insurance subsidiary The amount is included above but can only be used for insurance purposes or utilised by the Group with prior approval by the subsidiary board and relevant insurance regulator

22. Current asset investments

all figures in £ million	2007	2006
Listed investments	**4 0**	**11 2**

At 31 March 2007 the Group held 35 7 million shares in pSivida Limited (31 March 2006 35 7 million) a company listed on NASDAQ and the Australian and Frankfurt Stock Exchange The investment is held at fair value using the closing share price at 31 March 2007 of A$0 27 per share (31 March 2006 A$0 75) During the year the reduction in value of £7 2m has been recognised in the income statement as an impairment Additionally the prior year reduction in value of £1 6m has been recognised as an impairment in the income statement and credited to reserves (2006 £1 6m reduction in value recognised directly in reserves), resulting in a total charge to the income statement of £8 8m for the year to 31 March 2007 The original value of these shares was £15 1m and in prior periods £2 3m had been impaired through the income statement

Notes to the financial statements continued

23 Trade and other payables – current

all figures in £ million	2007	2006
Payments received on account	96 9	64 3
Trade creditors	31 3	37 3
Other tax and social security	46 3	42 2
Other creditors	20 4	22 9
Accruals and deferred income	144 5	133 4
	339 4	**300 1**

24. Provisions

Year ended 31 March 2007

all figures in £ million	Reorganisation	Other	Total
At 1 April 2006	9 4	17 1	26 5
Utilised in year	(8 4)	(2 2)	(10 6)
Released in year	(0 8)	(7 5)	(8 3)
Created in year	0 7	5 9	6 6
At 31 March 2007	**0 9**	**13 3**	**14 2**
Current liability	0 9	0 2	1 1
Non-current liability	–	13 1	13 1
At 31 March 2007	**0 9**	**13 3**	**14.2**

Year ended 31 March 2006

all figures in £ million	Reorganisation	Other	Total
At 1 April 2005	28 2	16 1	44 3
Utilised in year	(26 3)	(0 6)	(26 9)
Released in year	(1 9)	(3 8)	(5 7)
Created in year	9 4	5 4	14 8
At 31 March 2006	**9 4**	**17 1**	**26.5**
Current liability	9 4	7 9	17 3
Non current liability	–	9 2	9 2
At 31 March 2006	**9 4**	**17 1**	**26 5**

Reorganisation provisions relate to current year and prior year restructuring of the Group Other provisions comprise legal, environmental, statutory, property and other liabilities

25. Deferred tax

Deferred tax assets and liabilities are only offset where there is a legally enforceable right to offset and there is an intention to settle the balances net

Movements on the deferred tax assets and liabilities are shown below

Year ended 31 March 2007
Deferred tax asset

all figures in £ million	Pension liability	Other	Total
At 1 April 2006	50 4	–	50 4
Released	(23 3)	–	(23 3)
Transferred from deferred tax liabilities	–	0 7	0 7
Gross deferred tax asset at 31 March 2007	**27 1**	**0 7**	**27 8**
Less liability available for offset	–	–	(16 8)
Net deferred tax asset at 31 March 2007			**11 0**

The net deferred tax asset released in the year relating to the pension liability includes £17 9m (2006 £8 7m created) released to equity

Deferred tax liability

all figures in £ million	Accelerated tax depreciation and amortisation	Other	Hedging	Total
At 1 April 2006	(43 2)	(1 6)	(2 0)	(46 8)
Acquisitions	(6 1)	–	–	(6 1)
Created	(0 6)	–	–	(0 6)
Released	1 9	2 3	2 0	6 2
Transferred to deferred tax assets	–	(0 7)	–	(0 7)
Foreign exchange	0 3	–	–	0 3
Gross deferred tax liability at 31 March 2007	**(47 7)**	**–**	**–**	**(47 7)**
Less asset available for offset				16 8
Net deferred tax liability at 31 March 2007				**(30 9)**

Deferred tax movements on hedging have been recognised in equity At the balance sheet date, the Group had unused tax losses of £46 2m (2006 £40 2m) potentially available for offset against future profits No deferred tax asset has been recognised in respect of this amount These losses can be carried forward indefinitely

Year ended 31 March 2006
Deferred tax asset

all figures in £ million	note	Pension liability	Other	Total
At 1 April 2005		48 8	6 1	54 9
Created		1 6	–	1 6
Released		–	(7 7)	(7 7)
Transferred to deferred tax liabilities		–	1 6	1 6
Gross deferred tax asset at 31 March 2006		**50 4**	**–**	**50 4**
Less liability available for offset – restated	40			(38 6)
Net deferred tax asset at 31 March 2006 – restated	40			**11 8**

Notes to the financial statements continued

25 Deferred tax continued

Deferred tax liability

all figures in £ million	note	Accelerated tax depreciation and amortisation	Other	Hedging	Total
At 1 April 2005		(49 9)	–	–	(49 9)
Acquisitions – restated	40	(5 1)	–	–	(5 1)
Created		–	–	(1 5)	(1 5)
Released		12 5	–	–	12 5
Transferred from deferred tax assets		–	(1 6)	–	(1 6)
Foreign exchange		(0 7)	–	–	(0 7)
Created on adoption of IAS 32 and 39		–	–	(0 5)	(0 5)
Gross deferred tax liability at 31 March 2006		**(43 2)**	**(1 6)**	**(2.0)**	**(46 8)**
Less asset available for offset – restated	40				38 6
Net deferred tax liability at 31 March 2006					**(8 2)**

26 Financial liabilities – current

all figures in £ million	2007	2006
Loan notes	5 2	1 5
Deferred financing costs	(0 2)	(0 1)
Finance lease creditor	3 2	4 9
Derivative financial investments	0 3	–
Other bank borrowings	7 4	0 3
	15 9	**6 6**

Further analysis of the terms and maturity dates for financial liabilities are set out in note 28

27. Financial liabilities – non-current

all figures in £ million	2007	2006
Bank loan	180 1	291 4
Deferred financing costs	(0 6)	(0 5)
	179 5	290 9
US$135m loan, repayable 2013	69 9	–
US$125m loan, repayable 2016	64 4	–
Loan notes	–	3 8
Derivative financial instruments	–	0 5
Finance lease creditor	13 9	15 2
	327 7	**310 4**

Further analysis of the terms and maturity dates for financial liabilities are set out in note 28

28 Financial instruments

Financial assets and liabilities comprise

all figures in £ million	2007 Financial assets	2007 Financial liabilities	2006 Financial assets	2006 Financial liabilities
Trade and other receivables/(payables)	401 2	(344 9)	332 6	(303 0)
Cash and cash equivalents	20 0	–	58 9	–
Bank borrowings, loans and loan notes	–	(326 2)	–	(296 4)
Finance leases	17 1	(17 1)	18 0	(20 1)
Investments	32 5	–	12 5	–
Derivative financial instruments	2 6	(0 3)	7 1	(0 5)
Other	3 1	–	–	–
	476 5	**(688 5)**	**429 1**	**(620 0)**

(A) Fair values of financial instruments
All financial assets and liabilities have a fair value identical to book value at 31 March 2007 and 31 March 2006 except the following

all figures in £ million	2007 Fair value	2007 Book value	2006 Fair value	2006 Book value
Primary financial instruments held or issued to finance the Group's operations				
Long-term borrowings	(311 7)	(313 8)	(294 7)	(294 7)
Other financial assets/(liabilities)				
Finance lease assets	23 1	17 1	26 7	18 0
Finance lease liabilities	(21 9)	(17 1)	(25 2)	(20 1)

Market values where available, have been used to determine fair values Where market values are not available, fair values have been calculated by discounting cash flows at prevailing interest rates, except for unlisted fixed asset investments where a fair value equals book value

(B) Interest rate risk
31 March 2007
Financial assets

all figures in £ million	Financial assets Fixed or capped	Financial assets Floating	Financial liabilities Fixed or capped	Financial liabilities Floating
Sterling	17 1	14 3	(22 2)	(12 7)
US Dollar	–	8 4	(256 6)	(41 4)
Other	–	0 4	–	(10 4)
	17 1	**23 1**	**(278.8)**	**(64 5)**

Floating rate financial assets attract interest based on the relevant national LIBID equivalent Floating rate financial liabilities bear interest at the relevant national LIBOR equivalent All other financial assets and liabilities are non-interest bearing

Notes to the financial statements continued

31 March 2006

all figures in £ million	Financial asset		Financial liability	
	Fixed or capped	Floating	Fixed or capped	Floating
Sterling	180	531	(239)	(09)
US Dollar	–	58	(2537)	(331)
Other	–	–	–	(49)
	180	**58.9**	**(2776)**	**(389)**

Floating rate financial assets attract interest based on the relevant national LIBID equivalent Floating rate financial liabilities bear interest at the relevant national LIBOR equivalent All other financial assets and liabilities are non-interest bearing

For the fixed or capped rate financial assets and liabilities, the average interest rates and the average period for which the rates are fixed are

	2007			2006		
	Fixed or capped £m	Weighted average interest rate %	Weighted average years to maturity	Fixed or capped £m	Weighted average interest rate %	Weighted average years to maturity
Financial assets						
Sterling	171	134%	79	180	134%	90
Financial liabilities						
Sterling	(222)	109%	63	(239)	110%	76
US Dollar	(2566)	49%	58	(2537)	43%	32
	(2788)	**53%**	**58**	**(2776)**	**50%**	**36**

Sterling assets and liabilities consist primarily of finance leases with the weighted average interest rate reflecting the internal rate of return of those leases

Interest rate risk management

At 31 March 2007 80% (31 March 2006 87%) of the Group's bank and private placement borrowings were fixed or capped through a combination of interest rate swaps collars and fixed rate debt

(C) Currency risk

The table below shows the Group's currency exposures being exposures on currency transactions that give rise to net currency gains and losses recognised in the income statement Such exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating company involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas entities

Functional currency of the operating company

all figures in £ millions	Net foreign currency monetary assets/liabilities			
	US Dollar	Euro	Other	Total
31 March 2007 – Sterling	05	(03)	12	14
31 March 2006 – Sterling	12	04	03	19

The amounts shown in the table take into account the effect of the forward contracts entered into to manage these currency exposures

(D) Maturity of financial liabilities

At 31 March 2007

	Trade and other payables	Bank borrowings and loan notes	Finance leases and derivative financial instruments	Total
Due in one year or less	339 4	12 4	3 5	355 3
Due in more than one year but not more than two years	5 5	–	2 2	7 7
Due in more than two years but not more than five years	–	179 5	6 7	186 2
Due in more than five years	–	134 3	5 0	139 3
	344.9	**326 2**	**17 4**	**688 5**

At 31 March 2006

	Trade and other payables	Bank borrowings and loan notes	Finance leases and derivative financial instruments	Total
Due in one year or less	300 1	1 7	4 9	306 7
Due in more than one year but not more than two years	2 9	–	2 7	5 6
Due in more than two years but not more than five years	–	294 7	6 6	301 3
Due in more than five years	–	–	6 4	6 4
	303 0	**296 4**	**20 6**	**620 0**

(E) Borrowing facilities

At 31 March 2007, the following committed facilities were available to the Group

	Interest rate %	Total £m	Drawn £m	Undrawn £m
Multicurrency revolving facility	LIBOR plus 0 35%	500 0	180 1	319 9
US$135m loan repayable 2013	5 44%	69 9	69 9	–
US$125m loan repayable 2016	5 5%	64 4	64 4	–
HVR loan notes	Base minus 1 0%	0 1	0 1	–
Damega Corporation loan notes	7 5%	5 1	5 1	–
Committed facilities 31 March 2007		**639 5**	**319 6**	**319 9**
Committed facilities 31 March 2006		524 2	296 7	227 5

Loans drawn under the £500m multi-currency revolving facility are repayable within twelve months but have been classified as due in more than two years as the relevant committed facilities are available until 19 August 2011 with the Banks option at the Group's request to extend for a further year The loans bear interest at a variable margin over LIBOR of between 0 35% and 0 725% dependent on the ratio of EBITDA to Net Debt and the level of utilisation

During the year the Group completed a private debt placement for US$260m with a group of US financial institutions, obtaining US$135m on a seven year term at an interest rate of 5 44% and US$125m on a ten year term at an interest rate of 5 5%

The HVR loan notes were issued in connection with the acquisition of HVR Consulting Ltd They are repayable on request of the holders, but no later than 31 July 2009 and they bear interest at a discount to Lloyds TSB Base Rate

The Damega Corporation loan note relates to funding from the minority shareholder of Quintel Technology Limited The loan notes are repayable by Quintel Technology Limited on request by Damega Corporation

Notes to the financial statements continued

29. Reconciliation of net cash flow to movement in net debt

all figures in £ million	note	Year ended 31 March 2007	Year ended 31 March 2006
(Decrease)/increase in cash in the year		**(45 5)**	**53.6**
New loans		(131 3)	(191 3)
New loan notes		(1 3)	(7 6)
Bank loan repayments		79 2	72 2
Loan note repayments		1 4	45 9
Payment of deferred financing costs		0 4	–
Repayment of other borrowings		–	3 2
Preference Share and associated interest repayment		–	48 0
		(51 6)	**(29.6)**
Capital element of finance lease payments		5 9	2 2
Capital element of finance lease receipts		(3 5)	(3 0)
Change in net debt resulting from cash flows		**(94.7)**	**23.2**
Addition of deferred financing costs		–	0 7
Amortisation of deferred financing costs		(0 2)	(1 6)
Foreign exchange movements		30 2	(21 5)
Accrued US$ loan interest		(1 6)	–
Preference Share redemption and associated interest		–	(48 0)
Finance lease receivables		2 6	2 4
Finance lease payables		(2 9)	(18 2)
Adoption of IAS 32 and IAS 39		–	1 8
Movement on escrow cash		3 1	–
Movement on derivatives		(4 3)	4 8
Net debt at the start of the year		(233 0)	(176 6)
Net debt at the end of the year	30	**(300 8)**	**(233.0)**

30 Analysis of net debt

all figures in £ million	Year ended 31 March 2006	Cash flow	Non cash movements	Year ended 31 March 2007
Due within one year				
Bank and cash	58 9	(38 9)	–	20 0
Bank overdraft	(0 3)	(6 6)	(0 5)	(7 4)
Recapitalisation fee	0 1	–	0 1	0 2
Loan notes	(1 5)	0 1	(3 8)	(5 2)
Finance lease debtor	3 0	(3 5)	3 5	3 0
Finance lease creditor	(4 9)	5 9	(4 2)	(3 2)
Derivative financial assets	–	–	1 0	1 0
Derivative financial liabilities	–	–	(0 3)	(0 3)
	55 3	**(43 0)**	**(4 2)**	**8 1**
Due after one year				
Bank Loan	(291 4)	79 2	32 1	(180 1)
Recapitalisation fee	0 5	0 4	(0 3)	0 6
US$135m loan repayable 2013	–	(68 2)	(1 7)	(69 9)
US$125m loan repayable 2016	–	(63 1)	(1 3)	(64 4)
Loan notes	(3 8)	–	3 8	–
Finance lease debtor	15 0	–	(0 9)	14 1
Finance lease creditor	(15 2)	–	1 3	(13 9)
Escrow cash	–	–	3 1	3 1
Derivative financial assets	7 1	–	(5 5)	1 6
Derivative financial liabilities	(0 5)	–	0 5	–
	(288 3)	**(51 7)**	**31 1**	**(308 9)**
Total net debt	**(233 0)**	**(94 7)**	**26 9**	**(300 8)**

Non cash movements principally consist of movements arising from foreign exchange

31 Finance leases

Group as a lessor
The minimum lease receivables under finance leases fall as follows

	Minimum lease payments		Present value of minimum lease payments	
all figures in £ million	2007	2006	2007	2006
Amounts receivable under finance leases				
Within one year	3 0	3 0	3 0	3 0
In the second to fifth years inclusive	12 0	12 0	8 9	8 9
Greater than five years	10 5	13 5	5 2	6 1
	25 5	**28 5**		
Less unearned finance income	(8 4)	(10 5)		
Present value of minimum lease payments	**17 1**	**18 0**	**17 1**	**18 0**
Classified as follows				
Financial asset – current			3 0	3 0
Financial asset – non-current			14 1	15 0
			17.1	**18 0**

The Group leases out certain buildings under finance leases over a 12-year term expiring in 2015

Notes to the financial statements continued

31 Finance leases continued

Group as a lessee
The minimum lease payments under finance leases fall due as follows

all figures in £ million	Minimum lease payments 2007	Minimum lease payments 2006	Present value of minimum lease payments 2007	Present value of minimum lease payments 2006
Amounts payable under finance leases				
Within one year	3 2	4 9	3 2	4 9
In the second to fifth years inclusive	11 3	11 6	8 9	8 8
Greater than five years	9 7	12 8	5 0	6 4
	24 2	**29 3**		
Less future finance charges	(7 1)	(9 2)		
Present value of minimum lease payments	**17 1**	**20 1**	**17 1**	**20.1**
Classified as follows				
Financial liability – current			3 2	4 9
Financial liability – non-current			13 9	15 2
			17.1	**20.1**

The Group utilises certain buildings and computer equipment under finance leases Average lease terms are typically between two and ten years (31 March 2006 between two and ten years)

32 Share capital

Authorised share capital at 31 March 2007 and 2006

	£	Number
Attributable to equity interests		
Ordinary Shares of 1p each	14,000,000	1,400,000,000
Attributable to non-equity interests		
Special Share of £1	1	1
Total authorised share capital	**14,000,001**	**1,400,000,001**

Shares allotted, called up and fully paid

all figures in £	1 April 2006	Issued in year	31 March 2007
Attributable to equity interests			
Ordinary Shares of 1p each	6 505 650	95 500	6,601 150
Attributable to non-equity interests			
Special Share of £1	1	–	1
Total called up share capital	**6,505,651**	**95,500**	**6,601,151**

	Number of shares 1 April 2006	Number of shares Issued in year	Number of shares 31 March 2007
Attributable to equity interests			
Number of Ordinary Shares of 1p each	650,565,024	9,550,032	660,115,056
Number of Special Shares of £1	1	–	1
Total number of shares	**650,565,025**	**9,550,032**	**660,115,057**

9,550,032 Ordinary Shares of 1p each were issued during the year in respect of the exercise of share options and the Share Incentive Plan

32. Share capital continued

Year ended 31 March 2006

	1 April 2005 £	Share restructuring on IPO £	Issued/ (redeemed) in year £	31 March 2006 £	Number
Attributable to equity interests					
Ordinary Shares of 1p each	–	5,729,918	775,732	6,505,650	650,565,024
Convertible A Ordinary Shares of 1p each	77,010	(77,010)			
Convertible B Ordinary Shares of 1p each	5,833	(5 833)			
Convertible C Ordinary Shares of £1 each	450,135	(450,135)			
D Ordinary Shares of £1 each	537,250	(537 250)			
Convertible Non-Voting A Ordinary Shares of £1 each	425,960	(425,960)			
Convertible Non Voting B Ordinary Shares of £1 each	37,040	(37,040)			
Convertible Preferred Shares of 1p each	37,527	(37,527)			
	1,570,755	4,159,163	775,732	6,505,650	650 565 024
Attributable to non equity interests					
Redeemable Cumulative Preference Shares of £1 each	37,500,000	–	(37,500,000)	–	–
Special Share of £1	1		–	1	1
	37,500,001		(37,500,000)	1	1
Total called up share capital	**39,070,756**	**4,159,163**	**(36,724,268)**	**6,505,651**	**650,565,025**

75,000,000 Ordinary Shares were issued on the Company's IPO and the remaining Ordinary Shares were issued in respect of the exercise of share options

Except as noted below all shares at 31 March 2007 rank *pari passu* in all respects

Rights attaching to the Special Share

QinetiQ carries out activities which are important to UK defence and security interests To protect these interests in the context of the ongoing commercial relationship between the MOD and QinetiQ, and to promote and reinforce the Compliance Principles, the MOD holds a Special Share in QinetiQ The Special Share confers certain rights on the holder

a) to require the Group to implement and maintain the Compliance System (as defined in the Articles of Association) so as to make at all times effective its and each member of QinetiQ Controlled Group's application of the Compliance Principles, in a manner acceptable to the Special Shareholder,

b) to refer matters to the Board or the Compliance Committee for its consideration in relation to the application of the Compliance Principles,

c) to veto any contract, transaction, arrangement or activity which the Special Shareholder considers

  i) may result in circumstances which constitute unacceptable ownership, influence or control over QinetiQ or any other member of the QinetiQ consolidated Group contrary to the defence or security interests of the United Kingdom, or

  ii) would not, or does not, ensure the effective application of the Compliance Principles to and/or by all members of the QinetiQ Controlled Group or would be or is otherwise contrary to the defence or security interests of the United Kingdom

d) to require the Board to take any action (including but not limited to amending the Compliance Principles), or rectify any omission in the application of the Compliance Principles, if the Special Shareholder is of the opinion that such steps are necessary to protect the defence or security interest of the United Kingdom,

e) to exercise any of the powers contained in the articles in relation to the Compliance Committee, and

f) to demand a poll at any of the QinetiQ's meetings (even though it may have no voting rights except those specifically set out in the Articles)

The Special Shareholder has an option to purchase defined Strategic Assets of the Group in certain circumstances The Special Shareholder has, *inter alia*, the right to purchase any Strategic Assets which the Group wishes to sell Strategic Assets are normally testing and research facilities (see note 36)

The Special Share may only be issued to held by and transferred to H M Government (or as it directs) At any time the Special Shareholder may require QinetiQ to redeem the Special Share at par If QinetiQ is wound up the Special Shareholder will be entitled to be repaid the capital paid up on the Special Share before other shareholders receive any payment The Special Shareholder has no other right to share in the capital or profits of QinetiQ

The Special Shareholder must give consent to a general meeting held on short notice

The Special Share entitles the Special Shareholder to require certain persons who hold (together with any person acting in concert with them) a material interest in QinetiQ to dispose of some or all of their Ordinary Shares

The Directors must register any transfer of the Special Share within seven days

Notes to the financial statements continued

33 Changes in equity

all figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Own shares	Hedge reserve	Translation reserve	Retained earnings	Total	Minority interest	Total equity
At 1 April 2005	**1 6**	**1 9**	**11.4**	**–**	**1 3**	**–**	**244 5**	**260 7**	**(2.8)**	**257 9**
Exchange gain/(loss)	–	–	–	–	–	0 2	(2 2)	(2 0)	–	(2 0)
Profit for the year	–	–	–	–	–	–	58 1	58 1	2 3	60 4
Bonus issue	–	0 5	(4 6)	–	–	–	–	(4 1)	–	(4 1)
Issue of new shares	4 9	–	154 3	–	–	–	–	159 2	–	159 2
IPO costs	–	–	(13 6)	–	–	–	–	(13 6)	–	(13 6)
Share-based payments	–	–	–	–	–	–	0 1	0 1	–	0 1
Loss on available for sale financial assets	–	–	–	–	–	–	(1 6)	(1 6)	–	(1 6)
Increase in fair value of hedging derivatives	–	–	–	–	4 9	–	–	4 9	–	4 9
Deferred tax on hedging derivatives	–	–	–	–	(1 5)	–	–	(1 5)	–	(1 5)
Preference shares redeemed in year	–	37 5	–	–	–	–	(37 5)	–	–	–
Arising on acquisition	–	–	–	–	–	–	–	–	(0 1)	(0 1)
Actuarial (loss) recognised in the defined benefit pension schemes	–	–	–	–	–	–	(105 4)	(105 4)	–	(105 4)
Deferred tax asset on pension deficit	–	–	–	–	–	–	8 7	8 7	–	8 7
At 31 March 2006	**6 5**	**39 9**	**147 5**	**–**	**4 7**	**0 2**	**164 7**	**363 5**	**(0 6)**	**362.9**
Exchange loss	–	–	–	–	–	(14 4)	–	(14 4)	–	(14 4)
Profit for the year	–	–	–	–	–	–	69 0	69 0	–	69 0
Dividends paid	–	–	–	–	–	–	(22 7)	(22 7)	–	(22 7)
Issue of new shares	0 1	–	0 1	(0 1)	–	–	–	0 1	–	0 1
Share-based payments	–	–	–	–	–	–	1 1	1 1	–	1 1
Deferred tax on exercise of share options	–	–	–	–	–		4 8	4 8	–	4 8
Impairment of available for sale financial assets	–	–	–	–	–	–	1 6	1 6	–	1 6
Gain on available for sale financial assets	–	–	–	–	–	–	10 0	10 0	–	10 0
Decrease in fair value of hedging derivatives	–	–	–	–	(5 6)	–	–	(5 6)	–	(5 6)
Deferred tax on hedging derivatives	–	–	–	–	2 0	–	–	2 0	–	2 0
Arising on acquisition/disposal	–	–	–	–	–	–	–	–	0 7	0 7
Actuarial gain recognised in the defined benefit pension schemes	–	–	–	–	–	–	85 8	85 8	–	85 8
Deferred tax asset on pension deficit	–	–	–	–	–	–	(17 9)	(17 9)	–	(17 9)
At 31 March 2007	**6 6**	**39 9**	**147 6**	**(0 1)**	**1 1**	**(14.2)**	**296 4**	**477 3**	**0 1**	**477 4**

The translation reserve consists of the cumulative foreign exchange difference arising on translation since the Group transitioned to IFRS Movements on hedge instruments and hedged items, where the hedge is effective, are recorded in the hedge reserve until the hedge ceases

The capital redemption reserve is not distributable and was created following redemption of preference share capital and the bonus issue of shares

34. Share-based payments

The Group operates a number of share-based payment plans for employees

2003 employee share option scheme

Under the employee share option scheme all employees as at 25 July 2003 received share options which vested when the Group completed its IPO and which must be exercised within 10 years of grant The options are settled by shares

	2007		2006	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Outstanding at start of year	12,121,644	2 3p	295,880	100 0p
Forfeited in year before bonus issue	–	–	(5 200)	100 0p
Bonus issue in year (42 55 new shares for each 1 share)	–	–	12,077 754	100 0p
Forfeited in year after bonus issue	(275,724)	2 3p	(11,914)	2 3p
Exercised in year after bonus issue	(10,120,092)	2 3p	(234,876)	2 3p
Outstanding and exercisable at end of year	**1,725,828**	**2 3p**	**12,121,644**	**2 3p**

Options outstanding at 31 March 2007 had an average remaining life of 6 3 years (31 March 2006 7 3 years)

The average share price in year was 185p

Group Share Incentive Plan

Under the QinetiQ Share Incentive Plan the Group offers UK employees the option of purchasing up to £125 a month of shares at the prevailing market rate The Group will make a matching contribution of a third of the employee s payment The Group s matching contribution may be forfeited if the employee ceases to be employed by QinetiQ within three years of the award of the shares

Group Share Option Scheme

In the year the Group granted options to certain employees under the Group Share Option Scheme The exercise price of the options is the average market price of the Group's shares on the date of the grant. The options vest after three years For 10,382,585 (2006 217,805) of the options the number that will vest is dependent upon the growth of earnings per share (EPS') over the measurement period 25% of options will vest if EPS growth is 22 5% for the period and 100% will vest if growth is at least 52% No options will vest if EPS growth is below 22 5% Options will vest on a straight line basis if EPS growth is between 22 5% and 52% For the remaining 160,112 options the EPS growth target is replaced by a performance target based on QinetiQ's ranking by reference to total shareholder return ('TSR') against a comparator group comprising the FTSE 250 companies over a three year performance period such that a below median ranking will result in nil shares vesting, at the median level 30% of the options would vest and the amount vested will increase on a straight line basis such that 100% would vest if TSR reaches the upper quartile of the ranking over a three-year period

	2007		2006	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Outstanding at the start of year	377,917	208p	–	–
Granted	10,178,883	195p	377,917	208p
Lapsed in year	(14,103)	195p	–	–
Outstanding at end of year	**10,542,697**	**195p**	**377,917**	**208p**

Options outstanding at 31 March 2007 had an average remaining life of 2 5 years (2006 3 4 years)

Notes to the financial statements continued

34. Share-based payments continued

Option pricing
Share based payments have been valued using a binomial option pricing model Assumptions used within the model include expected volatility of 35%, an expected life of three years and a risk free rate of return of 3 78% and for the 2003 Share Option Plan options, a pre bonus issue weighted average share price of £1 and a weighted average exercise price of £1 based on third-party transactions in the Company's shares in the period immediately prior to the issue of the share options

Prior to IPO there was no active market for the Company's shares therefore expected volatility was determined using the average volatility for a comparable selection of businesses The Group had no established pattern of dividend payments therefore no dividends were assumed in this model

The total share based payment expense in the period was £1 1m (year to 31 March 2006 £0 1m)

35 Operating leases

Group as a lessor
The Group receives rental income on certain properties The Group had contracted with tenants for the following future minimum lease payments

all figures in £ million	**2007**	**2006**
Within one year	5 4	4 3
In the second to fifth years inclusive	4 6	2 5
Greater than five years	2 2	2 6
	12 2	**9 4**

Group as a lessee

all figures in £ million	**2007**	**2006**
Lease and sublease income statement expense – minimum lease payments	**12.2**	**10 9**

The Group had the following future minimum lease payment commitments

all figures in £ million	**2007**	**2006**
Within one year	18 0	9 6
In the second to fifth years inclusive	31 2	19 0
Greater than five years	13 7	10 0
	62.9	**38 6**

Operating lease payments represent rentals payable by the Group on certain office property and plant Leases are negotiated for an average of three to ten years

36 Transactions with the MOD

The MOD is a 18 9% (2006 19 2%) shareholder in the Group Detailed below are the agreements that have been entered into and the trading that has taken place with the MOD

Trading
The MOD is a major customer of the Group An analysis of trading with the MOD is presented below

all figures in £ million	**2007**	**2006**
Sales to the MOD excluding property rental income	584 5	595 8
Property rental income	6 8	9 1
Total income from the MOD	**591 3**	**604 9**
Purchased services from the MOD	**12 4**	**17 8**

all figures in £ million	**2007**	**2006**
Trade debtors	81 3	72 6
Trade creditors	0 1	0 3

Freehold land and buildings and surplus properties
Under the terms of the Group's acquisition of part of the business and certain assets of DERA from the MOD on 1 July 2001, the MOD retained certain rights in respect of the freehold land and buildings transferred These are

i) Restrictions on transfer of title
The title deeds of those properties with strategic assets (see below) or properties where strategic assets are in the course of being downgraded to becoming non-strategic include a clause that prevents their transfer without the approval of MOD The MOD also has the right to purchase any strategic assets in certain circumstances

ii) Property clawback agreement
The MOD retains an interest in future profits on disposal following a 'trigger event' A 'trigger event includes the granting of planning permission for development and/or change of use, and the disposition of any of the acquired land and buildings During the 12 years from 1 July 2001 following a 'trigger event', the MOD is entitled to clawback a proportion of the gain on each individual property transaction in excess of a 30% gain on a July 2001 professional valuation The proportion of the excess gain due to the MOD is based on a sliding scale which reduces over time from 50% to 9% and at 31 March 2007 stands at 41% The July 2001 valuation was approximately 16% greater in aggregate than the consideration paid for the land and buildings on 1 July 2001

Compliance Regime
The Compliance Committee monitors the effective application of the Compliance Regime required by the MOD to maintain the position of QinetiQ as a supplier of independent and impartial scientific/technical advice to the MOD and ensures that the required standards are met in trials involving human volunteers and trials where an incident may result in serious injury

Strategic assets
Under the Principal Agreement with the MOD, the QinetiQ controlled Group is not permitted without the written consent of the MOD, to

i) dispose of or destroy all or any part of a strategic asset, or

ii) voluntarily undertake any closure of, or cease to provide a strategic capability by means of all or any part of a strategic asset

The net book value of assets identified as being strategic assets as at 31 March 2007 was £3 1m (31 March 2006 £3 4m), the principal items being plant and machinery

Long-Term Partnering Agreement
On 27 February 2003 QinetiQ Limited entered into a Long Term Partnering Agreement to provide the Test and Evaluation (T&E) facilities and training support services to the MOD This is a 25-year contract with a total revenue value of up to £5 6bn, dependent on the level of usage by MOD, under which QinetiQ Limited is committed to providing the T&E services with increasing efficiencies through cost saving and innovative service delivery

Notes to the financial statements continued

37 Directors and other senior management personnel

The Directors and other senior management personnel of the Group during the year to 31 March 2007 comprise the Board of Directors and the QinetiQ Executive Committee

all figures in £ 000 s	2007	2006
Directors		
Short-term employee benefits	1,597	1 445
Post-employment benefits	57	79
Total	**1,654**	**1,524**
Other senior management personnel		
Short-term employee benefits	982	904
Post-employment benefits	80	102
Total	**1,062**	**1,006**

38. Contingent liabilities and assets

Subsidiary undertakings within the Group have given unsecured guarantees of £2 0m at 31 March 2007 (31 March 2006 £2 8m) in the ordinary course of business

The Group is aware of claims and potential claims by or on behalf of current and former employees, including former employees of the MOD and DERA and contractors, in respect of intellectual property, employment rights and industrial illness and injury which involve or may involve legal proceedings against the Group The Directors are of the opinion, having regard to legal advice received, the Group's insurance arrangements and provisions carried in the balance sheet that it is unlikely that these matters will, in aggregate, have a material effect on the Group's financial position, results of operations and liquidity

The Group has not recognised contingent amounts receivable relating to the Chertsey property which was disposed of during 2004 or the Fort Halstead property disposed of in September 2005 Additional consideration, subject to clawback to the MOD pursuant to the arrangements referred to in note 36 is potentially due upon the purchasers obtaining additional planning consents with the quantum dependent on the scope of the consent achieved

39. Post-retirement benefits

Introduction and background to IAS 19

International Accounting Standard 19 (Employee Benefits) requires the Group to include in the balance sheet the surplus or deficit on defined benefit schemes calculated as at the balance sheet date It is a snapshot view which can be significantly influenced by short term market factors The calculation of the surplus or deficit is, therefore, dependent on factors which are beyond the control of the Group – principally the value at the balance sheet date of equity shares in which the scheme has invested and long-term interest rates which are used to discount future liabilities The funding of the scheme is based on long term trends and assumptions relating to market growth, as advised by qualified actuaries

The QinetiQ Pension Scheme

In the UK the Group operates the QinetiQ Pension Scheme for the majority of its UK employees, a mixed benefit scheme The Defined Benefit (DB) section of the scheme provides future service pension benefits to transferring Civil Service employees All Group employees who were members, or eligible to be members, of the Principal Civil Service Pension Scheme or the UKAEA principal Non-Industrial Superannuation Scheme were invited to join the DB section of the scheme from 1 July 2001, together with all new employees who were previously members of schemes who are part of the Public Sector Transfer Club The Defined Contribution (DC) section of the scheme was set up for all employees who were not eligible or did not wish to join the DB section of the scheme

The most recent full actuarial valuation of the DB section was undertaken as at 31 March 2005 and resulted in an actuarially assessed deficit of £106 5m On the basis of the 31 March 2005 full valuation the Trustees of the scheme and the Company agreed that the 17 5% employer contribution rate would continue and in addition a further £10 0m per annum cash payment would be paid monthly for six years from October 2005, subject to review at the next valuation, due in March 2008, to cover the past service deficit Subsequently the Company agreed that part of the IPO proceeds would be used to prepay the balance of the first five years of the additional funding and a £45m payment was made into the scheme on 30 March 2006 The Company also made a further £45 3m payment into the scheme on the same date following the receipt of the payment from the MOD of the same value that was received in March 2006 in accordance with the indemnity given by the MOD to the Company as part of the agreement dated 3 December 2002 whereby QinetiQ Group plc acquired QinetiQ Holdings Limited There were no additional employer contributions in the year to 31 March 2007

Other UK schemes

In the UK the Group operates a further three small defined benefit schemes QinetiQ Prudential Platinum Scheme and schemes for the subsidiary companies ASAP Calibration Limited and Aurix Limited The net pension deficits of these schemes at 31 March 2007 amounted to £0 3m (31 March 2006 £0 3m) During the year the defined benefit scheme relating to ASAP Calibration Limited was closed to future benefit accruals

There were no outstanding or prepaid contributions at the balance sheet date (31 March 2006 £nil) Set out below is a summary of the overall IAS 19 defined benefit pension schemes' liabilities The fair value of the schemes' 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 schemes' liabilities, which are derived from cash flow projections over long periods, and thus inherently uncertain, were

all figures in £ million	2007	2006	2005	2004* (UK GAAP)
Equities	641 5	551 1	361 6	286 7
Corporate bonds	74 5	85 2	44 4	38 6
Government bonds	74 7	74 8	45 7	50 2
Cash	3 4	4 9	2 4	4 4
Total market value of assets	**794 1**	**716 0**	**454.1**	**379 9**
Present value of scheme liabilities	(884 9)	(884 4)	(617 2)	(525 3)
Net pension liability before deferred tax	**(90 8)**	**(168 4)**	**(163 1)**	**(145 4)**
Deferred tax asset	27 1	50 4	48 8	30 1
Net pension liability	**(63 7)**	**(118 0)**	**(114 3)**	**(115 3)**

* 2004 figures have been extracted from the UK GAAP results of the Group as no IFRS Group accounts were prepared in that year

Notes to the financial statements continued

39. Post-retirement benefits continued

Assumptions
The major assumptions (weighted to reflect individual scheme differences) were

	2007	2006
Rate of increase in salaries	4 6%	4 4%
Rate of increase in pensions in payment	3 1%	2 9%
Rate of increase in pensions in deferment	3 1%	2 9%
Discount rate applied to scheme liabilities	5 4%	4 9%
Inflation assumption	3 1%	2 9%
Mortality assumption in years		
Future male pensioners	86	86
Future female pensioners	89	89

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which due to the timescale covered, may not necessarily be borne out in practice It is important to note that these assumptions are long term, and in the case of the discount rate and the inflation rate are measured by external market indicators Assumptions for mortality for the year to 31 March 2007 have been maintained at the previous year levels and are in line with the mortality tables PMA92SC (for males) and PFA92SC (for females) as published by the Continuous Mortality Investigation and adopted by the actuarial profession

Scheme assets
Expected long term rates of return on scheme assets (weighted to reflect individual scheme differences) were

	2007	2006
Equities	7 70%	7 70%
Corporate bonds	5 30%	4 70%
Government bonds	4 60%	4 10%
Cash	5 50%	4 50%
Weighted average	**7 20%**	**6 90%**

all figures in £ million	2007	2006
Actual return on plan assets		
Expected return on scheme assets	50 4	34 1
Actuarial gain on scheme assets	1 5	85 8
Actual return on scheme assets	**51 9**	**119 9**

all figures in £ million	2007	2006
Changes to the fair value of scheme assets		
Opening fair value of scheme assets	716 0	454 1
Actual return on assets	51 9	119 9
Contributions by the employer	39 4	149 2
Contributions by plan participants	5 6	4 6
Net benefits paid out	(18 8)	(11 8)
Closing fair value of scheme assets	**794 1**	**716 0**

all figures in £ million	2007	2006
Changes to the present value of the defined benefit obligation		
Opening defined benefit obligation	884 4	617 2
Current service cost	47 7	40 1
Interest cost	44 3	34 4
Contributions by plan participants	5 6	4 6
Actuarial (gains)/losses on scheme liabilities	(84 3)	193 5
Net benefits paid out	(18 9)	(11 8)
Curtailments	6 1	6 4
Closing defined benefit obligation	**884 9**	**884 4**

all figures in £ million	2007	2006
Pension costs charged to the income statement		
Current service cost	47 7	40 1
Interest cost	44 3	34 4
Expected return on plan assets	(50 4)	(34 1)
Curtailment cost	6 1	–
Total expense recognised in the income statement (gross of deferred tax)	**47 7**	**40 4**

In the year to 31 March 2006 £6 4m of curtailment payments were provided for in the income statement for the year ended 31 March 2005 as part of the Group's restructuring costs

all figures in £ million	2007	2006	2005	2004* (UK GAAP)
Analysis of amounts recognised in statement of recognised income and expenses				
Total actuarial gain/(loss) (gross of deferred tax)	85 8	(105 4)	(9 9)	10 1
Cumulative total actuarial losses recognised in the Statement of Recognised Income and Expense	**(163 0)**	**(248 8)**	**(143 4)**	**(133 5)**
History of scheme experience gains and losses				
Experience gains on scheme assets	1 5	85 8	12 0	42 0
Experience gains/(losses) on scheme liabilities	84 3	(193 5)	(21 9)	(31 9)

* 2004 figures have been extracted from the UK GAAP results of the Group as no IFRS Group accounts were prepared in that year

The expected employer cash contribution to the defined benefit scheme for the year ending 31 March 2008 is £31 2m

Defined contribution schemes

Payments to the defined contribution schemes totalled £13 3m (March 2006 £7 9m)

Notes to the financial statements continued

40. Restatement of prior year comparatives

IFRS 3 Business Combinations requires the Group to finalise the fair value of assets and liabilities acquired from business combinations within one year of the acquisition date except certain deferred tax balances During the year the Group was required to adjust goodwill, intangible assets and deferred tax balances upon finalisation of the fair value of assets and liabilities on the acquisitions of Apogen Technologies Inc, Planning Systems Inc and SimAuthor Inc These balances have been restated in the prior year comparatives as follows

all figures in £ million	2006 As reported	2006 Adjustment	2006 Restated
Goodwill	315 0	(0 1)	314 9
Intangible assets	56 4	0 7	57 1
Deferred tax asset	12 4	(0 6)	11 8
Other net liabilities not restated	(20 9)	–	(20 9)
Net assets	**362.9**	**–**	**362 9**

41. Capital commitments

The Group had the following capital commitments for which no provision has been made

all figures in £ million	2007	2006
Contracted	**13 2**	**26 2**

Capital commitments at 31 March 2007 include £11 7m (2006 £24 7m) in relation to property, plant and equipment that will be wholly-funded by a third party customer under long term contract arrangements

42 Post balance sheet events

On 16 April 2007 the Group acquired ITS Corporation (ITS) for an initial cash consideration of £40 8m ($80 0m) The agreement to purchase ITS includes an additional deferred payment of £5 1m ($10 0m) based on the achievement of certain short term performance milestones ITS had revenues of £39 5m ($77 5m) for the 12 months ended 31 December 2006, EBITDA of £3 3m ($6 4m), and reported operating profit of £3 1m ($6 0m), after charging £0 6m ($1 2m) of non-recurring costs related to acquisitions completed in late 2005

On 23 April 2007 the Group announced that it had agreed to purchase all the shares of Applied Perception, Inc (API) and Automatika Inc (Automatika), both providers of robotics technologies, for up to £4 7m ($9 2m) each The transactions will close upon receipt of appropriate US Government regulatory approvals The acquisition of each company will be settled for an initial cash consideration of £3 1m ($6 0m), with an additional deferred consideration of up to £1 6m ($3 2m) two years after closing

Due to the recent announcement of the above acquisitions it is not practicable to provide information about the assets and liabilities as at the date of acquisition

43. Initial public offering

On 15 February 2006 the Group listed on the London Stock Exchange The transactions relating to the Group's IPO are analysed below

all figures in £ million	2006
Proceeds received on IPO	
Gross proceeds	150 0
Costs paid in year	(13 8)
Net (costs)/proceeds received in year	136 2
Accrued costs	(3 5)
Net (costs)/proceeds	**132 7**

In addition to the cash costs noted above the Company gifted £500 worth of free shares to all employees at the date of the IPO The value of these shares at the admission price of £2 00 per share amounts to £5 2m

The total costs of the IPO, inclusive of the value of the gift of shares, have been charged to the income statement or the share premium account as follows

all figures in £ million	2006
Income statement	(8 9)
Share premium account	(13 6)
Total costs	**(22 5)**

Income statement income/(costs) before corporation tax	
Employee shares (including associated tax costs)	(6 8)
Other IPO costs	(2 1)
	(8 9)
Release of remaining discount on MOD indemnity triggered by IPO	4 7
Net IPO related items	**(4 2)**

The net proceeds received from the IPO as at 31 March 2006 were applied as follows

all figures in £ million	note	2006
Contribution to defined benefit pension scheme	39	45 0
Reduction in net debt		91 2
Net proceeds		**136 2**

Notes to the financial statements continued

44 Subsidiaries, associates and investments

The principal subsidiaries and associated undertakings at 31 March 2007, all of which are included in the consolidated financial statements, together with the principal investments, are shown below

Name of company	Principal area of operation	Country of incorporation	Proportion of voting rights held[2][5]	Financial year end[1]	Nature of business
Subsidiaries					
QinetiQ Holdings Limited	UK	England & Wales	100%		Holding company
QinetiQ Limited	UK	England & Wales	100%		Research and development
ASAP Calibration Services Limited	UK	England & Wales	100%		Calibration and engineering
Aurix Limited	UK	England & Wales	88 0%		Research and development
cueSim Limited	UK	England & Wales	100%		Research and development
Graphic Research Corporation Limited	UK	England & Wales	100%		Research and development
HVR Consulting Services Limited	UK	England & Wales	100%		Research and development
QinetiQ Nanomaterials Limited	UK	England & Wales	100%		Research and development
QinetiQ Overseas Trading Limited	UK	England & Wales	100%		Research and development
Quintel Technology Limited[3][4]	UK	England & Wales	50 0%		Research and development
Trusted Experts Limited	UK	England & Wales	100%		Resource management
QinetiQ Insurance PCC Limited	UK	Guernsey	100%		Insurance
QinetiQ Overseas Holdings Limited	UK	England & Wales	100%		Holding company
Analex Corporation	USA	USA	100%		Research and development
Apogen Technologies, Inc	USA	USA	100%		Research and development
Foster Miller, Inc.	USA	USA	100%		Research and development
Ocean Systems Engineering Corporation	USA	USA	100%		Research and development
Planning Systems, Inc.	USA	USA	100%		Research and development
QinetiQ, Inc	USA	USA	100%		Research and development
QinetiQ Technology Extension Corporation	USA	USA	100%		Research and development
SimAuthor, Inc.	USA	USA	100%		Research and development
Westar Aerospace & Defence Group, Inc	USA	USA	100%		Research and development
Westar Display Technologies, Inc	USA	USA	100%		Research and development
QinetiQ North America Operations, LLC	USA	USA	100%		Holding company
QinetiQ North America, Inc.	USA	USA	100%		Holding company
QinetiQ Philippines Company Inc	Philippines	Philippines	100%		Research
Verhaert Design and Development NV	Belgium	Belgium	100%		Research and development
Associates					
Infoscitex, Inc.	USA	USA	27 8%		Research and development
QS4 Group Limited[4]	UK	England & Wales	50 0%	31 Dec	Holding company
QS4 Limited[4]	UK	England & Wales	50 0%	31 Dec	Research and development
Quintel (UK) Limited[4]	UK	England & Wales	50 0%	31 Dec	Research and development
Investments					
Last Mile Communications	UK	England & Wales	1 7%		Research and development
Metalysis Limited	UK	England & Wales	16 3%		Research and development
Nomad Holdings Limited	UK	England & Wales	8 6%		Research and development
pSivida Limited	USA	Australia	7 7%	30 Jun	Research and development
Sciemus Limited	UK	England & Wales	10 0%	30 Sep	Research and development
Stingray Geophysical Limited	UK	England & Wales	19 9%		Research and development
ZBD Displays Limited	UK	England & Wales	31 6%	31 Jul	Research and development

[1] Accounting reference date is 31 March unless otherwise stated Where the financial year of the entity is different to 31 March the management accounts of that entity as at that date have been used for the purposes of the consolidation

[2] Percentage of ordinary share capital unless otherwise stated

[3] Disclosed as a subsidiary due to management control exercised by the Group

[4] Employee warrants if exercised would dilute the Group s interest to 45 1%

[5] QinetiQ Holdings Limited is a direct subsidiary of QinetiQ Group plc All other subsidiaries associates and investments are held indirectly by other subsidiaries of QinetiQ Group plc.

Company balance sheet as at 31 March

all figures in £million	note	2007	2006
Fixed assets			
Investments in subsidiary undertaking	2	92.3	92.3
		92.3	**92.3**
Current assets			
Debtors	3	170.7	153.5
		170.7	**153.5**
Current liabilities			
Creditors amounts falling due within one year	4	–	(0.3)
Net current assets		**170.7**	**153.2**
Net assets		**263.0**	**245.5**
Capital and reserves			
Equity share capital	5, 6	6.6	6.5
Capital redemption reserve	6	39.9	39.9
Share premium account	6	147.6	147.5
Profit and loss account	6	68.9	51.6
Capital and reserves attributable to shareholders		**263.0**	**245.5**

There are no other recognised gains and losses

The financial statements were approved by the Board of Directors and authorised for issue on 31 May 2007 and they were signed on its behalf by

Graham Love
Chief Executive Officer

Doug Webb
Chief Financial Officer

Notes to the Company financial statements

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements

Basis of preparation
The financial statements have been prepared under the historical cost convention and in accordance with applicable UK accounting standards As permitted by section 230(4) of the Companies Act 1985, a separate profit and loss account dealing with the results of the Company has not been presented

Investments
In the Company's financial statements, investments in subsidiary undertakings are stated at cost less any impairment in value

Share-based payments
FRS 20 share based payments became effective for accounting periods beginning on or after 1 January 2005 The fair value of equity settled options for share based payments is determined on grant and expensed straight-line over the period from grant to the date of earliest exercise The fair value of cash settled options for share based payments is determined each period end until exercised or they lapse The value is expensed on a straight-line basis over the period from grant to the date of earliest exercise The fair value of both equity settled and cash settled share options is calculated by a binomial option pricing model The cost of share-based payments is charged to subsidiary undertakings

2. Investment in subsidiary undertaking

all figures in £ million	2007	2006
Subsidiary undertaking – 100% of ordinary share capital of QinetiQ Holdings Limited	**92 3**	**92 3**

A complete list of all subsidiary and sub subsidiary undertakings of QinetiQ Group plc is disclosed in note 44 to the Group financial statements

3. Debtors

all figures in £ million	2007	2006
Amounts owed by Group undertakings	170 6	152 8
Tax and social security	–	0 6
Other debtors	0 1	0 1
	170 7	**153 5**

4. Creditor amounts due within one year

all figures in £ million	2007	2006
Bank overdrafts	–	**0.3**

5. Share capital

The Company's share capital is disclosed in note 32 to the Group financial statements

6 Reserves

all figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Profit and loss	Total equity
At 1 April 2005	**1 6**	**1 9**	**11 4**	**–**	**14 9**
Profit	–	–	–	88 9	88 9
Preference Shares redeemed in year	–	37 5	–	(37 5)	–
Share options	–	–	–	0 2	0 2
IPO costs	–	–	(13 6)	–	(13 6)
Bonus issue	–	0 5	(4 6)	–	(4 1)
Issue of new shares	4 9	–	154 3	–	159 2
At 31 March 2006	**6 5**	**39 9**	**147 5**	**51 6**	**245 5**
Profit	–	–	–	38 1	38 1
Dividend paid	–	–	–	(22 7)	(22 7)
Share-based payments	–	–	–	1 9	1 9
Issue of new shares	0 1	–	0 1	–	0 2
At 31 March 2007	**6 6**	**39 9**	**147 6**	**68 9**	**263 0**

The capital redemption reserve is not distributable and was created following redemption of Preference Share capital

7 Share-based payments

The Company's share based payments are as those detailed in note 34 to the Group financial statements, however the total share-based payment expense has been recharged to other Group undertakings (2006 £nil)

8 Other information

The Group's ultimate holding Company, QinetiQ Group plc, had no employees during the year Details of the employees of the Group are shown in note 9 to the Group financial statements Directors emoluments, excluding company pension contributions were £1 6m (2006 £1 4m) These emoluments were all in relation to services provided on behalf of the QinetiQ Group with no amount specifically relating to their work for the Company Details of the directors' emoluments, share schemes and entitlements under money purchase and defined benefit pension schemes are disclosed in the Report of the Remuneration Committee

The remuneration of the Company's auditors for the year to 31 March 2007 was £5,000 (2006 £5,000) all of which was for statutory audit services No other services were provided by the auditors to the Company

Five year review for the years ended 31 March

all figures in £ million	IFRS 2007	IFRS 2006	IFRS 2005	UK GAAP 2004	UK GAAP 2003
Defence & Technology	657.9	669.6	664.9	657.7	631.4
Security & Dual Use	121.4	127.6	115.9	133.0	128.1
QinetiQ North America	358.2	248.4	70.1	0.3	1.6
Ventures	12.0	6.1	5.0	1.5	0.7
Central	–	–	–	2.9	13.1
Revenue	**1,149.5**	**1,051.7**	**855.9**	**795.4**	**774.9**
Defence & Technology	59.1	56.5	51.3	50.7	48.8
Security & Dual Use	13.9	17.2	15.9	11.9	(0.4)
QinetiQ North America	39.9	24.5	8.0	(0.6)	(5.6)
Ventures	(6.9)	(7.5)	(10.0)	(9.9)	(11.8)
Central	–	–	–	2.0	4.7
Operating profit[1]	**106.0**	**90.7**	**65.2**	**54.1**	**35.7**
Operating margin[1]	9.2%	8.6%	7.6%	6.8%	4.6%
Profit before tax	98.5	72.5	78.0	51.3	10.7
Profit after tax	78.1	60.4	72.3	41.2	7.1
Average number of employees	11,870	11,024	9,632	8,898	9,384
Cash flow from operations	107.5	107.6	36.9	142.7	(4.4)
Free cash flow	73.5	141.3	55.7	135.9	(33.1)
Net debt	300.8	233.0	176.6	3.6	133.2

[1] Before amortisation of intangibles arising from acquisitions restructuring costs in 2005 IPO costs in 2006 and profit on disposal of interests on subsidiaries in 2007 and profit on disposal of interest in associate in 2005

The combined and consolidated financial information has been prepared as set out below to show the results and financial position of the Company as if it has existed as a discrete operation from 1 April 2002

- for the year ended 31 March 2003, the consolidated financial statements of QinetiQ Holdings Limited for the period from 1 April 2002 to 28 February 2003 aggregated with the consolidated financial statements of QinetiQ Group plc for the period to 31 March 2003, and

- for the years ended 31 March 2004 2005, 2006 and 2007 the consolidated financial statements of QinetiQ Group plc.

Glossary

AFS	Aerospace Filtration Systems, Inc
AGM	Annual General Meeting
Backlog	the expected future value of revenue from contractually-committed and funded customer orders (excluding £4 8bn value of remaining 21 years of LTPA contract)
bn	billion
Book to bill ratio	ratio of orders received in the year to revenue for the year, adjusted to exclude revenue from the 25 year LTPA contract
BPS	Basis points
Carlyle	Former major investor and co owner of QinetiQ. Carlyle sold its remaining shareholding in QinetiQ on 14 February 2007
CATS	Combined Aerial Target Service
CR	Corporate Responsibility
D&T	QinetiQ's Defence & Technology Sector
DARPA	US Defense Advanced Research Projects Agency
DDA	Defence Diversification Agency
dstl	Defence Science & Technology Laboratory
DHS	US Department of Homeland Security
DoD	US Department of Defense
DTR	MOD s Defence Training Rationalisation programme
EBITDA	earnings before interest, tax depreciation, amortisation, gains on business divestments unrealised impairment of investment and gain on disposal of non-current assets
ESA	European Space Agency
EU	European Union
Free cash flow	net cash flow from operating activities less the net cash flow from the purchase and sale of intangible assets and the purchase and sale of plant, property and equipment
GPS	Global Positioning System
IAS	International Accounting Standard
IFRS	International Financial Reporting Standard
IP	Intellectual property
IPO	Initial Public Offering
KPI	Key Performance Indicator
LCD	Liquid Crystal Display
LIBID	London inter-bank bid
LIBOR	London international borrowing rate
LSE	London Stock Exchange
LTPA	Long-Term Partnering Agreement – 25-year contract established in 2003 to manage the MOD's test and evaluation ranges
m	million
MOD	Ministry of Defence
Non-recurring items and acquisition amortisation	IPO costs, major restructuring costs, disposals of property, plant and equipment, amortisation of intangible assets arising from acquisitions and impairment of goodwill and current assets (2005 only)
OEM	Original Equipment Manufacturer
Operating cash conversion	the ratio of cash flow from operations, less cash outflows on the purchase of intangible assets and property, plant and equipment and before additional pension contributions to operating profit excluding share of post-tax loss of equity accounted joint-ventures and associates
Organic growth	The level of year-on year growth, expressed as a percentage, based on the businesses that were part of the Group at the start of the initial period
OSEC	Ocean Systems Engineering Corporation
QNA	QinetiQ's North America Sector
R&D	Research and development
RFID	Radio frequency identification
S&DU	QinetiQ s Security & Dual Use Sector
SAIC	Science Applications International Corporation
SETA	Systems Engineering and Technology Assistance
SME	Small and medium sized enterprises
UK GAAP	UK Generally Accepted Accounting Practices
Underlying effective tax rate	the tax charge for the year excluding the tax impact of non-recurring items and acquisition amortisation expressed as a percentage of underlying profit before tax
Underlying operating cash conversion	the ratio of cash flow from operations (excluding cash spend on major restructuring items in 2006), less cash outflows on the purchase of intangible assets and property, plant and equipment and before additional pension contributions to underlying operating profit excluding share of post-tax loss of equity accounted joint-ventures and associates
Underlying operating margin	underlying operating profit expressed as a percentage of revenue
Underlying operating profit	earnings before interest tax, IPO-related items (2006 only) gains on business realisations and impairment of investment (2007 only), profit on disposal on non-current assets and amortisation of intangible assets arising on acquisitions
Underlying profit before tax	profit before tax excluding IPO-related items (2006 only) gains on business realisations and impairment of investment (2007 only), profit on disposal on non current assets and amortisation of intangible assets arising from acquisitions
Velcro®	Velcro® is a registered trademark of Velcro Industries B V

Financial calendar

26 July 2007	Interim management statement (provisional date)
26 July 2007	Annual General Meeting
1 August 2007	Ex-dividend date
31 August 2007	Final ordinary dividend payable
30 September 2007	Interim financial period end
28 November 2007	Interim results announcement (provisional date)
February 2008	Interim management statement (provisional date)
February 2008	Interim dividend payment (provisional date)
31 March 2008	Financial year end
May 2008	Preliminary announcement

Analysis of shareholders*

Financial institutions with shareholding greater than 0 5m shares	59%
Ministry of Defence	19%
Other (including employees, management and financial institutions with shareholding less than 0 5m)	22%
	100%

Analysis as at 22 May 2007

Advisers

Auditors
KPMG Audit Plc
8 Salisbury Square
London EC4Y 8BB

Corporate Brokers
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20 Moorgate
London EC2R 6DA

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London EC1A 1HQ

Principal Legal Advisers
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