

Modernise Build Invest



Who we are

QinetiQ is a leading science and engineering company operating primarily in the defence, security and aerospace markets. We work in partnership with our customers to solve real-world problems through innovative solutions, delivering operational and competitive advantage.

FY17^ Summary

Financial

Orders

£675.3m

2016: £659.8m

Revenue

£783.1m

2016: £755.7m

Underlying earnings per share*

18.1p

2016: 16.3p

Basic earnings per share

21.5p

2016: 18.1p

Non-financial

Customer satisfaction (score out of 10)

8.2

2016: 8.1

Employee engagement (score out of 1,000)

596

2016: 623

Operational highlights

LTPA contract amendment

Signed the largest and most significant contract since privatisation to ensure the UK has world-class competitive air ranges and training for test pilots and aircrew.

£1bn

Value of contract amendment

Acquisition of Meggitt Target Systems

Acquired Meggitt Target Systems business, which generates 90% of its revenue outside the UK, to support our international growth. The front cover image shows the launch of a Banshee Jet 40 in the desert in Kuwait. This target was used for tracking and live firing.

Customers in
over 40 countries

* Alternative performance measures

Alternative performance measures are used to supplement the statutory figures. These are additional key financial indicators used by management internally to assess the underlying performance of the Group. Definitions can be found in the glossary on page 151.

^ Year references (FY17, FY16, 2017, 2016) refer to the year ending 31 March.

Underlying operating profit*

£116.3m

2016: £108.9m

Total operating profit

£132.7m

2016: £75.3m

Health and safety (Lost time incident rate (LTI))

5.7

2016: 5.0

Investing in our future

In FY17 we drove operational efficiencies to create the headroom to invest in sustainable growth. These productivity savings were reinvested in our people, technology and campaigns.

£20m reinvested

Strategic report

An overview of our segments, and statements from both the Chairman and CEO. The factors in the external market impacting our business, our strategy and progress against our KPIs. Principal risks, including our viability statement, along with more detailed discussion on our performance, both non-financial and financial.

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www.QinetiQ.com



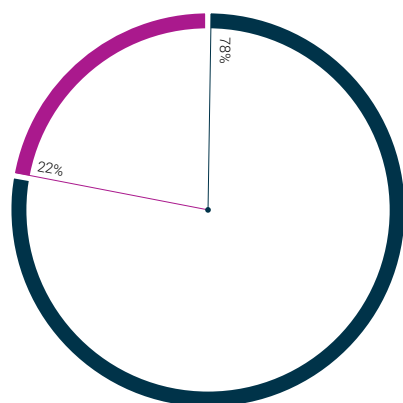
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At a glance

We are structured into two divisions:
EMEA[#] Services and Global Products.

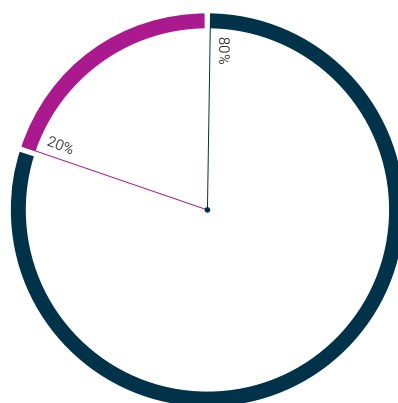
Revenue £783.1m

2016: £755.7m



Underlying operating profit* £116.3m

2016: £108.9m



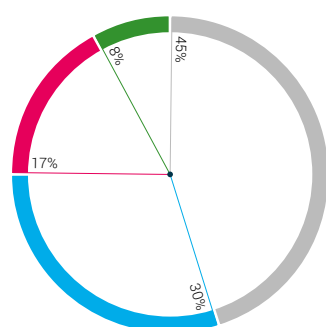
● EMEA Services
● Global Products

EMEA Services

Combining world-leading expertise with unique facilities to provide technical assurance, test and evaluation and training services, underpinned by long-term contracts.

Revenue £613.5m

2016: £616.4m



● Maritime, Land & Weapons
● Air & Space
● Cyber, Information & Training
● International

Air & Space

What we do

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

Revenue

c. £185m

Key sites

Farnborough and Boscombe Down, UK.

Cyber, Information & Training

What we do

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

Revenue

c. £100m

Key sites

Farnborough, Malvern and Crewe, UK.

Maritime, Land & Weapons

What we do

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

Revenue

c. £280m

Key sites

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

International

What we do

Deliver our products and services in international markets. The newly acquired RubiKon Group, based in Australia, is reported in the International business.

Revenue

c. £50m

Key sites

Australia, Sweden, Canada and Dubai, UAE.

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

[#] EMEA is Europe, Middle East and Australasia.

EMEA Services

£**613.5**m
FY17 annual revenue

5,301
FY17 total employees

Global Products

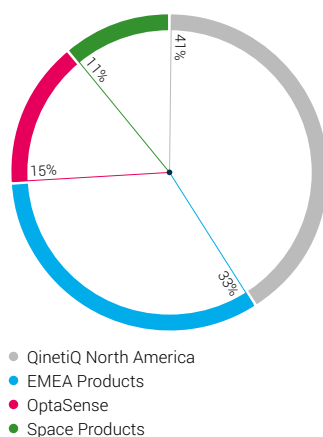
£**169.6**m
FY17 annual revenue

853
FY17 total employees

Global Products

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

Revenue £169.6m
2016: £139.3m

**QinetiQ North America****What we do**

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

Revenue
c. £70m

Key sites

Waltham, Massachusetts; Pittsburgh, Pennsylvania; and Virginia, USA.

Space Products**What we do**

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

Revenue
c. £20m

Key sites

Farnborough, UK and Antwerp, Belgium.

OptaSense**What we do**

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

Revenue
c. £25m

Key sites

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

EMEA Products**What we do**

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

Revenue
c. £55m

Key sites

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

Chairman's statement

The expertise of our people is in high demand as customers look for innovative ways to defeat new threats to security.



Mark Elliott
Non-executive Chairman

Context

FY17 will be remembered as the year in which many of the world's most newsworthy events were influenced by the challenges being created by globalisation and a marked return to national politics. Over the summer, I engaged in discussions with Non-executive Directors of other companies listed on the London Stock Exchange about the risks and opportunities presented by Brexit. In the United States, where I have spent much of my working life, some of the political and economic conventions that have been in place for many years are being challenged and the Board and I are working closely with QinetiQ's US leadership team to ensure that we are responding effectively to the new realities.

In defence and security, we are seeing increasing complexity with nations facing multiple global threats from both state and non-state actors. In this environment, QinetiQ continues to play a vital role making connections between technologies, across supply chains and internationally to support government customers with the rapid development of new capabilities to combat these threats.

In April 2015, we appointed Steve Wadey as CEO of QinetiQ. Steve has significant defence sector experience and is implementing a strategy to deliver sustainable growth founded on a thorough understanding of the dynamics in our markets and the needs of our customers now and in the future. The Board and I are encouraged by the progress that is being made by Steve and his leadership team, and the momentum that is clearly building in the implementation of our strategic priorities.

Performance

In the year to 31 March 2017, we delivered increased orders, revenue and profit. We will continue to prioritise the delivery of sustainable growth with ongoing capital discipline as key elements of QinetiQ's investment case.

New CFO

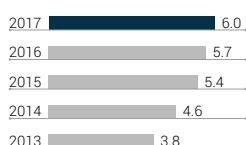
On 1 March 2017, the Board was delighted to welcome David Smith as Chief Financial Officer, following an extensive blue-chip career as CFO of both Rolls-Royce and of the technology group Edwards, and as CEO of Jaguar Land Rover. Our previous CFO David Mellors left QinetiQ at the end of 2016 to join Cobham plc. On behalf of the Board I would like to thank David Mellors for his contribution to QinetiQ; he drove a significant strengthening of the balance sheet providing a solid foundation for our future growth. We would also like to thank Dr Malcolm Coffin, QinetiQ Group Financial Controller, who assumed the CFO role on an interim basis.

"Achieving our ambition of becoming the chosen partner requires a relentless focus on meeting the needs of our customers both in our home markets and overseas."

Progressive dividend policy

The Group has articulated its priorities for capital allocation which include a progressive dividend policy.

Full year dividend



4.0p

Final dividend to be paid on 1 September 2017 (2016: 3.8p)

Return of capital

The Group has also returned capital to shareholders by buying back shares. We returned £150m between May 2014 and September 2015, and a further £50m between November 2015 and March 2017.

Annual General Meeting 2017

11am on 19 July 2017, at the offices of Ashurst LLP, Broadwalk House, 5 Appold Street, London EC2A 2HZ.

Strategy

Over the last 18 months, Steve and his executive team led an Integrated Strategic Business Planning process, which was thoroughly discussed in a two-day meeting with the Board. In addition to this active involvement in the development of future strategy, the Board also ensures the effective scrutiny of mergers and acquisitions. In FY17, the Group completed the purchase of two businesses to support our strategy, Meggitt Target Systems in the UK and Canada, and RubiKon Group in Australia, its first significant acquisitions since 2008. I would like to add my personal welcome to the employees of these two companies and wish them many rewarding years as part of the QinetiQ Group.

With a significant amount of activity under way to drive growth in the UK, in international markets and through innovation, the Board is undertaking 'deep dives' into a number of topics to monitor delivery of the strategy. These deep dives are scheduled throughout the year with relevant members of QinetiQ's executive team and papers are submitted in advance so the focus is on two-way discussion rather than presentations. Topics scheduled for FY18 include those related to our strategic priorities, progress of the transformation of the Company, and focus on our key stakeholders – customers, employees and shareholders.

Governance

In addition to the implementation of the Group's strategy for sustainable growth, an ongoing priority for the Board is strong governance and the effective stewardship of the Company. During the year, Board members visited a number of sites including QinetiQ North America in Waltham, MA, and MOD Boscombe Down, where a number of activities associated with the Group's strategic priority to modernise UK test and evaluation are currently under way. These visits provided the opportunity to see at first-hand how we are implementing strategy and managing risk.

Employees

The visits have also provided the opportunity to spend time with a number of our employees. I never fail to be impressed by our scientists and engineers, whose expertise is in high demand as customers look for innovative ways to defeat new threats to security. I'd like to thank all of our employees for their ongoing dedication to our customers.

The knowledge and skills of our people are at the heart of our business and so development of our talent is a vital investment. Equally important is the ongoing commitment to the next generation through offering apprenticeships and graduate schemes and outreach programmes with our local schools.

Across the Group, our employees have done what they do best: acting with integrity, working collaboratively and focusing on performance for the benefit of our customers – three values that underpin the way we work at QinetiQ. We know it's not just what we do that is important but how we do it. In FY18, the Board is committing more time to consider how we want our culture to evolve to deliver our vision and strategy, how we nurture that culture and how our transformation can contribute.

QinetiQ's leaders play a vital role of delivering day-to-day operational performance and driving change. Steve's first decision as CEO was to establish a Leadership Community at QinetiQ and bring together the top 100 leaders every month. Non-executive Directors have attended these Leadership Community events during the year, contributing to workshops and witnessing how leaders are driving the future direction of the Company. We will continue to focus on leadership and succession planning in FY18.

Customers

Achieving our ambition of becoming the chosen partner requires a relentless focus on meeting the needs of our customers both in our home markets and overseas. To achieve this, we are establishing productive partnerships with others – from the largest global companies to small businesses and universities – and aim to be open and professional in our relationships with our supply chain, basing them firmly on mutual respect.

Shareholders

Along with employees and customers, shareholders are key stakeholders in QinetiQ as the owners of the Company. This year, Michael Harper, Senior Independent Director and Chairman of the Remuneration Committee, has consulted shareholders about the new remuneration policy to ensure it is aligned to their interests. We also enjoyed a constructive dialogue with investors during the CFO transition, with a number of them meeting David Smith before he joined. We would like to thank our investors for their continued support.

Capital allocation

Unlocking QinetiQ's potential requires focused investment in growth coupled with continued capital discipline to ensure growing, sustainable returns. In recognition of this, our priorities for capital allocation are: organic investment complemented by bolt-on acquisitions where there is a strong strategic fit; the maintenance of balance sheet strength; a progressive dividend; and the return of excess cash to shareholders.

Dividend

The Board proposes a final dividend of 4.0p per share for the year ended 31 March 2017 (2016: 3.8p), making the full year dividend 6.0p (2016: 5.7p). Subject to approval at the Annual General Meeting, the final dividend will be paid on 1 September 2017 to shareholders on the register at 4 August 2017. The full year dividend represents an increase of 5%, reflecting our commitment to a progressive dividend.

Finally, I would like to thank Board members for their ongoing counsel. I value their considerable experience and the significant contribution that they have made this year.

Mark Elliott

Non-executive Chairman
25 May 2017

Chief Executive Officer's review

Good operational delivery and strategic progress.



Steve Wadey
Chief Executive Officer

Market environment

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

FY17 performance

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

Strategy

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

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

UK Defence Test & Evaluation

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

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

In December we signed an 11-year, £1bn amendment to the Long Term Partnering Agreement (LTPA), the largest and most significant contract since privatisation, which has significant mutual benefits for the MOD and QinetiQ. For the MOD, it ensures the UK has world-class competitive air ranges and training for test pilots and aircrew, and delivers the capability at less cost. For us, it provides the platform we need for growth by creating more relevant and competitive T&E capability for the UK armed forces as well as governments and commercial customers around the world.

Our focus during FY18 is to re-price the remaining LTPA contract, which is due on 31 March 2018, and to work together with the MOD and industry partners to develop a long-term vision for the UK's T&E capabilities.

"Our strategy is inherently outward looking... we have been building positive momentum with its implementation during the year."

Our strategic pillars

We have refined our strategy in its first year of implementation. It remains built on three strategic pillars:

UK

We will lead and **modernise** the UK defence test and evaluation enterprise by working in partnership with Government and prime contractors.

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International

We will **build** an international company that delivers additional value to our customers by developing our home markets, creating new home markets and exporting.

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Innovation

We will **invest** in and apply our core competences for customer advantage in defence and commercial markets.

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The objective of this vision is to deliver future military capability for the next decade and beyond, addressing current and emerging threats. This will provide a platform for growth in the UK T&E market, which we estimate to be double that which we currently access, and improve our ability to win work with customers outside the UK.

International

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

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

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

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

Innovation

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

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

We have identified more than 30 growth campaigns in pursuit of material opportunities, all of which are worth tens of millions of pounds and in some cases more.

We are not going to win every campaign, but the scale of the total opportunity is significant over a five to 10-year time period. We will pursue these campaigns with vigour in FY18, as well as extending our focus to more international markets.

Transformation

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

Air accident

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

Outlook – FY18

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

The Group's Global Products division has shorter order cycles than EMEA Services and its performance is dependent on the timing of shipments of key orders. As a result of its contracted orders and pipeline of opportunities, as well as the anticipated full year contribution from the Target Systems acquisition, the division is expected to continue to grow in FY18.

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

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

Outlook – longer term

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

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

Steve Wadey

Chief Executive Officer
25 May 2017

Our business model

Our unique expertise allows us to operate a sustainable business model that creates value for our customers.

Our unique expertise allows us to...

QinetiQ is a company of scientists and engineers essential to sovereign capability.

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

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

People and domain know-how

Over **3,000** scientists, engineers and technicians

Approx. **90%** of our people in the UK, and 75% in the US have national security clearance

Technical expertise

Over **1,000** granted patents

Over **300** patents pending

Distinctive facilities

1 of 3 Our low speed wind tunnel is one of just three in the world

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

operate a sustainable business model...

Our unique position in the market

Our customers are predominantly government organisations in our home markets of the UK, US and Australia, with a growing international and commercial presence.

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

We occupy a unique position in the market and collaborate with prime contractors, service providers and a broad-based supply chain that includes specialist firms.

Sustaining our business model

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

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

As a people and knowledge-based business, our capital requirements are relatively low. Our principal use of capital is investment in organic growth and, in particular, capital expenditure to modernise our facilities as a platform for that growth.

How we generate revenue

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

We operate two divisions:

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

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

How we deliver benefits to key stakeholders

Customers

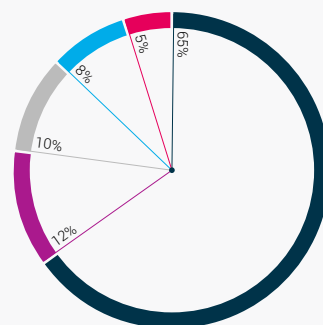
- Deliver mission-critical solutions
- Responsive and flexible
- Ensure value for money

Shareholders

- Deliver sustainable growth in revenue, operating profit and high quality earnings

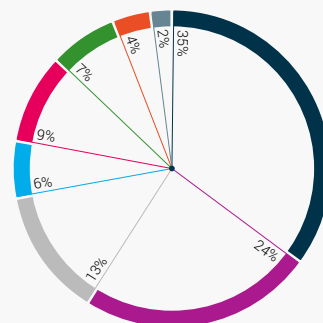
Employees

- Work in integrated teams
- Utilise expertise across QinetiQ



- UK Ministry of Defence (MOD)
- Government agencies
- Commercial
- US Department of Defence (DoD)
- Commercial defence

Revenue by key domain

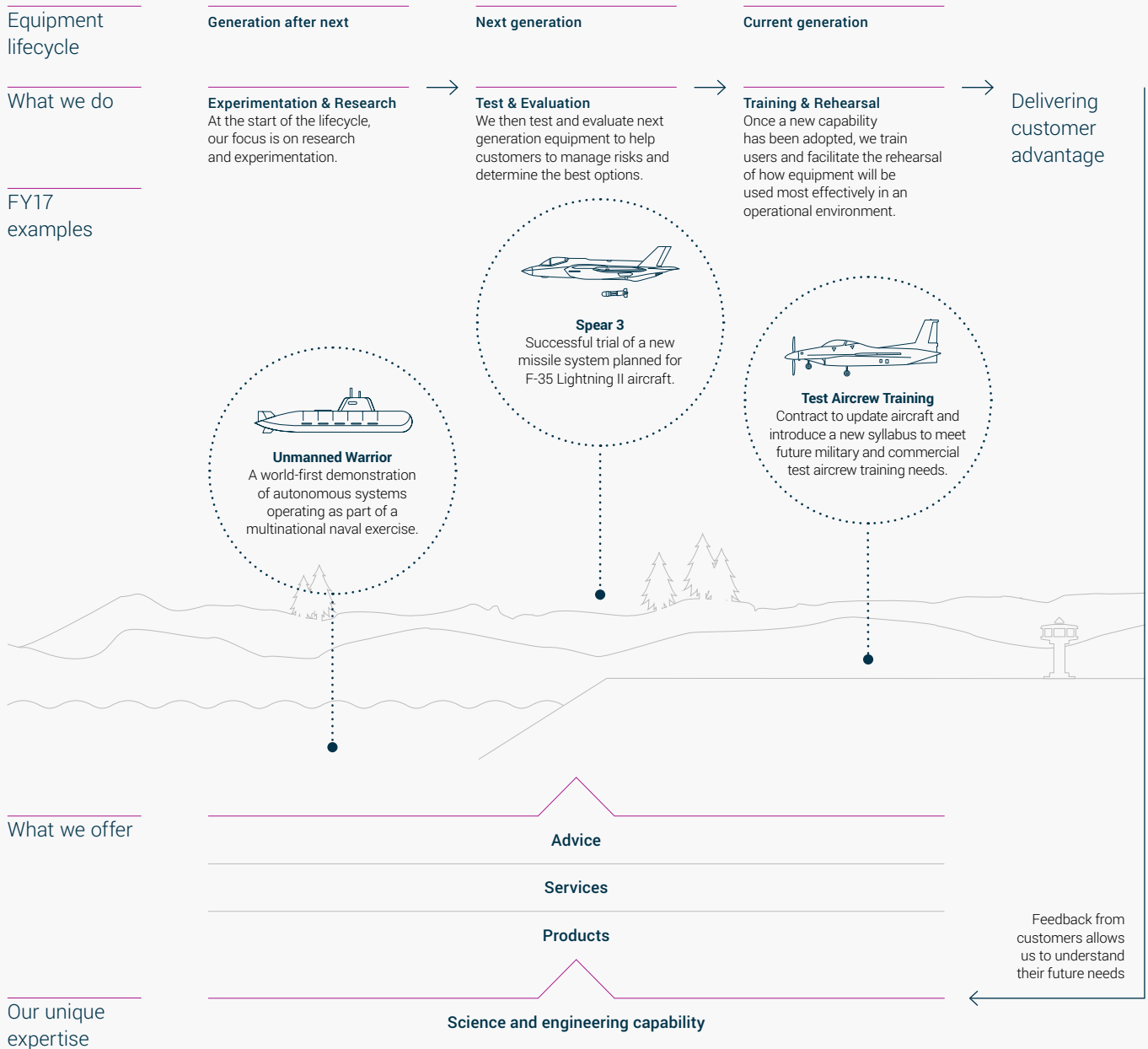


- EMEA Services – Maritime, Land & Weapons
- EMEA Services – Air & Space
- EMEA Services – Cyber, Information & Training
- EMEA Services – International
- Global Products – QinetiQ North America
- Global Products – EMEA Products
- Global Products – OptaSense
- Global Products – Space Products

that creates value for our customers.

How we create value for our customers

We work across the equipment lifecycle from initial concept through to final disposal.



Market overview

Several trends impact the markets we operate in.

Defence and security markets are changing rapidly. A number of emerging themes result in both challenges and opportunities for our industry.

Our strategy has been developed and will continue to be refined to respond to these themes.

Three key themes across our markets driving strategy:

- 1 Increasing global threat complexity
- 2 Partnering for innovation
- 3 Value for money in defence

To ensure we deliver sustainable growth in these markets our approach is to:

- Act with pace and agility to meet customer needs and market opportunities;
- Focus on the rapid development, experimentation and deployment of new capabilities;
- Support with Internal Research and Development;
- Prioritise commercial innovation and innovative business models;
- Select campaigns on the basis of our view of long-term customer needs;
- Build networks that bring together Government, industry, SMEs and academia;
- Take steps to ensure we have access to talent now and in the future;
- Drive outcome-based solutions for our customers that both improve services and deliver savings; and
- Work to build cross-border collaboration.

1. Increasing global threat complexity

We live in a time of unprecedented uncertainty. Threats to our security are becoming more numerous, more diverse and more intense. It is not possible to separate foreign affairs, defence and homeland security; national security challenges are complex and demand whole-of-government responses. In the last few years alone there have been multiple geopolitical concerns including instability in the Middle East and the associated displacement of refugees, terrorist attacks in Europe, Brexit, rising tensions with Russia including the recent deployment of NATO forces to Poland and the Baltic States, concerns about North Korean aggression, and the continued threat from cyber attack.

“The next five years will see rising tensions with and between countries... An ever-widening range of states, organisations, and empowered individuals will shape geopolitics.”

Source: National Intelligence Council “Global Trends”.

Our response:

In this dynamic market we aim to act with pace and agility to stay ahead of the competition and meet customer needs.

We are fortunate to have a solid foundation to build on because our strengths are particularly well matched to emerging themes in global markets. These include greater use of autonomy in a wide range of military and civil applications, growing demand for integrating capabilities, such as the teaming of manned and unmanned platforms and continued requirements in cyber security and Intelligence, Surveillance & Reconnaissance (ISR). More generally, the digital economy, new materials and energy sources provide future opportunities.

We work across all domains – land, sea, air, space and cyberspace and across the whole capability life cycle – from early stage research and experimentation through to training and rehearsal. We are developing these strengths to ensure a greater focus on the rapid development, experimentation and deployment of new security capabilities to respond to growing and diversifying threats. For example, the creation of a Strategy and Planning function and an expanded business winning team facilitate a better understanding of markets, and carefully targeted Internal Research and Development projects help us shape and take advantage of new opportunities.

Five-year defence budgets

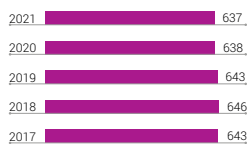
UK

£bn



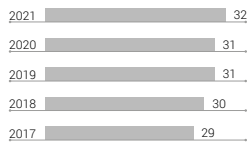
US

US\$bn



Australia

AU\$bn



Source: Janes Defence Budgets.

2. Partnering for innovation

Governments need innovation to respond to these fast evolving threats. Defence innovation initiatives are underway in a number of nations including the United Kingdom, Australia, and the United States. The core principle of the UK Defence Innovation Initiative is establishing: "fertile partnerships with innovators in industry and academia, as well as with key allies and partners." In Australia the aim is to: "access the potential of Australian defence industry to innovate". In the US, the Third Offset strategy aims: "to identify and invest in innovative ways to sustain and advance America's military dominance for the 21st Century" by developing capabilities in areas such as sensor fusion and man-machine interfaces.

Through these initiatives government customers are seeking new approaches to innovation across the "Defence Enterprise," in both equipment and processes, so that they can rapidly integrate new technologies into existing capabilities.

Many customers are keen to capture the innovation that comes from universities and SMEs, particularly as the defence sector is no longer the sole, or primary, incubator of new technology. They are looking for assistance from organisations that can collaborate and help them connect their supply chains and access ideas coming from outside defence.

Value of defence innovation initiatives

United States

US\$18bn
to FY21

United Kingdom

£800m
over ten years

Australia

AU\$1.4bn
over ten years

Our response:

We help customers meet new challenges through innovation. As a company we often fulfil an innovation integrator role, establishing partnerships with other organisations and building networks of suppliers. These networks bring together Government, industry, SMEs and academia in collaborating teams to facilitate innovation.

➞ Page 32 Relationships

Our ability to innovate and solve customer problems is based on the world-leading expertise of our people. As with many companies in our sector, the average age of our scientists and engineers has increased over the last decade. We are taking a number of steps to ensure our access to talent now and in the future, including launching Company-wide graduate and apprentice programmes, a QinetiQ Academy to drive the development of our employees and the 5% Club, a campaign which promotes opportunities for young people.

➞ Page 30 Our people

3. Value for money in defence

After several years of shrinking defence budgets, there is increasing evidence that the cycle is bottoming out. Growth is forecast in adjacent areas such as security of civil infrastructure due to continued concerns about unrest and insecurity. In the US, President Trump has committed to increase defence spending and other governments are expected to increase defence spending to meet the NATO target of 2% of GDP. The projections are less certain in the Middle East where the lower oil price could constrain spending and in the UK due to Brexit.

All governments, whether they are increasing or decreasing defence and security spending are under pressure to deliver greater value for money for taxpayers. This is being driven both by greater scrutiny of defence programmes and the need to create headroom for greater investment in innovation by ensuring better value for money for what they deliver today. For example, the UK Government is looking to achieve a 30% reduction in MOD civilian staff and built estate in the period 2015-2020.

The requirement for greater value for money is driving bilateral and multilateral approaches to developing new capabilities, which remain relevant irrespective of Brexit. For example, in December 2016, the French and British Governments signed a number of agreements committing them to work together on joint programmes such as the development of a new Unmanned Combat Air System.

2%

NATO target for % of GDP to be spent on defence

Our response:

We have a long track record of improving services and delivering savings in parallel for our customers and have, for example, delivered significant savings for the MOD over the last 14 years we have been delivering the Long Term Partnering Agreement. We also deploy the expertise of our people to help customers meet their own efficiency challenges.

The key objectives of our transformation are to increase customer focus and competitiveness. In some cases, this requires the introduction of innovative business models such as our Strategic Enterprise model for the delivery of UK aircraft engineering services where we are delivering both improved services and savings for our customers.

Through exercises such as the QinetiQ-facilitated Unmanned Warrior exercise in October 2016 – which the UK Secretary of State for Defence described as "a signal of our desire to work with global partners" – we are working to build cross-border collaboration between the UK and other nations. We are taking this approach in other home markets and also working with governments in new markets, which are looking to strengthen local industrial capabilities.

An update on our home markets

We operate in three home markets: the UK, US and Australia.

United Kingdom

In the UK, the Government is seeking to mitigate any negative impact from Brexit with a renewed focus on exports and a defence industrial policy.

The UK Government's Strategic Defence and Security Review (SDSR) published at the end of 2015 helped to clarify the UK's capability priorities. In the SDSR the MOD pledged to spend 2% of GDP on defence and to address capability gaps such as combat air and maritime surveillance. New capabilities will be funded by 30% reductions in MOD civilian staff and in its built estate, and by £11bn of savings from 2015-20. The introduction of new capabilities and, in particular, extending the life of existing capabilities, provides QinetiQ with opportunities to deliver engineering, test and evaluation services as well as further opportunities for providing outsourced services. It is possible that a Comprehensive Spending Review and a new SDSR will take place following the UK General Election but all major political parties are committed to spending 2% of GDP on defence.

Although competition is intense, the SDSR and focus on counter-terrorism is driving increases in budgets for C4ISR and cyber security. Investment in cyber security is to rise from £809m in 2015 to £1.9bn in 2020 and a new UK National Cyber Security Centre was established in 2016.

The UK Government is determined to get the best deal for Britain when exiting the EU and has a renewed focus on supporting exports as part of the Global Britain agenda. In the defence sector the Government is developing an industrial policy with the stated aim of bringing its prosperity and security agendas closer together. The policy is likely to require the MOD to spend more money with SMEs and companies that win large defence contracts will be required to ensure that 3% of employees working on that contract are apprentices. QinetiQ is well-placed to support these commitments as we already manage framework contracts for the MOD that involve more than 100 UK SMEs, and through our commitment to The 5% Club [Page 31](#).

The Single Source Regulations Office (SSRO) is developing a new methodology for calculating the baseline profit rate in future years, potentially introducing multiple profit rates. This baseline rate acts as the starting point for agreeing the profit rates of new and renewed contracts, and suppliers can both under- and over-perform the contracted rate depending on, for example, risk, capital servicing and project execution. Approximately three-quarters of the revenue of our EMEA Services division is derived from single-source contracts, an increased proportion of which is now contracted on a long-term basis. For example, the 11-year, £1bn amendment to the LTPA, signed in December 2016, was contracted using the FY17 single source profit formula.

In the 2015 SDSR the MOD committed investment in science and technology will continue to be protected at 1.2% of the defence budget with an increased emphasis on disruptive technologies and innovation, and a move away from some more traditional research programmes.

On 16 September 2016, the Secretary of State for Defence launched a new Defence Innovation Initiative for the UK focused on ensuring that Britain remains a credible military force against major adversaries, using traditional lethal and non-lethal effects to respond to evolving threats with pace and agility. A Defence and Security Accelerator has been launched as part of the Initiative to administer an £800m Innovation Fund. The Defence Innovation Initiative has a particular emphasis on partnership and the 'Whole Force' – military, civil servants and industry people – working as one.

UK defence budget to increase by

0.5% pa
above inflation to 2021

MOD spending on science and technology protected at

1.2%
of the defence budget

UK Government spending on cyber security

£1.9bn
by 2020

United States

In the US, the cycle appears to be bottoming out with a significant increase in the budget for operations.

In the US, the FY17 Defense Bill was published sooner than expected. Although it did not deliver the entirety of the \$54bn increase that President Trump had proposed for defence, it will result in a significant increase in the budget for Overseas Contingency Operations.

A renewed commitment by US military customers to unmanned ground vehicle products is reflected in plans to award new competitive Programs of Record for the development, acquisition and sustainment of US unmanned systems capability. Competitions are either under way or will be under way this year for these Programs of Record, funded by the US Department of Defense's base budget.

The previous administration's Defense Innovation Initiative, also known as the Third Offset Strategy, put \$18bn behind innovation and R&D in the period from 2016 to 2021. Although this may be de-emphasised or rebranded, many of the key enabling technologies, such as artificial intelligence, human-machine collaboration, cyber and electronic warfare, are expected to remain priorities to ensure the United States' "technological superiority."

President Trump's proposed defence spending increase in 2018

US\$54bn

Defence Innovation Initiative

US\$18bn
behind Innovation and R&D to FY21

Australia

Continued growth in defence budgets is projected in Australia.

The Australian Government remains committed to providing defence with a stable and sustainable funding growth path, and the budget is on track to grow to two per cent of GDP by 2020-21. This is likely to result in six per cent per annum growth in its defence budget through 2020 and the replacement of the majority of its platforms over the next 15 years. The trend in Australia is for the Government to place larger contracts for whole-life programmes with strategic partners. Many of these programmes have a significant integrated logistics support requirement, and through the purchase of RubiKon Group in January 2017, we have acquired this capability as well as a significant reference programme.

Government committed to increase defence expenditure to

2%
of GDP

Likely growth in defence budget

+6% pa
through 2020

Strategy

Our vision is to be: “The chosen partner around the world for mission-critical solutions, innovating for our customers’ advantage.”

To realise our vision, we are implementing three mutually-reinforcing strategic priorities designed to grow the Company.

Our three part strategy:

1. **Modernise** UK T&E
2. **Build** an international company
3. **Invest** in innovation

Our values are the foundation:

- Integrity
- Collaboration
- Performance

Transformation

We are transforming QinetiQ, our people, leadership, and our organisation, in order to deliver our vision and strategy. After the first year we have achieved a great deal, and the plan for FY18 is equally demanding. Not least is the ongoing challenge presented in embedding cultural change across the Company to enhance customer focus and improve competitiveness.

£20m

of operational efficiencies reinvested to drive growth.

Leadership and organisation

To drive higher performance and alignment, new leaders were appointed during FY17 for the International business and our Business Development, Human Resources and Finance functions, all from outside QinetiQ. Our top 100 leaders completed a leadership development programme and are being supported with ongoing coaching. Our focus during FY18 is on a similar development programme for managers, and on facilitating employee-enabled change via four Transformation Action Groups established by employees from across the Company. We have also renewed our focus on our values and behaviours which support us in operating safely and successfully, and in working together effectively to meet customer needs first time. Our values are ‘Integrity,’ which reinforces our responsibility and accountability for our actions, ‘Collaboration,’ which focuses us on delivering value through partnership and team work and ‘Performance,’ which emphasises excellent delivery to our customers.

We have completed the reorganisation of QinetiQ, establishing new businesses responsible for winning and delivering work, as well as enabling functions to provide support and resource. A Strategy and Planning function has been created to help position QinetiQ for future growth. The new function manages an Integrated Strategic Business Planning process which ensures we prioritise short-term actions within a coherent long-term plan for sustainable growth, and is developing a pipeline of potential bolt-on acquisitions where there is a strong strategic fit and investment rationale.

Business winning

In order to grow we need to win more work both in our home markets and internationally. Our new International business unit is now established. To improve our business winning capability, our sales and bidding employees have completed assessment and development programmes, and further development of their skills is planned for FY18.

Over the last year we have established more than 30 business winning campaigns across the Group to drive organic growth. The teams pursuing these campaigns comprise established expertise within the Company plus experienced hires to ensure we have the optimum mix of knowledge and capability. As part of their strategy, each campaign team considers the best approach to partnership and investment needed to win business by delivering compelling customer value.

Delivery and operational excellence

During the year, we successfully introduced a new operating model that allows us to resource as one company. Our UK scientists and engineers were transitioned to a new Engineering and Operations function at the beginning of 2017, ensuring that supply meets demand and we have the right skills mix over the long term. Our focus going forward is on embedding this change across QinetiQ to ensure the desired benefits are achieved, leading to greater innovation and value for our customers.

To support our ability to resource as one company, we introduced a dynamic resource planning process in FY17, driving improved productivity and deployment of capability to meet customer needs.

Our future success will be built on operational excellence – keeping our people safe, delivering what we say we are going to deliver, meeting milestones, exceeding expectations and improving customer satisfaction. David Smith, our new Chief Financial Officer, is driving a renewed focus on operational excellence in tandem with his role of executive sponsor for transformation. Safety remains our top priority in addition to our day-to-day focus on consistent operational delivery.

Investing in our future

In FY17, we delivered £20m of operational efficiencies to create the headroom to invest in sustainable growth. This was delivered by realigning our organisation and improving productivity and included a reduction of approximately 200 roles across the Company during the year. These efficiencies drove better value for money for our customers and allowed us to invest carefully in both our business winning capability and in research and development, particularly in support of our selected growth campaigns.

An Internal Research and Development (IRAD) programme is under way with appropriate Executive oversight to ensure that projects are customer-driven and properly controlled. We have over 40 live projects, more than half of which are related directly to our growth campaigns, where we are using our investment to position ourselves for new market opportunities. In FY18, we are launching an improved ideas management process to ensure we capture and exploit early-stage ideas and innovations.

Contract extension

£109m

supporting UK centre of excellence for maritime mission systems.

Over 50

autonomous systems deployed as part of Unmanned Warrior naval exercise.

Contract amendment

£1bn

11-year commitment for modernisation of air ranges and Test Pilot School.

1. Lead and modernise UK Defence Test & Evaluation.

FY17 Progress – a year of building momentum

In September 2016, we signed an 11-year, £109m contract extension for Naval Combat System Integration Support Services (NCSISS) to the MOD. This supports the development of our Portsmouth Technology Park site as the UK Centre of Excellence for maritime missions systems, improves the security of future revenues and provides a platform to win incremental work.

In October 2016, we hosted Unmanned Warrior, a world-first demonstration of how unmanned systems can operate as part of a major multinational naval exercise. Over 50 autonomous vehicles were deployed in the air, on the water and under the surface on missions ranging from anti-submarine warfare to mine countermeasures. From inception to delivery we were instrumental in making this exercise happen, leading the UK component, providing range management expertise and delivering a transportable command and control system.

In December 2016, we agreed an 11-year, £1bn commitment with the UK MOD that secures approximately half our revenue on the core LTPA contract until 2028. This amendment, which uses the FY17 single source profit formula, secures our operation and modernisation of the Empire Test Pilots' School at MOD Boscombe Down and the Air Ranges at MOD Aberporth and Hebrides. This gives us the confidence to invest approximately £180m to upgrade facilities and equipment, driving efficiencies to avoid cost increases that would have otherwise arisen and providing a platform for future growth. Our investment will be recovered from the MOD over time using the current LTPA mechanism.

Since its initial signature in November 2015, £80m of additional work has been added to the Strategic Enterprise contract, originally valued at £153m, under which we deliver aircraft engineering services to the MOD on an outputs-based model. We have added eight additional aircraft types to the contract, both fixed- and rotary-wing and see further opportunities to expand, working with partners to pool skills and bring collaborative teams together across industry.

FY18 – further enhancements to UK capability

Our focus is on working with the Front Line Commands and prime contractors to develop the future vision for UK T&E to meet the needs of the UK Defence Plan, support exports and international partnerships, and deliver the right outputs to enable future military capability. The five-year repricing of our Long Term Partnering Agreement with the UK MOD is due to take place at the end of FY18 so this is a particular focus.

In FY17, we were invited by Boeing to submit a proposal offering MOD Boscombe Down as a prospective location for its UK 'centre of excellence' driven by its fixed-wing business. We will continue to work with the MOD and Boeing to identify ways in which the site, which we operate on behalf of the MOD, could meet their requirements.

Simon Dale, using the binoculars on a Multiple Object Tracking Radar at MOD Aberporth to acquire and track a target. MOD Aberporth will benefit from the Air Range Modernisation investment, which is part of a commitment we made to modernise UK Test & Evaluation in the LTPA amendment signed in December 2016.



Strategy continued

QinetiQ Target Systems

90%

of revenue generated outside the UK.

2. Build QinetiQ as an international company.

FY17 Progress – International business established

On 1 April 2016, we created a new International business unit incorporating our Australian, Swedish, Canadian, Commerce Decisions and Advisory Services operations. In August we appointed Iain Farley as its Managing Director from Expro Group International where he was Vice President for Business Development and Emerging Business. Andreas Ward, previously Vice President Nordic and Baltics at Saab, was also appointed to run our operations in Sweden.

In December 2016, we acquired Meggitt's Target Systems business for £57.5m, or £60.3m including price adjustments for working capital and net debt. The business – now renamed QinetiQ Target Systems – holds a leading position in the global targets and services market which is growing strongly as customers seek to validate their defence capabilities using high-fidelity threat representation. In addition to a design and manufacture capability in the UK and Canada, the business supplies targets to more than 40 countries and has on-site target operations in 15 countries.

During FY17 we have focused on building our capabilities in our home markets – the US and Australia in addition to the UK. In the US we have engaged with customers such as the US Defense Advanced Research Projects Agency (DARPA), to collaborate to create new business opportunities. In Canada we secured our first home contract win with the Royal Canadian Coast Guard for work that will be delivered locally in Canada.

In Australia, we acquired RubiKon Group in January 2017 for £7.4m. The company is a leading integrated logistics support provider and helps customers meet

complex logistics, supply chain and procurement project challenges. Earlier in the year we were part of a RubiKon-led team which won the Strategic Support Partnership Contract for the Australian Government's procurement of maritime patrol aircraft to replace the AP-3C Orion. The acquisition of RubiKon better positions QinetiQ Australia to offer whole programme solutions to customers in the Asia Pacific region.

We are evaluating new home markets with a particular focus on the Middle East and Asia Pacific and developing plans which inform the prioritisation of resources and the identification of potential partners. We secured a number of aerial targets contracts in the United Arab Emirates and flew our latest Banshee Jet 110 for the first time in India. During the year, our OptaSense subsidiary also completed the delivery of a system for the world's largest distributed fibre sensing project for the 1,850km Trans-Anatolian Natural Gas Pipeline (TANAP) principally in Turkey.

We continue to develop opportunities to grow sales by exporting our products and services, working with partners such as the UK Trade and Investment's Defence and Security Organisation (UKTI DSO). While we were unsuccessful with our joint bid with BAE Systems for a competition in Chile to upgrade their Type 23 frigates, we have an increasing pipeline of sales opportunities, particularly in the Middle East.

FY18 – delivering international growth

The International business was established to grow QinetiQ as an international company. Our objective is to win significant contracts outside the UK. As our strategy prioritises collaborative working, on many of our growth campaigns we work in partnership with prime contractors and with the support of the UK Government.

With growing defence ambitions and close to the rapidly evolving Asia Pacific region, Australia is a particularly attractive market. During the year QinetiQ Australia continued to develop its core capabilities including extending its contract for the provision of Aircraft Structural Integrity services.



Over **30**
campaigns established.

Dragonfire consortium

£**30m**
programme to deliver
defensive laser capability.

Over £**10m**
of secured navigation
contracts awarded.

3. **Invest** in innovation and apply our core competence for customer advantage in defence and commercial markets.

FY17 Focus – campaigns initiated to drive commercial innovation

During FY17 we established business winning campaigns to drive commercial innovation, new processes, and innovative business models, in addition to the technical innovation that QinetiQ has always been known for. Campaigns are driven by horizon scanning of future customer needs and market opportunities. Group-level campaigns align with four main growth levers:

- Major government programmes, such as Ballistic Missile Defence and Carrier Strike;
- Areas of QinetiQ strategic capability, such as modernised T&E, cyber security, and experimentation and rehearsal;
- Major near-term competitions; and
- Exploitation of promising capabilities we have previously invested in, such as airborne surveillance.

To enhance our probability of winning, we resource these through investment and partnership, collaborating with prime contractors, small businesses and universities on many of the campaigns. During the year we established partnerships with companies such as MBDA on laser technology and Thales on Defence Operational Training.

In January 2017, the Dragonfire consortium – led by MBDA and including QinetiQ as well as other industry partners – was awarded a £30m programme by the UK MOD to deliver a defensive Laser Directed Energy Weapon (LDEW) Capability Demonstrator. QinetiQ's

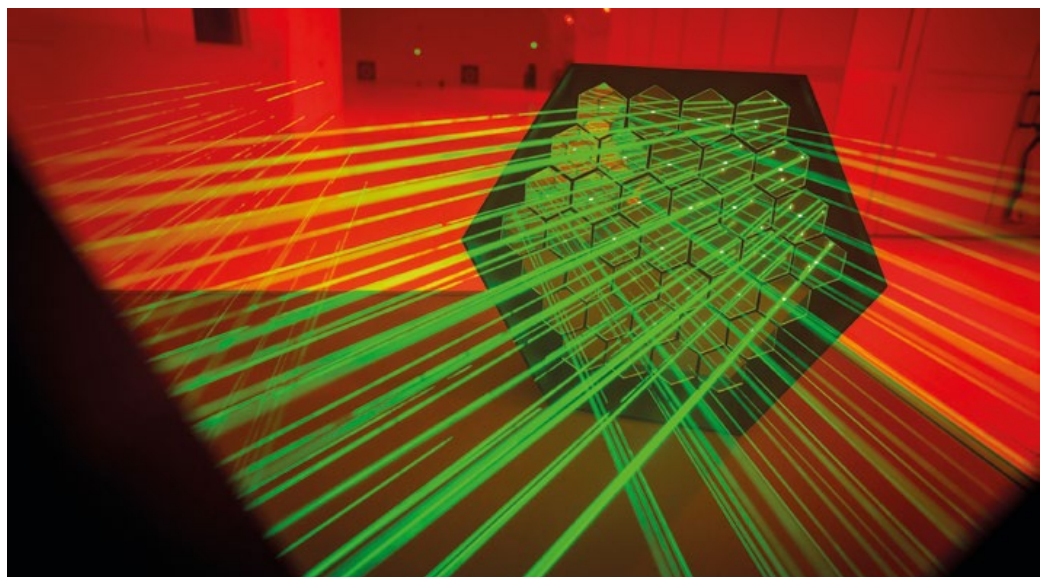
role is to provide the high-powered laser technology for the programme and conduct trials over land and water at various ranges that we manage under the LTPA. We are supporting this campaign with IRAD funding to further develop our core laser technology which will be the enduring element of our offering.

During the year we secured contracts worth more than £10m for secured navigation working with both European and UK Government customers. Our work helps users to effectively exploit the Galileo constellation of satellites – the European Union version of GPS which is due to go live in FY21. This included the first demonstration of accessing the encrypted Public Regulated Service (PRS) real-world applications. At the end of the year we secured a global agreement with Rockwell Collins, the market leader in secure navigation, who will become the primary route to market for our software technology worldwide.

FY18 – growth campaigns in international markets

We will have capture plans and resourcing in place for all of our major campaigns in FY18. Because our International business was only established in April 2016, our international growth campaigns are less mature than those focused on our home markets so they are a particular focus.

QinetiQ's multi-channel laser system, for coherent beaming is being developed as part of the Dragonfire consortium consisting of MBDA, QinetiQ and other industry partners.



Key performance indicators

Non-financial KPIs

Key performance indicators (KPIs)

Work is under way led by David Smith, our newly appointed Chief Financial Officer, to review the key performance indicators and other metrics that we use to monitor the performance of the Company and measure the progress of the implementation of our strategy. We expect to update our KPIs during FY18 to reflect this review and that changes will be reflected in next year's Annual Report and Accounts.

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

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

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

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People and relationships

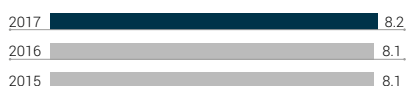
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Resources and environment

Customer satisfaction (score out of 10)

8.2

2016: 8.1



Description

QinetiQ's customer satisfaction survey asks all UK customers with contracts over £200,000 about QinetiQ's delivery and engagement. In the US, customer satisfaction metrics are reviewed on a contract-by-contract basis.

Rationale

Using an independent third party we annually survey around 100 of our largest projects to help us understand our performance and what we need to be doing to continuously improve. We also gather qualitative feedback through structured interviews.

Performance this year

Of those surveyed, we received an average rating for our performance overall of 8.2 out of 10, up from 8.1 out of 10 in 2016 which shows progress. We saw an upward trend for most metrics and for bidding in particular.

Link to strategy

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

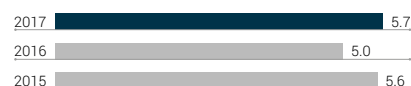
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Directors' Remuneration Report

Health and safety (LTI)

5.7

2016: 5.0



Description

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

Rationale

Health and safety performance is monitored to drive continual improvement in minimising risks to employees and reducing harm.

Performance this year

The LTI rate and the absolute number of lost time incidents resulting in at least one day off work have increased from the previous year. Safety is a top priority of all our businesses. A collective objective for FY18, used for remuneration, is to implement Safe for Life across the whole Group and in terms of how we operate with our supply chain. This programme focuses on improving safety behaviours.

Link to strategy

The safety, health and well-being of our people are intrinsically linked to our strategic success.

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Directors' Remuneration Report

Page 30

People and relationships

Apprentices and graduates (%)**4.9%**

2016: 5.7%

**Description**

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

Rationale

Provides a measure of QinetiQ's ability to attract and develop new employees. It is also a measure of our commitment to The 5% Club, an industry-led initiative of which we are a founding member, to grow the number of young people on apprenticeships, graduate programmes and student sponsorships.

Performance this year

There was a reduction in FY17 due in part to the acquisition of QinetiQ Target Systems and changes to how we recruit as a result of our reorganisation. We will increase our investment in Early Careers programmes across the Group in FY18.

Link to strategy

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

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

Employee engagement (Score out of 1,000)**596**

2016: 623

**Description**

A measure of employee engagement (excluding QNA) on a scale of 0–1,000, based on the Best Companies Employee Survey. A separate survey is conducted in the US.

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

Rationale

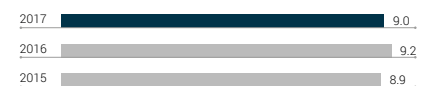
The annual survey enables comparison between QinetiQ and other UK companies. The primary purpose of the survey is to provide guidance to Team Leaders about how they can improve employee engagement.

Performance this year

FY17 was a year of significant change for many employees as we transform the Company and this is reflected in the fall in the overall score. We are committed to acting on the feedback we received in the survey during FY18.

Voluntary employee turnover (%)**9.0%**

2016: 9.2%

**Description**

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

Rationale

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

Performance this year

Despite the reorganisation of the Company and the adoption of a new way of working, voluntary employee turnover reduced during the year.

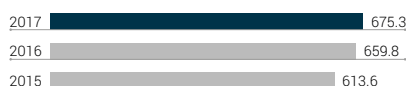
Key performance indicators continued

Financial KPIs

Orders (£m)

£**675.3m**

2016: £659.8m



Description

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

Rationale

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

Performance this year

Orders grew 2% to £675.3m (2016: £659.8m), which included the award of the £109m, 11-year renewal from the UK Ministry of Defence (MOD) for the Naval Combat System Integration Support Services (NCSISS).

The £1bn LTPA amendment signed during the year significantly increased the Group's order book. As in previous years this was not included in reported orders to avoid distortion.

The contribution from businesses acquired during 2017 was £3.9m.

Link to strategy

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

Organic revenue growth/decline (%)

1%

2016: (1)%



Description

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

Rationale

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

Performance this year

Revenue grew 4% to £783.1m (2016: £755.7m). Organic revenue growth, excluding the impact of foreign exchange and acquisitions, was 1% compared to a 1% decline in 2016. Global products grew 8% organically, with EMEA Services stable.

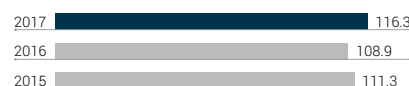
Link to strategy

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

Underlying operating profit* (£m)

£**116.3m**

2016: £108.9



Description

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

Rationale

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

Performance this year

Underlying operating profit* increased to £116.3m (2016: £108.9m). EMEA Services benefited from a £5.2m credit relating to the release of engine servicing obligations as we invest in new aircraft for test aircrew training. Global Products benefited from favourable foreign exchange movements and £2.2m of credits relating to historical overseas contractual disputes.

The contribution from businesses acquired during 2017 was £1.2m.

Link to strategy

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

Underlying earnings per share (EPS)* (p)**18.1p**

2016: 16.3p

**Description**

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

Rationale

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

Performance this year

Underlying EPS grew 11% due to the increase in operating profit and the reduced share count, following the completion of the £50m share buyback.

Link to strategy

This is a measure of growth in quality earnings for our shareholders. It is used for the Performance Share Plan incentive scheme.

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Total Group profit after tax (£m)**£123.3m**

2016: £106.1m

**Description**

This is the total Group profit, net of interest and tax, including all specific adjusting items* and including discontinued operations.

Rationale

This shows the overall financial performance of the Group reflecting both underlying and specific adjusting items of income and expenditure. It is a key financial measure used to reflect overall financial performance for the year.

Performance this year

Total Group profit after tax increased due to the higher underlying operating profit and an £18.4m profit on the disposal of property. The prior year included a £31.9m impairment charge and £16.2m profit on the sale of the Cyveillance business.

Link to strategy

This measure reflects the impact of all aspects of Group performance. As well as the underlying operating performance it incorporates the financial impact of tax, treasury, property disposals and the Group's mergers and acquisitions.

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Note 4: Specific adjusting items

Underlying operating cash flow* (£m)**£79.0m**

2016: £103.6m

**Description**

This represents net cash flow from operations before cash flows of specific adjusting items, less net cash outflows on the purchase/sale of intangible assets, plant and equipment, and pension deficit repair payments.

Rationale

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

Performance this year

Underlying operating cash flow was £79.0m (2016: £103.6m) and included a £7m payment for a very old overseas dispute, an increase in capital expenditure and some working capital unwind.

Link to strategy

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

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Directors' Remuneration Report

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

Principal risks

Effective risk management is key to delivering our strategic objectives and realising our vision.

The Board is accountable for effective risk management across the Group. Board-level oversight is discharged through two committees:

- Audit Committee: focuses on risks where the primary impact is financial; and
- Risk & CSR Committee: focuses on risks where the primary impact is non-financial.

The reports of the Audit Committee and Risk & CSR Committee can be found on pages 59 to 65. Details of the Group's system of risk management and internal control can be found in the Corporate Governance statement on pages 54 to 58.

Risk appetite

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

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

- Balanced: Preference for delivery options that have a low or moderate degree of residual risk. Applying innovation only where successful delivery is likely.
- Cautious: Avoidance of uncertainty with negligible or low residual risk. Applying innovation prudently where the risks are fully understood.

Commercial appetite

These three categories are then used within the context of the business strategy to define the Board's commercial appetite as:

Delivery/ capabilities	+ Markets/ Customers	= Commercial appetite
Proven	Existing	Eager
Proven	New	Eager/balanced
New	Existing	Balanced
New	New	Balanced/cautious

Risk register

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

Longer-term viability assessment

Assessing the prospects of the Group

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

1. An annual Integrated Strategic Business Plan (ISBP) process that looks at the detailed financials for the subsequent three years, together with an overview of one additional year, to 31 March 2021.
2. An annual budget process that covers the subsequent year.
3. A bi-annual detailed forecast process to update the view of the first budget year (the year now in progress).
4. A rolling monthly 'latest best estimate' process to assess significant changes to the budget/forecast for the year in progress.

The corporate planning process is underpinned by assessing scenarios and risks that encompass a wide spectrum of potential outcomes, both favourable and adverse. The downside risk scenarios are designed to explore the resilience of the Group to the potential impact of all the significant risks set out on pages 23 to 25, or a combination of those risks.

The scenarios are designed to be severe but plausible, and take full account of the availability and likely effectiveness of the mitigating actions that could be taken to avoid or reduce the impact or occurrence of the underlying risks, and that realistically would be open to them in the circumstances. In considering the likely effectiveness of such actions, the conclusions of the Board's regular monitoring and review of risk and

internal control systems, as discussed on page 64, is taken into account. It is assumed that existing undrawn bank facilities could be re-financed as they mature in FY20.

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

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

The period over which we confirm longer-term viability

While the Directors have no reason to believe the Group will not be viable over a longer period than three years, given the inherent uncertainty involved, the period over which the Directors consider it possible to form a reasonable expectation as to the Group's longer-term viability is the three-year period to 31 March 2020. This period, essentially the period used for our mid-term business plans that are subject to stress-testing and scenario planning, has been selected because it presents the Board and readers of the Annual Report with a reasonable degree of confidence whilst still providing an appropriate longer-term outlook.

Confirmation of longer-term viability

As noted on page 58, the Directors confirm that their assessment of the principal risks facing the Group was robust. Based upon the robust assessment of the principal risks facing the Group and their stress-testing-based assessment of the Group's prospects, all of which are described in this assessment, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to 31 March 2020.

Strategic risks

UK defence test and evaluation strategy

Risk

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

Impact

A reduction in revenue and associated profitability from the Group's T&E contracts.

Mitigation

Positive stakeholder engagement. QinetiQ monitors and responds to potential opportunities arising from the MOD's actions to deliver improved value for money by making proactive proposals that deliver the desired customer outcomes.

Metrics

- Customer satisfaction
- All financial KPIs

Responsibility

Group Director Business Development

Risk appetite

Eager

Likelihood/Impact

Medium/High

Proximity/Velocity

2+ yrs/Low

International strategy

Risk

Failure to execute the international strategy.

Impact

Failure to execute this strategy would negatively impact future growth.

Mitigation

The Group's Integrated Strategic Business Planning process is used to articulate clearly strategy, appropriate objectives and metrics.

The Group has established and is investing in a new International business.

Metrics

- All financial KPIs

Responsibility

Managing Director International

Risk appetite

Cautious

Likelihood/Impact

Medium/High

Proximity/Velocity

2+ yrs/Low

Innovation strategy

Risk

Failure to sustain a culture of innovation or to invest adequately in, or create value from, our innovation investment.

Impact

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

Mitigation

Innovation will be driven through cultural change, investment in, and application of, our core competences for our customers' advantage in defence and commercial markets.

Internal Research and Development (IRAD) investment process.

Metrics

- Customer satisfaction
- Employee Engagement
- Metrics under development as part of CFO review
- IRAD investment rate

Responsibility

Group Director Engineering & Operations
Chief Technology Officer

Risk appetite

Eager

Likelihood/Impact

Medium/High

Proximity/Velocity

1-2 yrs/Low

Principal risks continued

Strategic risks continued

Transformation

Risk

The transformation does not result in change that embeds customer focus and creates value from increased innovation and competitiveness.

Impact

An internal culture which leads to sub-optimal performance.

Mitigation

Our way of working has been designed to support the delivery of our strategy to increase customer focus, improve our competitiveness and deliver collaboration across the Company.

Leadership Development training to upskill teams on how to implement a high-performance culture.

Metrics

- Customer satisfaction
- Employee engagement
- Transformation scorecard

Responsibility

Chief Financial Officer
Group Director Human Resources

Risk appetite

Eager

Likelihood/Impact

Medium/High

Proximity/Velocity

0-1yr/Medium

Recruitment and retention

Risk

The Group operates in many specialised engineering, technical and scientific domains where a lack of domain-specific graduates leads to a future skills shortage.

Impact

Key capabilities and competences may be lost.

The UK workforce has a skewed age distribution which creates risk on future skills shortage.

Mitigation

Implemented a talent management review across the Group to include succession planning at Executive Committee level and ensuring our resourcing pipelines are focused on our critical skills for the future, including Early Careers.

Metrics

- Employee engagement
- Apprentices and graduates
- Voluntary employee turnover

Responsibility

Group Director Human Resources

Risk appetite

Balanced

Likelihood/Impact

Medium/High

Proximity/Velocity

0-1yr/Low

Operational risks

Single source contract regulations

Risk

Group performance is adversely affected by application of the UK Government regulations for profit rates of contracts awarded without competition.

Impact

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

Mitigation

QinetiQ is supporting a joint industry position in the Single Source Regulations Office (SSRO) consultation of the Profit Rate methodology.

The contract and orders pipeline is regularly reviewed to identify qualifying contracts.

We will continue to focus on the efficient and effective delivery of contracts for the benefit of all stakeholders.

Metrics

- Customer satisfaction
- All financial KPIs

Responsibility

Chief Financial Officer

Risk appetite

Balanced

Likelihood/Impact

High/High

Proximity/Velocity

2+yr/Low

Operational risks continued

Security and IT systems

Risk

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

Impact

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

Mitigation

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

Information systems are designed with consideration to single points of failure and comply with relevant accreditation standards. Cyber security is monitored using an internal cyber dashboard.

Metrics

- All financial KPIs
- Cyber dashboard
- Security dashboard

Responsibility

Group Director Engineering and Operations

Risk appetite

Cautious

Likelihood/Impact

Medium/High

Proximity/Velocity

0-1yr/High

Significant breach of relevant laws and regulations

Risk

The Group operates in highly regulated environments and recognises that its operations have the potential to have an impact on a variety of stakeholders.

Impact

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

Mitigation

The Group has robust policy, procedures and training in place.

The QinetiQ Code of Conduct defines clear expectations for the Group and its employees.

Key areas of focus for the Group include the following: safety of product and services; health, safety & environmental; bribery & ethics, and international trade controls.

Metrics

- All financial KPIs
- Health & safety
- Mandatory training compliance
- Commercial intermediary monitoring

Responsibility

Company Secretary/Group General Counsel

Risk appetite

Cautious

Likelihood/Impact

Medium/High

Proximity/Velocity

0-1yr/High

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

Risk

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

Impact

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

Mitigation

In December 2016, the Group signed a £1bn, 11-year amendment to the Long Term Partnering Agreement (LTPA). The next scheduled 're-pricing' point for areas beyond the amendment is scheduled for March 2018.

Metrics

- All financial KPIs except orders
- Customer satisfaction
- LTPA as a % of total Group revenue

Responsibility

Group Director Business Development
Group Director Test & Evaluation

Risk appetite

Balanced

Likelihood/Impact

Medium/High

Proximity/Velocity

1-2yrs/Low

Operating review – EMEA Services

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

Financial performance

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

¹ Excludes the £998m third-term of the LTPA contract agreed in 2013 and the £1bn contract amendment signed in December 2016. B2B ratio is orders won divided by revenue recognised, excluding the LTPA contract.

² The 2017 margin excluding the £5.2m non-recurring release in respect of LTPA engine servicing obligations was 14.3%.

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

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

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

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

Underlying operating profit* reduced to £92.7m (2016: £93.8m). FY17 underlying operating profit* included a £5.2m credit relating to the

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

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

FY17 review

Air & Space (30% of EMEA Services revenue)

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

Modernising UK Test & Evaluation

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

Investing in innovation

- The business' relationship with the European Space Agency continues with its transceiver operating successfully as part of the ExoMars mission to Mars, despite the Schiaparelli lander on which it was mounted being lost. The business is continuing to deploy significant resources to develop the

gridded ion engine electric propulsion system for the flight module to be used on ESA's BepiColombo mission to Mercury. This ambitious, multi-spacecraft mission is due to launch in October 2018.

- The business secured £2m of research funding to lead a team to upgrade the scale models used in the Farnborough wind tunnel using technology adapted from F1 motor racing, leading to improved efficiency and increased capacity.
- It unveiled an innovative material, Titan Weave, that reduces the weight of aircraft and is three times stronger than current materials used to protect against bird strikes and other impacts.
- It entered a teaming agreement with Thales and Textron to provide an innovative offer to the MOD for the Air Support to Defence Operational Training Programme.

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

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

Modernising UK Test & Evaluation

- The business delivered the successful trial of the new Spear 3 missile system planned for the UK's F-35 Lightning II stealth fighter aircraft.
- It secured an 11-year contract extension worth £109m for the Naval Combat Systems Integration & Support Services based at Portsmouth Technology Park. Later in the year the site hosted the Royal Navy's Information Warrior exercise designed to develop and test new information warfare capabilities through a series of trials, including defensive cyber operations, digital influence operations and artificial intelligence.
- The business led a team from across QinetiQ to deliver Unmanned Warrior for the Royal Navy, a demonstration by 40 companies of how autonomous vehicles under the water, on the surface and in the air, can be used for future operations such as mine hunting.
- Later in 2017, it will host another international exercise at MOD Hebrides – Formidable Shield.
- To enable similar exercises to take place, the business is modernising the air ranges, with work beginning to upgrade facilities and tracking radar at the Hebrides range.

Investing in innovation

- The business is a member of a UK industrial consortium, called Dragonfire, which won a £30m contract for a Capability Demonstrator Programme for laser technology. The demonstration is reliant on an innovative QinetiQ-developed technology, with the trials taking place on LTPA sites.

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

- It won an £8m contract to implement and evaluate vehicle survivability for Dstl, including installing a Soft-Kill Defensive Aids System on a Challenger 2 tank.
- It also won a £5m contract to deliver a Real Time Simulation System for the Sentry E-3D aircraft to enable effective operations with NATO countries.

Cyber, Information & Training (CIT) (17% of EMEA Services revenue)

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

Modernising UK Test & Evaluation

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

Building an international company

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

Investing in innovation

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

International (8% of EMEA Services revenue)

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

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

EMEA Services FY18 outlook

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



QinetiQ is enabling Royal Air Force Typhoon pilots to train together in virtual environments from different locations by linking simulators at the Squadrons' Main Operating Bases. The project is a new addition to QinetiQ's existing Distributed Synthetic Air Land Training (DSALT) contract with the UK Ministry of Defence, which provides synthetic mission training at RAF Waddington's Air Battlespace Training Centre (pictured).

Operating review – Global Products

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

Financial performance

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

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

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

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

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

FY17 Review

QinetiQ North America (41% of Global Products revenue)

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

- QNA delivered very good orders and revenue performance in FY17 driven by the continued strength of its US military robot business, sales of aircraft armour, and its continued role supporting the next generation of US Navy aircraft carriers.
- In total, the business was awarded more than \$40m of orders for unmanned ground vehicles principally for the reset of robots previously used in operations and for capability upgrades such as detection of CBRNE (chemical, biological, radiological, nuclear and explosives).
- The business is bidding for multi-year Programs of Record, that are under way now or will be under way this year. These Programs of Record will be funded out of the Department of Defense's base budget for TALON-class and Dragon Runner-class systems, robotic applique kits for route clearance vehicles and squad mission equipment transports.
- In October 2016, it announced a strategic partnership with the Estonian company Milrem for Titan, a modular, hybrid military unmanned ground vehicle (UGV) for dismounted troop support.
- QNA also confirmed a \$41m contract with General Atomics which follows the initial \$16m announced in December 2015. The business will deliver control hardware and software for the Electromagnetic Aircraft Launch System and the Advanced Arresting Gear to be installed on the US Navy's next aircraft carrier, the John. F. Kennedy (CVN 79).
- In September, QNA launched a new meteorological sensing product, iQ-3, that provides real-time atmospheric data in support of military requirements such as artillery fire support, tactical weather modelling, and air drop.
- Its LineWatch product, which accurately measures the current and voltage of power distribution lines, is being piloted by 10 North American utility companies following the delivery of its first production unit in FY16.

- In international markets, robots, vehicle protection, and soldier protection systems, remain highly relevant as security challenges and instability persist in the Middle East and elsewhere.
- In addition to product sales, QNA is building its base of contract R&D projects to drive technology development, explore new customer problems and expand its competitive offerings. Progress continues with awards for an airborne wind profiling radar, robotic enhancement projects, a turbine-based power and thermal management system, and a number of other commercial research and development projects.

OptaSense (15% of Global Products revenue)

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

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

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

Space Products (11% of Global Products revenue)

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

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

EMEA Products (33% of Global Products revenue)

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

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

Global Products FY18 Outlook

The Group's Global Products division has shorter order cycles than EMEA Services and its performance is dependent on the timing of shipments of key orders. As a result of its contracted orders and pipeline of opportunities, as well as the anticipated full year contribution from the Target Systems acquisition, the division is expected to continue to grow in FY18.



A Mk. II TALON robot from Japan-based Explosive Ordnance Disposal Mobile Unit 5, is used to inspect a suspicious package during a force protection and anti-terrorism training exercise at a United States Navy base in Japan. The exercise trained first responders and support personnel how to react to an improvised explosive device scenario.

People and relationships

Our employees and their relationships with others are at the heart of our vision to be the chosen partner.

At the heart of our vision is partnership, innovation and a vision-led strategy. Our people are critical to this and they make QinetiQ a truly unique organisation. Our values and the strong relationships we have with our people, customers, suppliers, business partners and communities are core to our business success. By harnessing these relationships, we can also create value for society by developing the skills of the next generation and contributing positively to the communities where we work.

Our people

People strategy

In FY17, we created a new people strategy to support our vision and strategy, that is values-led and balances the needs of employees and other stakeholders. The strategy is based on four integrated elements that work together to develop 'Engaged People in Winning Teams'. The elements are 'Right People', 'Right Culture', 'Right Learning' and 'Right Reward'. We will drive the development of the key elements in FY18.

Engaging our people

Engaged employees are vital to a successful business. The Employee Engagement Group (EEG) is an independent consultative forum which provides a trusted and effective two-way dialogue between the Company and employees. It ensures that our people are informed and engaged on key people issues, especially during times of change and it has been particularly valuable during our transformation. We regularly communicate with employees to ensure they understand QinetiQ's strategy, performance and business priorities. Our communication channels include the intranet, monthly face-to-face Q-Talks with leaders and six-monthly roadshows with the Executive Committee. This ensures that across the Group our people understand how what they do contributes to our strategy and that they are knowledgeable about our Company. In FY18, we will be introducing the 'Global Portal' a new intranet platform, enabling greater connectivity for our people across the Group. We use a number of channels to gather and understand employee engagement. We seek regular feedback as part of our face-to-face sessions with leaders (Q-Talks and roadshows) as well as more formally through surveys. In addition we monitor voluntary employee turnover, which reduced in FY17 (page 19). In FY17 we again used Best Companies to run a survey for all employees (excluding QNA, where they use the Top Work Places survey, administered by Workplace Dynamics), to independently measure levels of employee engagement. This annual survey is complemented by a shorter six-monthly 'pulse' to provide a detailed view of how engaged our people feel. The response rate was 70% and we scored 596 (compared to 623 in FY16). FY17 was a year of significant change, which has been understandably challenging for many employees and this is reflected in the fall in the score. Feedback from the executive roadshows is seeing an upward trend on specific issues, e.g. 'I am confident about the future'. Our employee surveys and feedback help us identify specific areas where we can work to improve performance and engagement and we are committed to acting on the feedback we receive. In FY18 we are seeking to simplify our approach to measuring and action planning on engagement, empowering teams

to support change. One such approach will be to introduce 'Rapid Improvement Events' to remove barriers and support team collaboration.

➔ **Page 19** Non-financial KPIs: Employee engagement and Employee turnover

Corporate values and culture

In FY17, we introduced new corporate values – integrity, collaboration and performance – to underpin our vision and strategy. These values reinforce our ongoing commitment to responsible business practice and our focus on delivering for our customers, through partnership. Their introduction followed a programme to engage with our people in the process of change and to ensure that our values resonate across the diversity of our workforce. The values have been embedded in our updated Code of Conduct and Performance Development Review (PDR) to ensure we capture 'how' people deliver results as well as what results they deliver. Cultural development is a key part of our transformation and four Transformation Action Groups (TAGs) have been set up to address Collaboration, Recognition, Culture and Communication. Under the Recognition TAG, a new employee recognition scheme has been initiated, with categories such as living our values, customer focus, innovation and community.

Safety, health and wellbeing

The safety, health and wellbeing of our people and the environment we operate within are intrinsically linked to our success and underpin our strategic goals.

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

The lost time incident (LTI) rate is calculated as the number of lost time incidents, where the employee is away from work for one or more days, times 1,000, divided by the total number of employees. The LTI rate has increased from 5.0 to 5.7 following a small increase in lost time incidents. There were no prosecutions, prohibition notices or improvement notices issued by regulators in the UK during the last financial year.

Lost Time Incident Rate	2017	2016	2015
QinetiQ Group	5.7	5.0	5.6

FY18 will see the launch of a new three-year Health Safety and Environment strategy. We are working together to reduce work-related ill-health and injury where our people are safe and healthy and enjoy a good work-life balance while feeling empowered and involved in making improvements. To assist this we have put in place a new Steering Committee, chaired by the Company Secretary and Group General Counsel, to coordinate the development and implementation of the strategy. Part of our new strategy involves the ongoing roll out of 'Safe for Life' across the Group during FY18, which focuses on behavioural safety aspects to improve safety and health (See page 18).

Integrity

Trusted to do the right thing at all times, we take pride in our decisions, and work to create a sustainable and responsible business.

Collaboration

The chosen partner for customers and industry colleagues, we are a diverse and inclusive community with a common purpose; every contribution is valued.

Performance

Customer focused and highly responsive, providing operational excellence and assuring safe and secure delivery.

Equality, diversity and inclusion (ED&I)

For sustained business success, it is vital to create a workplace that is inclusive; where our diversity drives innovation and creativity for our customers. To achieve this, we have revitalised our programme to ensure we create a workplace and culture where everyone can be authentic, feel valued and realise their full potential. Under the new ED&I strategy we will focus on leadership and culture, training, communication and awareness, recruitment and outreach. In FY18 we will deliver updated training for key roles, review policy and introduce Fair Treatment Advisors who will provide an additional route for advice and support for our people. We will continue to collaborate with like-minded organisations and networks to share ideas. QinetiQ is subject to new Gender Pay Reporting legislation and will be publishing information later in 2017. The breakdown of employees by gender as at the end of March 2017 is shown below.

	Female	Male
Board Directors ¹	2 (22%)	7 (78 %)
Senior Managers ²	40 (17% ³)	201 (83%)
All Employees ⁴	1,169 (20%)	4,742 (80%)

¹ For more information on Board diversity see page 53.

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

³ Up from 14% in FY16.

⁴ Excluding senior managers.

For more information on ED&I

www.QinetiQ.com/about-us/corporateresponsibility



The 5% Club – Investing in a Generation

As with many companies in our sector, we need to consider the age diversity of our scientists and engineers and we are taking a number of steps to ensure access to talent now and in the future. QinetiQ is a founding member of The 5% Club, which aims to increase the employment and career prospects of today's youth and equip the UK with the skilled workforce it needs. A commitment of the campaign is to publish the number of employees on apprenticeships and graduate programmes and sponsored students; the breakdown is shown below. We have seen a slight reduction this year, due in part to the acquisition of QinetiQ Target Systems, and as a result of our reorganisation, which has meant a change to how we recruit. Our plans for next year will see us increase our investment in QinetiQ Early Career programmes.

	FY17	FY16	FY15
Apprentices ¹	146	150	208
Graduates	106	135	102
Sponsored students	10	25	8
% UK workforce	4.9%	5.7%	5.9%

¹ Not including 12 employees undertaking the Systems Engineering Masters Apprenticeship Programme.

The Academy is executing Company-wide graduate and apprentice programmes with core learning modules and managed placements. This will be a significant factor in attracting people to our Early Careers programmes and our continuing commitment to The 5% Club. Our QinetiQ Apprentice Training School is confirmed as a Registered Approved Training Provider and we train not only our own apprentices but also those of customers such as DSTL and the National Crime Agency.

➔ **Page 24** Principal risks and uncertainties: recruitment and retention

➔ **Page 19** Non-financial KPI: apprentices and graduates

Learning and development

The QinetiQ Academy is a fundamental enabler of our vision and strategy, helping our people to develop and fulfil their potential, through three faculties – People, Business and Engineering, Science and Technical. Our learning management system has been developed further in FY17, providing employee access to a growing catalogue of training courses and we have invested in supporting a number of our people to undertake PhDs, as part of our IRAD programme. Key highlights in FY17 include a suite of aligned development programmes:

- Executive Committee development programme.
- Leadership development programme for our top 100 leaders (see page 14).
- Managers have been trained on a revised PDR process, via a programme called 'Raising the Bar'.
- A management development programme (MDP) to develop our 1,100 line managers; MDP covers managing transformation and leadership culture.

Business ethics and anti-bribery

Our Code of Conduct lays out our ethical standards, providing our people with clear direction and guidance on how we do business across the Group and how to get help. The Code (which has been updated) forms a cornerstone of our Operating Framework (see page 64 for more on governance and the role of the Risk & CSR Committee). Training on business ethics is mandatory for all of our people, as well as Board members and is available for our suppliers and customers. As well as explaining the Code of Conduct, the training provides challenging scenarios to help our people know what to do if they were to come across issues such as bribery, conflict of interest, discrimination and modern slavery. Our people are provided with a number of routes to seek help or raise concerns. They are encouraged to talk to a manager, use our ethics email advice services and our independently-run 24/7 confidential reporting line (see page 58). We have provided prompt help and advice in response to all queries received via our ethics email advice services and all communication through the confidential reporting line is appropriately investigated.

We have a zero-tolerance approach to bribery and corruption and have put in place a range of governance measures. Our anti-bribery programme is overseen by our Chief Ethics Officer (the Group General Counsel and Company Secretary). We address the risk of bribery in our international business risk management process; undertaking due diligence, monitoring and auditing of our use of commercial intermediaries. We use expert third-party providers of due diligence where appropriate. We provide more in-depth anti-bribery training for those in higher risk roles, for example those who carry out overseas business.

➔ **Page 22** Principal risks and uncertainties

People and relationships continued

Human rights

We seek to anticipate, prevent and mitigate potential negative human rights impacts through our policy and processes, which underpin our commitment to responsible business practices. These include our Code of Conduct, business ethics training and policies to support adherence to export controls, health and safety, non-discrimination, anti-bribery and environmental laws. This is further supported by our procedures on product and service trading, product safety, sustainable procurement, due diligence and risk management. We monitor the application of these policies and procedures through our business assurance processes. We believe that this embedded approach is effective. We have a structured approach to understanding human rights risk within our international business risk management process and in our supply chain. Our ongoing programme to address modern slavery has resulted in updated policies and training. Our statement on modern slavery and human trafficking is published on our website.

➤ **For more information on business ethics**
www.QinetiQ.com/about-us/corporateresponsibility

Relationships

The relationships we have with customers, suppliers, business partners and communities are core to our business today and in the long term. For us, working collaboratively with these groups delivers better outcomes which will drive growth, innovation and transformation. Collaboration – one of our three values – will help us to realise our vision to become the chosen partner around the world for mission-critical solutions, innovating for our customers' advantage.

Customer focus

Collaborative working is a critical enabler of success throughout our strategic campaigns, for us, our customers, partners and suppliers (page 6). During FY17, we have placed significant, focused effort on strengthening our relationships with the UK MOD and the broader UK Government agencies and this can be seen in the progressive contracts we have won under the LTPA delivering true transformation across the UK test and evaluation enterprise. We have also taken significant steps forward on improving vital connections with industry partners, with collaborative agreements signed with BAE Systems, Boeing Defence UK, MBDA and Thales. By working collaboratively, we will secure joint growth with our partners and suppliers to provide our customers with better capability and value for money while accelerating programme timelines and reducing risk.

We are signatories to the Armed Forces Corporate Covenant. In 2016, Steve Wadey was presented with the MOD's Gold Award by the Duke of Cambridge, as part of the Defence Employer Recognition Scheme. The scheme encourages employers to support defence and inspire others to do the same. The award recognised our approach to recruitment and our commitment to our employees who are reservists.

➤ **Page 18** Non-financial KPI: customer satisfaction

Supply chain

At QinetiQ, we see our supply chain as a critical asset as we look to grow our business. This year has seen an unprecedented investment in our supply chain in support of the test aircrew training and air range modernisation interventions, and many of our future key campaigns are dependent on partnering and contracting with industry to deliver integrated solutions to our customers. We are committed to making QinetiQ easy to do business with, especially for the SME community. This commitment has been demonstrated by our innovative approach to supply chain engagement on our Strategic Enterprise programme. Our approach to safety and governance in our supply chain remains paramount. We continue to refine our approach to risk management in the supply chain across the Group to both protect the interests of QinetiQ and its shareholders, and also the employees of our subcontractors.

Community relationships

As a responsible employer, we invest in making a positive difference in the communities where we operate. Across QinetiQ Group, we provide employees with time for skills-based volunteering, (typically one day, at manager discretion). Our main focus is our Science, Technology, Engineering and Maths (STEM) outreach programme which aims to inspire the next generation of scientists and engineers, contributing to solving skills shortages and youth unemployment and underpinning our approach to skills, recruitment and retention. This year we have engaged with over 5,700 young people through bespoke activities and with teachers (see case study). We have also engaged with over 6,300 young people at events such as The Skills Show. Outreach focused on girls forms part of our ED&I strategy. As part of National Women in Engineering Day 2016 we hosted inspirational events for young women at six locations across the UK. We will continue to promote the benefits of skills-based volunteering in FY18.

➤ **Page 24** Principal risks and uncertainties: recruitment and retention.

Some of the sites we manage on behalf of the MOD have dedicated full-time Community Liaison Officers who manage local community and stakeholder relationships specific to the site. This year saw the end of our five-year partnerships with our existing employee charities, donating a total of £251,800 through employee fundraising and corporate matched funding. In the UK, employees have voted to select new corporate charities and we have also selected local Charity of the Year partners across many of our UK sites. In the US, employees fund-raise for a number of defence charities and in Australia we have a two-year partnership with the Australian War Memorial in Canberra to provide in-kind advisory services and engineering expertise.

➤ **For more information on community relationships**
www.QinetiQ.com/about-us/corporateresponsibility



STEM Outreach:

Empowering teachers

In July 2016, we hosted teachers from Farnborough Sixth Form College for a week-long STEM Insight placement to offer them a real-world insight and a better understanding of the skills young people need in STEM careers. The programme is run by STEM Learning and is supported by face-to-face and online Continuing Professional Development. A full case study is available at www.QinetiQ.com/about-us/corporate-responsibility.

Resources and environment

Our aim is to deliver continuous improvement in our environmental management so that we play our part in protecting the environment.



Graduates participated in a workshop designed to raise awareness of our approach to energy management and to grow our network of Energy Champions. One of the speakers joined the workshop by video conference, to demonstrate our improved facilities. Commenting on the day, a graduate said: "Throughout the workshop as you understand more about consumption, the easier it becomes to think of ideas that may seem small but could have the potential to have a big impact on our usage."

With increasing pressure on natural resources, climate change and global ambitions arising from the Paris Agreement and the UN Sustainable Development Goals, we play our part in protecting the environment and support the sustainability requirements of our customers.

Environmental stewardship

Our overall aim is to deliver continuous improvement in our environmental management. We are on target to successfully transition to ISO 14001:2015 and are due to achieve certification in the next financial year. Part of this, has been our ongoing commitment to review policy and process and communication with our people. In FY17, we assessed climate change risks on some of the main sites we operate and identified appropriate mitigations. We continue to be active members of the MOD – Industry Sustainable Procurement Working Group to ensure that we understand the sustainability agenda of a key customer. During FY17 we supported the successful delivery of Unmanned Warrior through close working and collaboration with QinetiQ project teams, industry partners and customer representatives. This involved sharing knowledge and experience to help meet and exceed our customers' expectations, ensuring local areas of conservation were not affected and in particular, important seal haul-outs.

FY18 will see the launch of a new three-year health, safety and environmental strategy. Through continuing to mitigate our main environmental impacts and risks, and ensuring environmental considerations are addressed through the supply chain, we will continue to improve our environmental performance. The development of a stakeholder focused communication plan will enable us to improve the transparency of our environmental performance and embed our environmental approach into our whole culture to meet the expectations of our stakeholders.

Greenhouse gas emissions and energy management

Managing our energy reduces our impact on the environment and it improves our operational efficiency. In the UK business last year we achieved certification to ISO 50001 (BS EN ISO 50001:2011 Energy Management System) in recognition of the systems and processes in place to manage our energy consumption. We have used the framework to improve our approach to energy management and strive to embed energy efficiency best practice across the UK business. We continued our Energy Matters programme, communicating with our people, growing our network of Energy Champions and empowering our Energy Engineers to identify and implement energy saving projects. As part of transformation, the modern working environment programme has seen significant improvements in our video conferencing capability which can support a reduction in travel. We meet the requirements of ESOS (the Energy Savings Opportunity Scheme) through a combination of ISO 50001 certification and an energy audit report produced by our appointed ESOS Lead Assessor. We continue to submit voluntarily to the Carbon Disclosure Project Climate Change Programme, and are registered for the Carbon Reduction Commitment (CRC) scheme.

Our Group greenhouse gas (GHG) emissions are captured to meet the requirements of the Companies Act 2006 (Strategic report and Directors' report) Regulations 2013. The table below provides a summary of the Group's GHG emissions from 1 April 2016 to 31 March 2017, giving a summary of Scope 1 (fuel combustion and operation of facilities) and Scope 2 (purchased electricity) emissions and an intensity ratio (per £m of revenue). We have adopted a financial control approach and have used the latest emissions factors from the UK Government, and the International Energy Authority. Our overall emissions have reduced by 13,192 tonnes of CO₂ (tCO₂e) against the FY14 base year (our first year of GHG reporting for the Group). In FY17, we saw a 10% reduction against the previous financial year through a combination of new building management system projects, changes to operational activity, a milder winter and changes in GHG emission factors. We have made improvements to our GHG calculation methods and have identified some minor new emission sources. We have therefore corrected the FY16 data reported below compared with previously reported data. Our Scope 1 and Scope 2 emissions have been externally verified by an independent third party, Carbon Credentials, against the ISO 14064-3 standard. The verification statement can be found on our website.

➞ **For more information on GHG verification**
www.QinetiQ.com/about-us/corporateresponsibility

	FY17	FY16	FY15
Total Scope 1 emissions (tCO ₂ e)	21,245	23,691	26,534
Total Scope 2 emissions (tCO ₂ e)	31,210	36,857	39,668
Total Scope 1 and 2 emissions (tCO ₂ e)	52,455	60,548	66,202
Intensity ratio (tCO ₂ e per £m of revenue)	67	80	87

Energy use in the UK currently forms 81% of our total emissions and were 42,416 tCO₂e in FY17. We set a target of a 17% reduction in our GHG emissions due to UK energy use by 2020 from a 2013 baseline of 53,567 tCO₂e. At the end of FY17, we surpassed our target with a 23% reduction against the base year. We have committed to carry out a review of our existing GHG target, using a science-based targets assessment framework, and this will inform our decision on our future approach.

Chief Financial Officer's review

Maintaining capital discipline
and driving sustainable growth.



David Smith
Chief Financial Officer

Financial highlights

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

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

"The financial position
of the Group is strong.
I am excited about building
on this to help QinetiQ
realise its potential."

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

^a 2016 includes discontinued operations.

Total backlog

£2.2bn
2016: £1.3bn

Organic revenue growth

1%
2016: (1)%

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

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

Overview

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

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

Orders bridge:

	£ million	
2016 Orders	659.8	
Cyveillance disposal	(5.3)	
Acquisitions	3.9	
EMEA Services timing of multi-year contracts	6.5	
EMEA Services other performance	17.4	
Global Products other performance	(27.1)	
Foreign exchange	20.1	
2017 Orders [†]	675.3	

[†] Excludes the £1bn LTPA contract amendment announced in December 2016.

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

Revenue bridge:

	£ million	
2016 Revenue	755.7	
Cyveillance disposal	(8.0)	
EMEA Services organic	(2.9)	
Global Products organic	10.5	
Acquisitions	9.2	
Foreign exchange	18.6	
2017 Revenue	783.1	

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

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

Underlying operating profit* bridge:

	£ million	
2016 Underlying operating profit*	108.9	
Cyveillance disposal	0.3	
FY16 non-recurring trading items	(3.0)	
EMEA Services organic	(4.6)	
Global Products organic	3.6	
FY17 non-recurring trading items	7.4	
Acquisitions	1.2	
Foreign exchange	2.5	
2017 Underlying operating profit*	116.3	

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

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

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

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

Chief Financial Officer's review continued

Specific adjusting items

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

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

Acquisitions

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

On 31 January 2017, the Group acquired 100% of the issued share capital of RubiKon Group Pty Limited from its founder management team for £7.4m (AU\$12.6m). This Australian company provides solutions to complex logistics, supply chain management and procurement projects. RubiKon was integrated into the Group's Australia business and goodwill of £3.9m and intangible assets of £3.1m were recognised on acquisition.

Net finance costs

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

Taxation

The underlying effective tax rate of 10.6% (2016: 11.8%) continues to be below the UK statutory rate, primarily as a result of the benefit of research and development expenditure credits in the UK. The effective tax rate is expected to remain below the UK statutory rate in the medium term, subject to the impact of any tax legislation changes, the geographic mix of profits and the assumption that the benefit of net R&D expenditure credits retained by the Group remains in the tax line.

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

The current tax liability is £43.7m as at 31 March 2017 (31 March 2016: £39.9m). This includes a tax liability in the US related to an unfavourable court decision in respect of the tax treatment of the Group's acquisition of Dominion Technology Resources, Inc. in 2008. An insurance policy was taken out by the Group at the point of acquisition and, if the court's decision is final, the funds required to settle this dispute will be provided by the insurers. Hence, an offsetting receivable is reported on the balance sheet as at 31 March 2017 (included within trade and other receivables).

Cash flow, working capital and net cash

	31 March 2017	31 March 2016
Net cash flow from operations (pre-capex)*	£111.9m	£133.4m
Net cash flow from operations (post-capex)*	£79.0m	£103.6m
Cash conversion (post-capex)*	68%	95%
Net cash	£221.9m	£274.5m

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

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

Total profit for the year

£123.3m
2016: £106.1m

Underlying* effective tax rate

10.6%
2016: 11.8%

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

Net cash

£ **221.9m**
2016: £274.5m

Dividend

6.0p
2016: 5.7p

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

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

Capital allocation

Priorities for capital allocation are:

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

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

Dividend

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

Pensions

The net pension asset under IAS 19, before adjusting for deferred tax, was £156.0m (31 March 2016: liability £37.7m). The market value of the assets at 31 March 2017 was £1,926.3m (2016: £1,410.4m) and the present value of scheme liabilities was £1,770.3m (2016: £1,448.1m). The movement from a liability to an asset was driven by an increase in asset prices and the benefit of our continued strategy to reduce risk through hedging.

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

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

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

Assumption	Change in assumption	Indicative effect on scheme liabilities (before deferred tax)
Discount rate – small movement	Increase/decrease by 0.1%	Decrease/increase by £35m
Discount rate – large movement	Increase by 1.0%	Decrease by £320m
Discount rate – large movement	Decrease by 1.0%	Increase by £422m
Inflation	Increase/decrease by 0.1%	Increase/decrease by £34m
Life expectancy	Increase by 1 year	Increase by £46m

The impact of movements in Scheme liabilities will, to an extent, be offset by movements in the value of Scheme assets as the Scheme has assets invested in a Liability Driven Investment Portfolio. As at 31 March 2017, this hedges against 63% of the interest rate risk and 100% of the inflation rate risk, as measured on the Trustees' gilt-funded basis.

The last triennial valuation of the scheme, on a funding basis, was a net surplus of £31.0m as at 30 June 2014, although if a funding valuation was carried out today the valuation could be a net deficit and may differ materially from the IAS 19 accounting valuation due to the inherent methodology differences. There has been no change to the cash contributions required under the recovery plan, which continues to require £13m of Company contributions per annum until 31 March 2018. The next actuarial valuation is due as at 30 June 2017.

Critical accounting estimates and judgements.

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 financial statements on page 106.

David Smith

Chief Financial Officer
25 May 2017

In FY17, OptaSense began the delivery of devices for the 1,850km Trans-Anatolian Natural Gas Pipeline (TANAP), one of its largest Distributed Acoustic Sensing (DAS) projects to date. OptaSense is providing a single pipeline monitoring system that integrates leak detection, third-party interference prevention and other security functionality.





Corporate governance

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Corporate governance statement

An introduction from our Chairman.



Mark Elliott
Non-executive Chairman

“It is critical that the Board of Directors provides leadership, guidance and oversight.”

Dear shareholder,

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

During the year under review, QinetiQ has progressed with delivery against the targets of its vision and strategy, which it developed and rolled out in 2015 and 2016, under the guidance of the Executive Committee which was set up at the end of the last financial year. As part of this process, QinetiQ has sought to change its internal operating model, to provide greater efficiency in its offering to key customers and to expand internationally. Against this backdrop of change, it is therefore critical that the Board of Directors provides leadership, guidance and oversight, to ensure that QinetiQ operates a sound system of corporate governance and internal control through effective stewardship and risk management.

On the strategic and commercial front, during the year, the Board of Directors was involved in decisions concerning critical strategic campaign activity, including the efficiencies provided to its key customer, the UK Ministry of Defence, under the amendment to the Long Term Partnering Agreement, the Strategic Enterprise contract, the Naval Combat Systems Integration Support Services contract, the acquisition of the Target Systems business in the UK and Canada, and the acquisition of RubiKon in Australia.

In terms of oversight and assurance, during the year we carried out an external audit tender process which resulted in the appointment of PricewaterhouseCoopers LLP as QinetiQ's auditor for the financial year ending 31 March 2018, subject to their appointment at the forthcoming Annual General Meeting, in place of KPMG LLP, who has been QinetiQ's auditor since its formation in 2001. Further details of the audit tender process can be found on page 63 in the Audit Committee report.

In terms of leadership, as noted on page 4, the Chief Financial Officer, David Mellors, resigned in December 2016 and was replaced by David Smith in March 2017. There has been no change in Non-executive Directors during the year. The Nominations Committee has reviewed the skills required in the current and future Non-executive Directors and, during the coming year, the composition of the Board and diversity will remain areas of focus. During the current year, the Non-executive Directors have met with the wider leadership community at quarterly events, to increase their knowledge and understanding of the Company's businesses and how they operate.

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

Mark Elliott
Non-executive Chairman
25 May 2017

Corporate governance statement

Compliance statement

The Board considers that QinetiQ has complied with all relevant Provisions of the Code throughout the last financial year.

Overview of the application of the Main Principles of the Code

QinetiQ is subject to the Financial Reporting Council's UK Corporate Governance Code (the Code) as currently in effect. The Code and associated guidance are publicly available on the Corporate Governance page of the Financial Reporting Council's website, www.frc.org.uk.

This statement provides details of the way in which the Main Principles of the Code have been applied during that year.

An overview of the Group's corporate governance arrangements can be found on the QinetiQ website at www.QinetiQ.com/about-us/corporate-governance.

“The Board of Directors is responsible for overseeing the Group's strategy and performance and ensuring the implementation of operational activity which supports the strategy.”

Code Principle A Leadership

A1

The Role of the Board

The Board represents the interests of QinetiQ and its shareholders. It comprises a range of experience and expertise required to meet the challenges facing the Group. The Board of Directors is responsible for overseeing the Group's strategy and performance and ensuring the implementation of operational activity which supports the strategy. It has mandated the organisation's standards of behaviour and its risk appetite, along with key policies and processes, and enables the business to implement strategy and monitor operational performance through its direction and advice.

The Directors' powers are subject to the Articles of Association and any applicable legislation. The Board has delegated the day-to-day operational management of the Company to the Executive Directors and members of the senior management team, but certain matters are reserved to it for its decision. The Board monitors the performance of the senior management team and organises its business to have regular interaction with key members of senior management.

The Board met seven times during the year. The schedule of matters reserved to the Board and the Board's objectives and responsibilities can be found on page 44. This report contains a statement of how the Board operates, including which types of decisions are taken by the Board and which are delegated to management. Details of the Board and Committee membership and Directors' attendance at Board and Committee meetings are set out on page 46.

A2

Division of Responsibilities

The roles of Chairman and Chief Executive are not exercised by the same individual and their separate responsibilities are established, set out in writing and approved by the Board.

A3

The Chairman

The Chairman, working with the Company Secretary, sets the agenda for Board meetings and encourages an open and constructive debate. In accordance with the Code, the Chairman was independent on appointment.

A4

Non-executive Directors

The Non-executive Directors bring independent judgement on key issues affecting the Group and its business operations, including strategy, performance, resources (including key appointments) and standards of conduct. They provide constructive challenge to management and help develop proposals on strategy. The Board has appointed a Senior Independent Non-executive Director. Regular meetings are held with the Chairman and Non-executive Directors without the executives present.

The Board considers that all the Non-executive Directors were 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 throughout the last financial year. In accordance with the Code, the Board undertakes an annual review of the independence of the Non-executive Directors.

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

Code Principle B Effectiveness

B1

The Composition of the Board

In compliance with provision B.1.2 of the Code, at least half the Board (excluding the Chairman) comprises independent Non-executive Directors. The Board considers the overall size and composition to be appropriate, having regard to the experience and skills that individual Board members bring to their duties. They are able to operate at a high level independently of each other but also work together as a team.

The Board considers that the skills and experience of its individual members, particularly in the areas of UK defence and security, the commercialisation of innovative technologies, corporate finance and governance, international markets and risk management, have provided both support and challenge to the Chief Executive Officer, Chief Financial Officer and the executive management team during the year, in terms of both the formulation of the new strategy and transformation programme and also in respect of 'business as usual' items which require Board oversight, such as financial and trading matters and significant commercial projects.

At the date of this report, the Board has nine members: the Non-executive Chairman; six other Non-executive Directors; and two Executive Directors – the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO).

The following changes in Board membership took place during the year:

- David Mellors resigned as an Executive Director and CFO on 31 December 2016.
- David Smith was appointed as an Executive Director and CFO on 1 March 2017.

Details of the process for the appointment of the new CFO can be found in the report of the Nominations Committee on page 52.

Corporate governance statement continued

“ During the year, individual Non-executive Directors visited the Shoeburyness and Boscombe Down sites in the UK and the Waltham site in the USA.

”

Details of the Directors, including their names, skills and experience can be found in the biographies on pages 48 to 49.

The Nominations Committee seeks to ensure that the composition of the Board and its Committees provides the optimum balance of skills, knowledge, background and experience, and to oversee succession planning for the Board and senior management. The report of the Nominations Committee can be found on page 52.

B2 Appointments to the Board

The Nominations Committee oversees appointments to the Board, its balance of skills and experience and the succession planning process for the Board and senior management. It ensures that the requirements for updating Board membership are met on a timely basis. The report of the Nominations Committee can be found on page 52.

B3 Time Commitment

The anticipated time commitment required in respect of the non-executive role is communicated in the appointment process. The Board is notified of changes to other significant commitments and the Chairman consulted where appropriate.

B4 Director Training and Development

On appointment, Directors receive a tailored induction programme, comprising site visits, meetings with management, and training where required. On an ongoing basis, Directors receive appropriate training about the Company and their duties. The Directors are also required to complete the annual business ethics training, as noted on page 31. The Company Secretariat organises site visits and training to suit individual requirements.

David Smith, who joined the Board in March 2017, has received technical materials in respect of the Group's policies and procedures, had a series of meetings with senior management, members of the Finance team and members of the wider leadership community, and has visited a number of QinetiQ sites, including Malvern and Portsmouth in the UK and Waltham in the USA. He has also met with the Company's auditors, brokers, and financial and corporate relations advisors.

During the year, individual Non-executive Directors visited the Shoeburyness and Boscombe Down sites in the UK and the Waltham site in the USA, as a result of specific requests. The Board received collective training in the form of technical briefings from KPMG on accounting changes, from Ashurst on the Market Abuse Regulation and a corporate governance update from the Company Secretary. Non-executive Directors also personally arranged and attended external updates and training courses.

B5 Information and Support for Directors

The Chairman, working in conjunction with the Company Secretary, ensures that the Board receives accurate, timely and clear information.

B6 Performance Evaluation

An evaluation of the performance of the Board, its Committees and individual Directors, is carried out annually, with an external, independent, review in each third year.

The most recent external review took place in 2016. It was carried out by Lintstock and took place in the final quarter of the year so that it could be fully focused on outside the financial reporting cycle and strategy meetings. The key findings of the prior year external evaluation review and progress against them can be found on page 50.

During the year under review, an evaluation of the effectiveness of the Board and its Committees was carried out internally by way of a questionnaire completed by Board members. Details of the process and key findings of this evaluation and resulting priorities for the coming year can be found on page 51.

B7 Re-election of Directors

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

Code Principle C Accountability

C1 Financial and Business Reporting

The Board presents its results at the full year and the half year and provides quarterly updates to the market. The Annual Report and Accounts contains a Strategic report which provides an explanation of how the Company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the Company. A going concern statement and longer-term viability statement are included on pages 58 and 22 respectively, responsibility statements can be found on page 95, and details of the process for ensuring that the Annual Report is fair, balanced and understandable can be found on page 61. There is also a statement in the auditor's report on page 99 about their reporting responsibilities.

C2 Risk Management and Internal Control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness in safeguarding shareholders' interests and the Company's assets.

“
All shareholders are invited to attend the Annual General Meeting (AGM) and to ask questions.
”

AGM date

19 July 2017

The system is designed to manage and mitigate, rather than eliminate, the risk of failure to achieve business objectives, and, like any appropriate or proportionate system of corporate internal control, cannot provide absolute assurance against material misstatement or loss.

Details of risk management and internal control processes can be found on pages 54 to 57. The risk management process and the system of internal control necessary to manage risks are assessed and monitored by the Audit Committee (financial risks) and the Risk & CSR Committee (non-financial risks). A report on specific risk review activity undertaken during the year by those committees, together with the current risk registers, is presented by the CEO to the Board annually. The Strategic report contains on pages 22 to 25 details of the Company's principal risks and uncertainties, their impact and how they are managed.

An explanation of how the Directors have assessed the prospects of the Company and a statement in respect of the Board's assessment of the Company's longer-term viability are set out on page 22.

C3

Audit Committee and Auditors

The Board has established an Audit Committee comprising at least three independent Non-executive Directors, with formal terms of reference. It oversees the financial risk management and internal controls process, the effectiveness of internal audit activities, the external auditor's independence and objectivity and makes recommendations to the Board in respect of the reappointment of the external auditor and their remuneration. The report of the Audit Committee can be found on pages 59 to 63.

Code Principle D

Remuneration

D1

Level and Components of Remuneration

The Board has established a Remuneration Committee with formal terms of reference. It is responsible for ensuring that levels of remuneration are of sufficient quality and that any performance related elements are relevant, stretching and designed to promote the long-term success of the Company.

D2

Developing Remuneration Policy and Packages

The report of the Remuneration Committee can be found in the Directors' remuneration report on pages 82 to 84. It provides details of, or links to, the Group's reward and remuneration policies and payments, and also the procedure for setting policy on Executive Director remuneration.

The Committee also recommends and monitors the level and structure of remuneration for senior management. The Directors' remuneration report is incorporated into this corporate governance statement by reference.

Code Principle E

Relations with Shareholders

E1

Dialogue with Shareholders

The Chairman ensures that all Directors are made aware of major shareholder issues and concerns, by way of reports from the Executive Directors at Board meetings, attendance at key financial calendar events and by making themselves available to meet shareholders as required.

The Company attaches significant importance to maintaining an effective engagement with shareholders to ensure a mutual understanding of objectives and to deal with issues of concern. Responsibility for communications with shareholders rests with the Executive Directors, assisted by the Group Director, Investor Relations and Communications. The Company Secretary oversees communications with private individual shareholders. As noted on page 67, meetings with investors during the year were led by the Chairman and the Senior Independent Director. Investor roadshows, analyst presentations and webcasts were carried out during the year, as detailed on page 67.

An analysis of the shareholder register, by type of holder and by size of holding, can be found on page 152.

E2

Constructive Use of the Annual General Meeting

All shareholders are invited to attend the Annual General Meeting (AGM) and to ask questions. The Chairs of the Audit, Nominations, Remuneration, Risk & CSR and Security Committees attend the meeting and are available to answer any questions on the work of the committees.

The 2016 AGM was held at the offices of Ashurst LLP, Broadwalk House, 5 Appold Street, London EC2A 2HA, on 20 July 2016 and each member of the Board attended the meeting and was available to take questions.

The 2017 AGM is scheduled to be held at Ashurst LLP, Broadwalk House, 5 Appold Street, London EC2A 2HA, on 19 July 2017. The Company confirms that it will send the Notice of Meeting 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 in the 'Investors' section of the Group's website.

Code Principle A – Leadership

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Non-executive Directors have attended each of the quarterly extended leadership meetings run by the Executive Committee and which are attended by approximately 100 senior leaders within the Group.

”

Board objectives

The overarching remit of the Board is to demonstrate the highest standards of corporate governance in accordance with the Code and to carry out the Directors' fiduciary duties:

- To demonstrate strategic leadership and oversight;
- To agree the strategy and to ensure the continuing evolution and implementation of the Group's strategy to deliver value to all stakeholders: customers, employees and shareholders;
- To develop challenging objectives for the business and monitor management performance against those goals;
- To provide a framework of effective controls to assess and manage risks, with clear expectations of conduct to the highest standards of ethics;
- To provide support and constructive challenges to the CEO and senior management to promote the Group's success;
- To demonstrate leadership in management systems around health, safety and environment; and
- To manage succession planning for the Board and the Group's executive management.

Matters reserved to the Board

The Board has a clearly articulated set of matters which are specifically reserved to it for consideration, in addition to those specified in the Company's Articles of Association.

These include (but are not limited to):

- Reviewing and approving the annual budgets;
- Raising indebtedness;
- Granting security over Group assets;
- Approving Group strategy and the corporate plan;
- Approving the Annual and Half-Year Report and Accounts;
- Approving significant investment, bid, acquisition and divestment transactions;
- Approving HR policies (including pension arrangements);
- Reviewing material litigation; and
- Monitoring the overall system of internal control, including risk management.

Operation of the Board

The Board has an annual calendar of meetings and operates through a comprehensive set of processes which define the schedule of matters to be considered by the Board and its Committees during the annual business cycle. This includes the level of delegated authorities (both financial and non-financial) available to Executive Directors and other layers of management in the business, QinetiQ's business ethics, risk management, and health, safety and environmental processes. The Board devotes one entire meeting each year to consider strategy and planning issues that have

an impact on the Group, from which the corporate plan is generated. It is also regularly kept up to date on strategic issues throughout the year.

For each meeting, as standing items, the Board receives a written report from the CEO and CFO and a report produced by the Company Secretary on key legal and regulatory issues that affect the Group.

The CEO's and CFO's report contains a financial overview, addresses the key actions taken in pursuit of strategic initiatives which have had an impact on the Group since the previous Board meeting, with particular focus on the progress of each of the businesses, a report on investor relations which is prepared in consultation with QinetiQ's brokers and a report on employee matters.

During the year under review, in response to comments arising from the annual Board effectiveness review (as detailed on page 50), the format of the CEO's and CFO's report was adjusted to lay greater emphasis on the growth strategy of the Company, to give more detail on customer engagement and to give details of progress with strategic goals. Other matters which might be included in the report as and when required include health, safety and environmental matters, corporate responsibility, the status of key account management/customer relationship initiatives, the pipeline of potential bids, acquisitions, disposals and investments, and the post-acquisition performance of recently acquired businesses.

The Board also receives updates from key functional areas on a structured basis, on issues such as human resources, treasury, corporate responsibility, real estate, security, trade controls and pensions.

During the year under review, members of the senior management team presented to the Board and its Committees on specific areas, including research and development activity, recruitment and retention, reputational risk, corporate responsibility, cyber risk and strategy. Non-executive Directors have attended each of the quarterly extended leadership meetings run by the Executive Committee and which are attended by approximately 100 senior leaders within the Group. The meetings take place over a two-day period, include updates on key business developments and provide networking and development opportunities for the wider leadership community.

Board and Committee meetings are generally spread over a two-day period, to allow sufficient time for the Board to deal with the various items of business. The Chairman meets with the Non-executive Directors, without executives present, after each Board meeting.

The Board also meets informally, to facilitate Board integration and working together as a team, and to allow time for the Directors to consider other matters outside of the formal agenda.

Key issues considered by the Board in the past year

During the year under review, the Board continued to focus on its drivers for growth – implementation of strategy, oversight of progress with the Group transformation programme and organisational design, business development initiatives and financial performance.

1 Group strategy and transformation programme

The Board has had full oversight of the progress of the Group strategy and transformation programme during the year. Of the seven Board meetings held during the year, Group strategy was presented at five of them, the other two Board meetings having a particular focus on the financial results. At three of the meetings, the Group Director, Strategy and Planning, gave an update on key aspects of the Group strategy, on mergers and acquisitions, on progress against strategic goals, on market conditions and on particular areas of strategic focus. At these meetings the Board had the opportunity to question and challenge the work being undertaken.

The October Board Strategy meeting was a two-day meeting held at an off-site location where the strategy for the Group as a whole was reviewed by the Board. Reading materials were circulated in advance of the meeting, setting the strategic market context and including updates on strategic initiatives, the strategy

for each business area (Air and Space, Maritime Land and Weapons, Cyber Information and Training, International, OptaSense, QinetiQ North America and Business Development), and updates on the Group's financial performance and trajectory, and on the ongoing internal business transformation programme in respect of process excellence, competitiveness, and working environment. At the outset, the CEO set out the objectives for the meeting and the Board advised on the details they wished to understand from the discussions. In the concluding remarks, it was noted that the matters raised by the Board had been addressed and the conclusions noted.

Business leaders attended the two-day meeting and presented on key subject areas where required. There was also time allocated during the two-day period to enable the Board and the senior managers to meet informally.

At the March Board meeting, the Group Director, Strategy and Planning, presented the Integrated Strategic Business Plan for the coming financial year, the plan being the culmination of feedback from the October strategy meeting, progress against existing strategic objectives and targets for the coming year.

In 2016, the Company initiated a two-year transformation programme, designed to deliver growth through improved customer focus and greater operational efficiency. As part of this programme, a new operating model based on collaboration, improved efficiency and new ways of working across the Company was rolled out. An organisational design programme in the Company's employee structure was completed during the year under review to support the delivery of this operating model. The Board was kept up to date on progress against objectives and was able to challenge developments by way of regular reports from the Group Director, Transformation and by way of updates in the CEO's and CFO's report. At the October Board Strategy meeting, a specific report on the transformation programme was presented by the Group Director, Transformation, and the impact of the organisational design programme was referred to in a wider report by the CEO and Group Director, Human Resources in respect of HR strategy, talent management and succession planning.

The progress of the Integrated Strategic Business Plan and transformation programme will continue to be on the Board agenda for review and measurement over the coming year. Details of the Group strategy can be found in the Strategic report on pages 14 to 17.

2 Business development – contract amendment to the Long Term Partnering Agreement

In December 2016, QinetiQ announced a £1bn contract amendment to the Long Term Partnering Agreement with the UK Ministry of Defence, under which Test and Evaluation ('T&E') services have been delivered since 2003. Under the amendment,

QinetiQ will modernise and operate the air ranges at MOD Aberporth and MOD Hebrides, and test aircrew training through the Empire Test Pilots' School at MOD Boscombe Down. The Board of Directors considered the proposal at a Board meeting in July and approved it for initial presentation to the customer. An update on progress was provided in the CEO's and CFO's report at the September meeting and a formal presentation was made by the Group Director, Test & Evaluation at the Board Strategy meeting in October on the priorities related to the Company's T&E strategy, approach, progress to date, targets and next steps. The contract

amendment was finally agreed and announced in December 2016. At the January Board meeting the Group Director, Business Development and the Group Director, Test & Evaluation presented an update on how work under the new arrangement was progressing and provided an update on progress against the objectives relating to T&E. Throughout the process the Board was kept up to date on developments and had the opportunity to challenge management where appropriate.

3 Financial reporting

Financial reporting is an ongoing area of Board governance, which is carried out in three principal ways: (i) by way of a standing report at each Board meeting from the CEO and CFO; (ii) by way of review of the full year and half-year results; and (iii) by way of an update at the annual Board Strategy meeting. As noted above, the CEO's and CFO's report tabled at each Board meeting contains a Group financial report. This report contains an overview, split by month and full year summary, and sets out details of Group financial performance to date, the latest forecast, and performance by sector.

In conjunction with the Audit Committee, the Board reviews the results at the half-year and the full year,

in November and May respectively. At the May Board meeting, the draft annual report and financial results announcement were considered. The Company's brokers attended relevant parts of the meeting. The Board received a report from the CFO and considered the recommendation from the Audit Committee in respect of the work undertaken to satisfy the 'fair, balanced and understandable' requirement and the longer-term viability assessment. The Board received a summary of the principal controls put in place by the executive to ensure the integrity of the audit process, including the provision of information to the auditor, the self-certification process and internal management representations, and a going concern review. A paper was also tabled to discuss dividend considerations.

At the November Board meeting, the half-year announcement and draft results presentation were presented by the CEO and CFO to the Board for their consideration, together with a paper to discuss dividend considerations. The Company's auditor and brokers attended relevant parts of the meeting.

In terms of dividend considerations, at both the full year and the half-year, the CFO tables a dividend paper which contains a recommendation as to whether to retain the current dividend policy and to propose consideration of a dividend payment based on that policy. The current dividend policy was reinstated in May 2011, when the Group recommenced payment of a dividend on the basis of 'a progressive dividend policy which will take into account the profitability of QinetiQ's businesses and underlying growth, as well as its capital requirements and cash flows, while maintaining an appropriate level of dividend cover. The final dividend will normally represent approximately two-thirds of the full year dividend in future periods.' The dividend paper presented to the Board covers these various aspects and also looks at sustainability and market expectations.

At the annual Board Strategy meeting, the CFO gave a presentation on the financial performance trajectory, looking at Group performance against key financial parameters across a range of scenarios.

Code Principle A – Leadership continued

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The Disclosure Committee was established during the year under review to ensure compliance with the Market Abuse Regulation.

”

Attendance at meetings of the Board and its Committees: 1 April 2016 to 31 March 2017

Members	Board	Audit Committee	Nominations Committee	Remuneration Committee	Risk & CSR Committee
Mark Elliott	7/7	–	6/6	5/5	4/4
Steve Wadey	7/7	–	6/6	–	4/4
David Smith (Appointed 1 March 2017)	1/1	–	–	–	–
Lynn Brubaker	7/7	6/6	6/6	5/5	4/4
Admiral Sir James Burnell-Nugent	7/7	6/6	6/6	5/5	4/4
Michael Harper	7/7	6/6	6/6	5/5	4/4
Ian Mason ¹	6/7	5/6	5/6	4/5	4/4
David Mellors (Resigned 31 December 2016)	5/5	–	–	–	3/3
Paul Murray ²	7/7	6/6	5/6	5/5	4/4
Susan Searle	7/7	6/6	6/6	5/5	4/4

¹ Ian Mason was unable to attend the March Board and Committee meetings due to a prior commitment.

² Paul Murray was unable to attend the July Nominations Committee meeting due to a prior commitment. There was no requirement for the Security Committee to meet during the year.

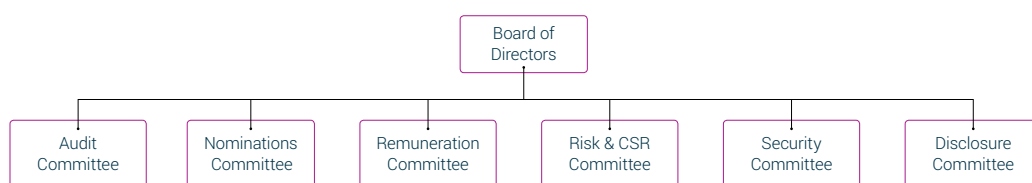
Committees

During the year, QinetiQ operated by way of five principal Board Committees and the Executive Committee.

In the interests of full Board participation and transparency, the Board maintains a policy of all of the Directors being members of all of the Board

Committees, with the exception of the Disclosure Committee (as noted below) and other than where prohibited by the Code, statutory or Security Committee requirements. As a result, all Board members are members of the Risk & CSR Committee, which facilitates full consideration of the oversight of internal controls and non-financial risk management, with all of the Non-executive Directors being the members of the Audit Committee and focusing on financial controls and financial risk management. Details of the key issues discussed, and decisions taken, are circulated to all members of the Board after the relevant Committee meeting.

Board Committees



The Board has established five principal Committees: the Audit Committee, the Nominations Committee, the Remuneration Committee, the Risk & CSR Committee and the Security Committee, together with a Disclosure Committee. Each operates within written terms of reference approved by the Board.

The Disclosure Committee was established during the year under review to ensure compliance with the Market Abuse Regulation. The Disclosure Committee comprises the Chairman, the CEO, the CFO and any one of the Non-executive Directors that chair the Audit Committee, Remuneration Committee or Risk & CSR Committee. The role of the Committee is, on an ad hoc basis, to determine whether information is inside information which would require disclosure, and to make recommendations as to when that information should be disclosed, in accordance with regulatory requirements. In addition, a meeting of the Disclosure

Committee is held after each Board meeting, with all Board members in attendance, which reviews the work of the executive-level Disclosure Panel that has taken place since the previous Board meeting.

The full terms of reference of each Committee can be found in the Governance section of the QinetiQ website at www.QinetiQ.com/about-us/corporate-governance.

A report in respect of each of the five principal Committees is set out in this report on the pages noted in the index on page 39. The details of attendance at Committee meetings are set out in the table on the previous page.

The relevant Code disclosures in respect of the Remuneration Committee are set out in the Directors' remuneration report on pages 68 to 91 and are incorporated into this Corporate governance statement by reference.

“ Executive Committee members and members of the senior management team present to the Board and the Board Committees on key matters. ”

The Executive Committee

The Executive Committee comprises the CEO, CFO, the MDs of the business groups and functional heads. The full list of members can be found in the Governance section of the QinetiQ website at www.QinetiQ.com/about-us/corporate-governance and as at the date of this report is as set out in the table below:

Executive Committee membership:

Steve Wadey	Chief Executive Officer
David Smith	Chief Financial Officer
Jon Messent	Company Secretary & Group General Counsel
John Anderson	Managing Director, Air & Space
Ian Beresford	Group Director, Engineering & Operations
David Bishop	Group Director, Investor Relations & Communications
Michelle Cummins	Group Director, Human Resources
Iain Farley	Managing Director, International
Sarah Kenny	Managing Director, Maritime, Land & Weapons
Jamie Pollard	Chief Executive Officer, OptaSense
Neville Salkeld	Group Director, Strategy & Planning
Andy Thorp	Group Director, Business Development
Vicky Weise	Chief of Staff
Jeff Yorsz	President, QinetiQ North America

During the year under review, the Committee met on a two-weekly basis, and reported via the Chief Executive Officer to the Board. Its focus continued to be on the achievement of the Group's strategic goals in respect of growth and operational excellence, with an ongoing consideration of governance issues. The Executive Committee received, discussed and acted upon subject presentations on health, safety and environment, risks and opportunities, trade controls, business ethics, security and General Compliance matters. It was responsible for the day-to-day management of the Group's activities, with the exception of QinetiQ North America (which is managed through the Proxy Board, as described on page 57 in the section headed 'Management and control of US subsidiaries') and the oversight of the risk management process and its implementation by the businesses and functions.

The Group uses a number of different committees to monitor and drive operational excellence and to ensure appropriate actions are taken to deliver the strategy. These committees are split between strategic and operational focus.

In addition, the Executive Committee has set up a number of sub-committees to drive integration, alignment and monitoring of policies and processes across the Group, to ensure functional excellence and best practice. Each sub-committee is led by a member of the Executive Committee and comprises representatives from relevant businesses and functions.

Communication between the Board and the Executive Committee

The Executive Directors and Company Secretary are members of the Executive Committee and are involved in the day-to-day management of the Group's business, operations and underlying committees. Other Executive Committee members and members of the senior management team present to the Board and the Board Committees on key matters. This interaction enables the Board to receive information first-hand about the Company and its operations and to give guidance on strategy and oversight of the business direct to senior management.

Board of Directors

The Board represents the interests of QinetiQ and its shareholders.



Mark Elliott, Non-executive Chairman

Appointed in June 2009; elected Chairman in March 2010.

N **R** **RC**

Skills and experience: Mark has experience of a variety of industry sectors from membership of the boards of FTSE listed companies.

Mark was a Non-executive Director of G4S plc, where he was the Senior Independent Director and Chairman of the Remuneration Committee, from September 2006 until May 2016. He was a Non-executive Director of Reed Elsevier Group plc (and also Chairman of its Remuneration Committee) and Reed Elsevier NV from April 2003 until April 2013. He worked for IBM for over 30 years where he occupied a number of senior management positions, including General Manager of IBM Europe, Middle East and Africa and was a member of IBM's worldwide Management Council.

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



Steve Wadey, Chief Executive Officer

Appointed in April 2015.

N **RC** **S**

Skills and experience: Steve has in-depth experience of the defence industry and technology, and extensive operational and corporate experience and stewardship. He is a Fellow of the Institution of Engineering and Technology, a Fellow of the Royal Aeronautical Society and a Fellow of the Royal Academy of Engineering.

He was previously Co-chair of the UK Defence Growth Partnership, a member of the Prime Minister's Business Advisory Group, Co-Chair of the National Defence Industries Council Research and Development Group and a Non-executive director of the UK MOD Research and Development Board. Steve held various roles with MBDA from 2001 to 2014, most recently as Managing Director, MBDA UK and Technical Director for the MBDA Group. Before that, he held various roles in engineering with Matra BAe Dynamics from 1996 to 2001, and various roles with British Aerospace held from 1989 to 1996.

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



Admiral Sir James Burnell-Nugent, Non-executive Director

Appointed in April 2010.

A **N** **R** **RC** **S**

Skills and experience: Sir James has significant experience of the defence industry, contracting with government and management.

Sir James was High Sheriff of Devon during 2015. During a 37-year career in the Royal Navy, which culminated in his appointment as Commander-in-Chief Fleet, he commanded the aircraft carrier HMS Invincible and three other ships and submarines. Between operational duties, Sir James held several positions at the MOD and gained cross-Whitehall experience while on secondment to HM Treasury.

Other appointments: Sir James is the Non-executive Chairman of Witt Limited.



Ian Mason, Non-executive Director

Appointed in June 2014.

A **N** **R** **RC** **S**

Skills and experience: Ian has considerable experience in strategy, business transformation, eCommerce and international development.

He was Group Chief Executive of Electrocomponents plc from 2001 until 31 March 2015, having joined that company in 1995. Previously he worked for The Boston Consulting Group and was a Non-executive Director of the Sage Group plc from 2007 to 2013.

Other appointments: In October 2016, Ian was appointed Chief Executive Officer of Domestic & General Insurance Limited.

Committee membership key

- A** Audit
- N** Nomination
- R** Remuneration
- RC** Risk & CSR
- S** Security
- Committee Chairman


David Smith, Chief Financial Officer

Appointed in March 2017.

RC S

Skills and experience: David has extensive executive experience in blue-chip companies and has worked in the aerospace and defence, technology and automotive sectors. David is an Associate of the Chartered Institute of Management Accountants and a member of its Advisory Panel.

Before joining QinetiQ, David was Chief Financial Officer and a director of Rolls-Royce Holdings plc from November 2014, having joined that company in January 2014 as Chief Financial Officer of the Aerospace Division. Prior to Rolls-Royce, David was Chief Financial Officer and a Board member of Edwards Group from 2010 to 2013. David was Chief Executive Officer of Jaguar Land Rover from 2008 to 2010, having been Chief Financial Officer and Interim CEO in 2008 and, from 1983 to 2008, held a variety of roles with Ford Motor Company. During the year under review, David ceased to be an Advisory Board member for the Warwick Business School.

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


Michael Harper, Deputy Chairman and Senior Independent Non-executive Director

Appointed in November 2011; elected Deputy Chairman and Senior Independent Non-executive Director in February 2012.

A N R RC S

Skills and experience: Michael has a wealth of operational and corporate experience and stewardship, including in the engineering sector.

Michael was Chairman of Ricardo plc from November 2009 until November 2014, having joined that Board in 2003, Chairman of BBA Aviation plc from June 2007 until May 2014 and CEO from February 2006 until June 2007, having joined that Board in 2005, and Chairman of Vitec Group plc from 2004 to 2012. He was Senior Independent Director of Catlin Group Limited from 2005 to 2011. Michael was previously a Director of Williams plc where, at the time of the demerger in 2000, he became CEO of Kidde plc.

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


Lynn Brubaker, Non-executive Director

Appointed in January 2016.

A N R RC

Skills and experience: Lynn has considerable experience in the international aerospace industry, including responsibility for business development, strategy, operational and manufacturing issues. She has a strong track record of running international operations, as well as experience of businesses in which technology and intellectual property are important.

Previously, Lynn was a Non-executive Director of Force Protection, Inc., Seabury Group, Graham Partners, Cordiem, Chairman of the Flight Safety Foundation, and a member of the Management Advisory Council of the Federal Aviation Administration. Lynn retired from Honeywell International in 2005, where she was Vice President and General Manager of Commercial Aerospace. Prior to that, she held a variety of roles in the commercial aerospace sector working for Allied Signal (which acquired Honeywell in 1999), the McDonnell Douglas Corporation, Republic Airlines and ComAir Airlines.

Other appointments: Lynn is a Non-executive Director of FARO Technologies Inc., Hexcel Corp. and The Nordam Group.


Paul Murray, Non-executive Director

Appointed in October 2010.

A N R RC S

Skills and experience: Paul has a broad range of experience in finance and corporate governance from a cross-section of industries, all of which leverage technology.

Previously, Paul was a Director of Knowledge Peers plc, Senior Independent Director of Taylor Nelson Sofres plc, a Non-executive Director of Thomson SA and Tangent Communications plc, and has also been Group Finance Director of Carlton Communications plc, Group Finance Director of LASMO plc and a Trustee of Pilotlight. During the year under review, Paul ceased to be a Director of Independent Oil and Gas plc.

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


Susan Searle, Non-executive Director

Appointed in March 2014.

A N R RC S

Skills and experience: Susan has extensive experience of investing in growing technology businesses, acquisitions, intellectual property and exploitation of new technologies.

She was a founder of Touchstone Innovations plc (formerly Imperial Innovations Group plc), leading it as CEO from 2002 to July 2013, and previously has served on a variety of private company boards in engineering, healthcare and materials. Susan was a Trustee of Fight for Sight from 2013 to 2016. During the year under review, Susan ceased to be a member of the international advisory board of PTT. Susan held a variety of commercial and business development roles in her early career with Shell Chemicals, the Bank of Nova Scotia and Montech (Australia).

Other appointments: Susan is the Senior Independent Non-executive Director and Chair of the Remuneration Committee of both Benchmark Holdings plc and Horizon Discovery Group plc. She is Chair of Woodford Patient Capital Trust plc and Chair of Mercia Technologies plc (and Chair of its Nominations Committee), having been previously Deputy Chair and Chair of the Audit Committee.


Jon Messent, Company Secretary and Group General Counsel

Appointed in January 2011.

Appointment to the Board: Appointed as Company Secretary and Group General Counsel in January 2011.

Skills and experience: Jon Joined QinetiQ from Chloride Group plc where he held a similar role. He has a background in legal private practice as well as general counsel and company secretarial experience in other FTSE250 companies.

Code Principle B – Effectiveness

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The 2017 review being carried out internally by way of a questionnaire completed by Board members.

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Board performance evaluation

As noted on page 42, an evaluation of the performance of the Board, its Committees and individual Directors, is carried out annually, with an external, independent, review in each third year. An external review took place in 2016, with the 2017 review being carried out internally by way of a questionnaire completed by Board members.

Set out below are details of, and progress against, the key findings of the 2016 review. Set out on the next page are details of the 2017 evaluation process, its key findings and the priorities for the coming year.

Progress against prior year review

The key findings of the prior year external evaluation review and progress against them are as follows:

	Key findings	Action taken
1	The Board requested a review of its annual agenda, in order to ensure focus on issues of strategy while maintaining the requisite reporting rigour on operational and governance activity, and fulfilling the Company's governance responsibilities.	The schedule of Board agenda items for the year was reviewed during the year. In addition to Standing and Governance items, the Board would also follow a timetable of deep dive subject reviews, and Executive Committee members would be attending Board meetings to present on these. Further, the format of the CEO and CFO report to the Board was updated during the year to provide more detail on customer engagement and on progress against strategic goals and the growth strategy, as noted on page 44.
2	The Board requested greater oversight of HR policy and the development of a more in-depth understanding of the management of employee engagement, performance management, diversity and succession planning.	At the September Board meeting, the Group Director, HR presented a report on HR processes, with particular emphasis on the challenges presented by the organisational design aspect of the ongoing transformation programme, the matrix structure, details of the leadership development programme and activity with regard to gender pay legislation. An HR review process was put in place and its progress would be monitored.
3	Reviewing Executive Committee succession planning.	As noted on page 45, at the October Board strategy meeting, the CEO and Group Director, Human Resources gave a presentation on HR strategy, talent management and succession planning.
4	Reviewing the Board's composition and skills.	The format of the Board skills matrix was reviewed, revised and updated during the year, following a review by the members of the Board in conjunction with the Company's recruitment advisors.
5	Reviewing risk management and reporting processes.	The Board reviewed and approved a revised and updated Group Risk Register at its September meeting, and will consider its effectiveness during the financial year ended 31 March 2018. Further details can be found in the report of the Risk & CSR Committee on page 66.
6	Ensuring further interaction with the leadership community and senior executives during the year.	As noted in item (1) above, Executive Committee members would be attending Board meetings to discuss deep dive topics, and business growth would be discussed at each Board meeting. In addition, as noted on page 44, Non-executive Directors have attended each of the quarterly extended leadership meetings run by the Executive Committee and which are attended by approximately 100 senior leaders within the Group.

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The overall conclusion of the 2017 review was that the Board was satisfied that the performance of the Board had improved and it continued to be effective in executing its duties.

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2017 Review process

The review in respect of the 2017 financial year took place in the final quarter of the year and consisted of a series of externally-provided questionnaires in respect of each of the Board and its Committees and the Chairman, which were completed by each Director and the Company Secretary. In order to obtain a complete overview of the workings of the Board and its Committees, the Committee questionnaires covered time management and composition, Committee processes and support, the work of the Committee and priorities for change. The Board questionnaire covered composition, expertise, dynamics, management of meetings, support, Board Committees, focus of meetings, strategic oversight, risk management and internal control, succession planning and human resource management, and priorities for change.

Respondents were encouraged to include illustrative comments with their feedback.

Key findings

The results of the review were presented by the Chairman at the Board's March meeting. The overall conclusion of the 2017 review was that the Board was satisfied that the performance of the Board had improved and it continued to be effective in executing its duties.

The Board composition, expertise, interaction with management, oversight of strategy, risk and succession planning were all highly rated, with an area for improvement identified as better management reporting (in terms of length of reports and the use of executive summaries).

Succession planning for the members of the Board was identified as a top priority, with the possible addition of greater international experience to align with QinetiQ's strategic goals. The level of interaction between the Board and senior management in Board meetings, in the business and in informal/social settings was highly valued.

The management of the Board's annual cycle of work, the agenda for Board meetings, the time and input during the meetings, and the quality and frequency of presentations made by management to the Board were positively rated. Further work was required to standardise the format and length of management reports and the inclusion of executive summaries.

The importance of the Board monitoring progress made against the strategy was noted and the Board's oversight of various aspects of risk management and internal control was rated highly, as was the oversight of the company's health and safety performance.

Priorities for the coming year

The Board's priorities for the coming year were identified as:

- i) succession planning and longer-term Board composition to support implementation of strategic goals;
- ii) a continued focus on strategy, and its implementation
- iii) monitoring the effectiveness of the executive management team
- iv) ensuring effective emphasis on governance matters;
- v) defining, developing and monitoring cultural development and change; and
- vi) continuing with the implementation of the proposals from the 2016 review.

Details of the outcomes of the effectiveness reviews for the following committees can be found in the individual Committee reports, as follows: Audit Committee – page 62, Risk & CSR Committee – page 66, and Remuneration Committee – page 82.

Code Principle B – Effectiveness continued

Report of the Nominations Committee.



Mark Elliott
Nominations Committee Chairman

Key points:

- Six meetings during the year
- Change of CFO
- Succession and development planning.

Dear shareholder,

During the year under review, the Nominations Committee focused on succession planning and a review of the balance of skills, background and experience of the Board. The Committee oversaw the appointment of David Smith as the new CFO, following the resignation of David Mellors. Board diversity and succession planning will remain key priorities for the coming year.

Mark Elliott

Nominations Committee Chairman

Main responsibilities

The role of the Committee is to ensure that the composition of the Board and Committees comprises the optimum balance of skills, knowledge and experience, and to oversee succession planning for the Board and senior management. It considers diversity, including skills mix, international industry experience and gender, when seeking to appoint a new Director to the Board. The Committee's full terms of reference can be found in the Governance section of the QinetiQ website at www.QinetiQ.com/about-us/corporate-governance.

The Committee meets as necessary and when called by its Chair. During the financial year ended 31 March 2017, the Committee met on six occasions.

Overview

Key activities during the year were as follows:

- a) Change of Chief Financial Officer;
- b) Succession and development planning for senior management immediately below Board level, i.e. at Executive Committee level; and
- c) Board succession planning, and in particular settling upon the skills required in current and future Non-executive Directors to support the Company's strategic intent, and corporate governance requirements.

(a) Change of Chief Financial Officer

A sub-committee comprising the Chairman, Senior Independent Director and CEO was set up in June 2016 to deal with the change in CFO. The CEO, in conjunction with the Group Director, HR, prepared a role specification and conducted a review of potential recruitment consultants. Three potential search partners were shortlisted and, in July, the CEO reported to the Committee that Russell Reynolds had been appointed, due to their in-depth knowledge and experience of CFO recruitment. Russell Reynolds had no other connections with the Company. The Committee agreed at its meeting in July that the CEO would work with Russell Reynolds to produce a final shortlist of candidates for review at the Committee's September meeting. A shortlist of four potential candidates was put forward and a preferred candidate identified. The preferred candidate met with the CEO, the Audit Committee Chair and the Chairman. At its September meeting, the Committee considered the appointment and made a recommendation to the Board of the proposed appointment, which was then approved.

(b) Succession and development planning for senior management immediately below Board level, i.e. at Executive Committee level

The Committee continues to maintain oversight of the processes for ensuring that succession plans are in place for the top layer of management, with a focus on improving the talent pipeline and diversity. This process includes ensuring that the Board as a whole meets with senior management, that remuneration policy and long-term incentives for senior management are reviewed by the Remuneration Committee and that the Chairman works with the CEO to review succession planning and to ensure the right mix of skills and experience at the executive level. During the year

Target

25%
of board women

Currently

22%
of board women

under review, the Committee and the Board were updated by the CEO and the Group Director, HR, on HR strategy, including details of leadership skills required, leadership and career development activity, and succession planning for the Executive Committee and senior management. The strengths of, and development opportunities for, Executive Committee members were considered and agreed.

(c) Succession planning at Non-executive Director level

As noted on page 50, an action arising from the Board's 2016 annual effectiveness review was to review the Board's composition and skills to ensure the right balance of skills and experience as the Company evolves in pursuit of its strategic objectives. The Chairman and the CEO began this process and a skills matrix was formulated for consideration by all members of the Board. At the Committee's January meeting, the form of the matrix was agreed and circulated to the Board for completion, in readiness for the Committee's March meeting. The matrix was split between three key areas, (i) personal qualities, including a range of skills and behaviours; (ii) foundation skills, including business experience, mergers and acquisitions, financial and governance; and (iii) markets experience, including government, defence, security and other commercial areas. Each of the three areas was given a weighting and a rating as to current and future requirements, with an opportunity to add comments.

The outcome from the skills matrix was considered at the Committee's meeting in March 2017. In particular, it was noted that personal qualities remained very important, with strategic thinking of particular importance, and that business experience would become more important in the future, in terms of business development. The outcome of the review will be instrumental in the process for identifying future Non-executive Director appointments.

At its meeting in March 2017, the appointment and retirement dates of Non-executive Directors were considered, so that an appropriate calendar of activity can be prepared for timely succession planning. These dates are detailed below.

Board Diversity Policy

The Board Diversity Policy was approved by the Board in 2013. The key statement and objectives of that policy (the full text of which is available on the QinetiQ website www.QinetiQ.com/about-us/corporate-governance) are as follows:

Statement:

The QinetiQ Board recognises the benefits of diversity. Diversity of skills, background, knowledge, international and industry experience, and gender, amongst many other factors, will be taken into consideration when seeking to appoint a new Director to the Board. Notwithstanding the foregoing, all Board appointments will always be made on merit.

Objectives:

The Board should ensure an appropriate mix of skills and experience to ensure an optimum Board and efficient stewardship. The Board should ensure that it comprises Directors who are sufficiently experienced and independent in character and judgement.

The Board aimed to increase the proportion of women on the Board to 25% by 2015. Thereafter, the Board aimed to maintain a minimum Board composition of 25% women, such percentage to be reviewed annually.

Progress against the policy:

Having previously met the 2015 target of 25% of the Board comprising women, changes since then led to a reduction in this proportion. Following the appointment of Lynn Brubaker in January 2016, the proportion of women members of the Board increased to 22%, which is working towards the Board's original objective of 25%. The Committee notes the recommendation in the five-year review of the Davies report to achieve a minimum representation of 33% by 2020.

Gender and ethnic diversity will be taken into consideration for all future Board appointments, with the proviso that future appointments will be made on merit, and will continue to take into account diversity in its broader sense, to ensure an appropriate mix of skills, background and experience as identified from the Board skills review.

Details of Company-wide diversity and inclusion activity can be found in the People and relationships section on page 31.

Succession planning: Non-executive Director appointment and retirement dates

Name	Appointment date	6-year date	9-year date	AGM Retire date
Mark Elliott	1 Mar 2010 (as Chair)	1 Mar 2016	1 Mar 2019	July 2019
Admiral Sir James Burnell-Nugent	10 Apr 2010	10 Apr 2016	10 Apr 2019	July 2019
Paul Murray	25 Oct 2010	25 Oct 2016	25 Oct 2019	July 2020
Michael Harper	22 Nov 2011	22 Nov 2017	22 Nov 2020	July 2021
Susan Searle	14 Mar 2014	14 Mar 2020	14 Mar 2023	July 2023
Ian Mason	3 June 2014	3 June 2020	3 June 2023	July 2023
Lynn Brubaker	27 Jan 2016	27 Jan 2022	27 Jan 2025	July 2025

Code Principle C – Accountability

“

The Board routinely challenges management to ensure that the systems of internal control are constantly improving to maintain their effectiveness.

”

Board oversight of risk management

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

At its meeting in March 2017, the Board reviewed the effectiveness of the system of internal control that was in operation during the financial year ended 31 March 2017. Details of specific risk review activity undertaken during the year by the Executive Committee, the Audit Committee and the Risk & CSR Committee, together with the current risk registers, were presented by the CEO.

The following activity was noted at that review:

Executive risk review

- Risk owners had reviewed and updated their risks prior to review by the Executive Committee.
- Executive Committee formal risk reviews had been undertaken at four meetings during the year.

Board Committee risk review

- The Audit Committee had undertaken a detailed review of the financial risk register at two meetings during the year.
- The Risk & CSR Committee had reviewed the non-financial risk register at four meetings during the year.
- The Risk & CSR Committee had undertaken deep dive reviews into specific risks through the year.

Update to risk reporting format

- A revised risk reporting format had been prepared and reviewed by the Audit Committee, Risk & CSR Committee and Executive Committee. Following various revisions, it had been approved and implemented during the year under review. Details of the work of the Risk & CSR Committee in respect of the review of risk management and its reporting can be found in the report of the Risk & CSR Committee on page 66.

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

Committee oversight of risk management

The risk management process and the system of internal control necessary to manage risks are managed by the Audit Committee (financial risks) and the Risk & CSR Committee (non-financial risks). The full Board attends these Committee meetings, either as a Committee member or as a guest so as to receive at first-hand the findings of the Committee. Details of the Committee memberships are set out on page 46. The internal audit function independently reviews the risk identification and control processes implemented by management, and reports to the respective Committee.

The Audit Committee and the Risk & CSR Committee also review the assurance process, ensuring that an appropriate mix of techniques is used to obtain the level of assurance required by the Board. The reports of both Committees can be found on pages 59 and 64 respectively.

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

Internal audit function

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

Board statements relating to risk management

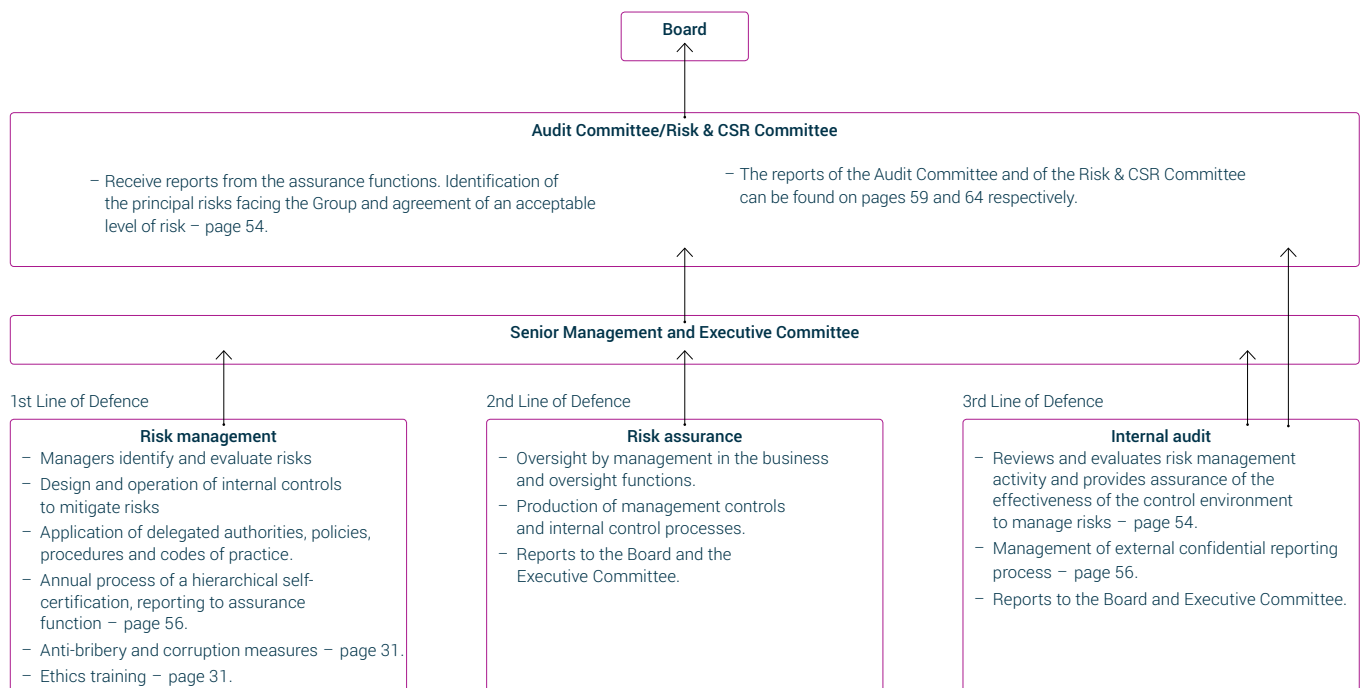
Board statements relating to the ‘fair, balanced and understandable assessment’, principal risks, the effectiveness of the risk management and internal control process, and going concern statement, can be found on page 58. The longer-term viability assessment can be found in the Strategic report on page 22.

Risk management and assurance activity

– Three lines of defence model

Risk management and assurance activity conforms to the three lines of defence model as detailed on page 55. The first line of defence is performed by the businesses, through managing activities in accordance with established operating principles; the second line of defence is performed by the oversight functions, including the safety and governance team; and the third line of defence is performed by the internal audit team, reporting to the Executive Committee, to the Board’s Audit Committee in respect of financial risks, and to the Board’s Risk & CSR Committee in respect of non-financial risks.

Three lines of defence model



Details of key strategic and operational risks can be found in the Strategic report on pages 22 to 25, details of the assurance process in respect of financial reporting and the preparation of consolidated accounts can be found on page 56, and details of risk management and assurance activity in respect of US subsidiaries within the requirements of the US National Industry Security Program can be found on page 57.

Review of significant risks

The Board, the Audit Committee and the Risk & CSR Committee regularly review significant risks to the business. Significant risks are risks, both financial and non-financial, which are related to the achievement of business objectives. They are identified, evaluated and mitigated by QinetiQ's managers and are assessed on a continual basis. They may be associated with a variety of internal and external events, including control breakdowns, competition, disruption, regulatory requirements, and natural and other catastrophes. Managers are responsible for the implementation of suitable internal controls to ensure effective mitigation.

Internal control system

QinetiQ's businesses are responsible for ensuring that a robust risk and control environment is in place as part of their day-to-day operations. Management in the business oversee this process and a clear set of delegated authorities is in place, covering financial and non-financial activities, and is consistent with effective operational control and risk management and the Board's risk appetite. Key business policies, procedures and codes of practice, together with the Company's Code of Conduct, are available on the Company's intranet and apply to every employee within the QinetiQ Group, including all subsidiaries, with the exception of Foster-Miller, Inc., due to the proxy arrangement as detailed on page 57. Foster-Miller, Inc. is, however, an active and supportive participant in this overall framework and their President is a member of the Executive Committee.

Code Principle C – Accountability continued

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

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Risk assurance activity during the year

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

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

Self-certification process

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

Risk management and internal control:

Financial reporting process

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

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

The Company operates a financial management and control framework, comprising a system of targets, reporting (external and internal) and controls, that is embedded throughout the businesses and on which progress is reported to the Audit Committee and to the Board. The finance function consists of different financial reporting teams who report to the CFO. The Group Finance team comprises suitably qualified and experienced professionals, including accountants. It is

responsible for the preparation of the half-year and annual reports and for internal financial reporting to senior management and the Board. To ensure a consistency of approach and accuracy in financial reporting, the team provides advice on accounting and financial reporting issues to QinetiQ's businesses and sets the Group's accounting policies which are contained in the Finance Accounting Manual. The team liaises with the external auditor.

The internal control and risk management systems described on pages 54 to 57 apply to the Company's process of financial reporting and the preparation of consolidated accounts. The internal audit and external audit functions, and the reviews by the Audit Committee and the Board, provide a structured approach to the review and challenge of financial information and financial reporting. The report of the Audit Committee can be found on page 59 and the work of the Board in respect of financial oversight can be found on pages 45 and 54.

Employee reporting and guidance:

Confidential reporting process

QinetiQ has in place a confidential reporting process which is detailed on the Company's intranet. If an individual does not feel that they can resolve any concerns with the Company directly, either through discussions with their line manager or directly with the Company Secretary or Group Internal Audit Manager, they can use an externally provided confidential internet and telephone reporting system, as noted in the People and relationships section on page 31. All concerns are passed by the external third party to the Group Internal Audit Manager who will ensure that they are held in strict confidence and are properly investigated. Reports on confidential reporting activity and the outcome of investigations are regularly reported to the Audit Committee. The Audit Committee reviewed the effectiveness of the Group's confidential reporting process during the year, as noted on page 60.

Anti-bribery and the prevention of corruption

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

Ethics

The Company provides employees with guidance to assist them in making informed ethical decisions on a day-to-day basis, including the Company's Code of Conduct, mandatory annual ethics training for all employees and the Company's Directors, and links to the country risk table and review panel processes for doing business in high risk countries. Further details can be found in the People and relationships section on page 31.

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It has been placed under a Proxy arrangement as it is required by the US National Industrial Security Program

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Management and control of US subsidiaries

The US Global Products division, trading as QinetiQ North America, which contributed approximately £70m to the Group's revenue in 2017, operates under a Proxy arrangement, as detailed below, with the remainder of the US business operating outside the Proxy regime and therefore following the same reporting lines and processes as the Group's other, non-regulated businesses.

US Global Products division and the Proxy arrangement

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

The current Proxy holders comprise David Carey, John Currier, Tom Mills and Scott Webster and have all been in office during the year under review. The Proxy holders are also Directors of FMI, with David Carey as Chairman. In addition to their powers as Directors, the Proxy holders have power under the Proxy arrangements to exercise all prerogatives of share ownership of FMI. The Proxy holders have a fiduciary duty, and agree, to perform their role in the best interests of QinetiQ as shareholder (including the legitimate economic interest), and in a manner consistent with the national security interests of the US. QinetiQ Group plc does not have any representation on the Board of FMI. QinetiQ Group plc may not remove the Proxy holders other than for acts of gross negligence or wilful misconduct or for breach of the Proxy agreement (and always only with the consent of the US Defense Security Service).

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

- sell or dispose of, in any manner, capital assets or the business of FMI;
- pledge, mortgage or encumber assets of FMI for purposes other than obtaining working capital or funds for capital improvements;
- merge, consolidate, reorganise or dissolve FMI; and
- file or make any petition under the federal bankruptcy laws or similar law or statute of any state or any foreign country.

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

The Company maintains its involvement in FMI's activities through normal business activity and liaison with the Chair of the Proxy Board. QinetiQ's CEO and/or CFO attended four meetings of the Proxy Board during the year under review. In addition, the March Board and Committee meetings were held at the FMI site in Waltham. Members of the local leadership team met with Board members and attended part of the Board meeting, and the Board went on a site visit and met local employees.

The President of FMI is a member of the Executive Committee (as detailed on page 47). FMI commercial and governance activity is included in the business update provided in the regular executive report to the Board. This activity is subject always to the confines of the Proxy regime to ensure that it meets the requirement that FMI must conduct its business affairs without external control or influence, and the requirements necessary to protect the US national security interest.

Code Principle C – Accountability continued

Board statements relating to risk management.

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The Group continues to adopt the going-concern basis in preparing its financial statements.

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

All of the Directors consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy. In this context, the coordination and review of the Group-wide input into the Annual Report is a vital part of the control process upon which the Directors rely and is an exercise which spans a period wider than the timetable for compiling the Annual Report itself. Critically these processes include the controls the business operates throughout the year to identify key financial and operational issues. Further details can be found in the report of the Audit Committee on page 61.

Board assessment of principal risks

The Board confirms that it has carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity. The way in which the Board understands and manages risk is set out on pages 54 to 66 and details of principal risks and their management and mitigation can be found on pages 22 to 25. Board level oversight is carried out by the Audit Committee and the Risk & CSR Committee. At its meeting in March 2017, the CEO presented details of the risk review activities that had taken place during the year.

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

The Board confirms that it has conducted a review of the effectiveness of the Company's risk management and internal control systems in operation during the year, as required by the Code. The Board considers that the risk review activities undertaken during the year under review, as presented by the CEO at the Board's March meeting, amounted to an effective system being in place to ensure that all aspects of risk management and internal control had been considered for the year under review. Details of the Company's principal risks and uncertainties and how they are managed and mitigated can be found in the Strategic Report on pages 22 to 25. Details of the Company's risk management and internal control systems are set out in this Corporate governance statement on pages 54 to 66, and the reports of the Audit Committee and Risk & CSR Committee in respect of the oversight of risk management can be found on pages 59 and 64 respectively.

Going concern

The Group's activities, combined with the factors that are likely to affect its future development and performance, are set out on pages 2 to 37. The Chief Financial Officer's review on pages 34 to 37 sets out details of the financial position of the Group, the cash flows, committed borrowing facilities, liquidity, and the Group's policies and processes for managing its capital and financial risks. Note 26 on page 129 to the financial statements also provides details of the Group's hedging activities, financial instruments, and its exposure to liquidity and credit risk.

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

The Group is exposed to various risks and uncertainties, the principal ones being summarised in the 'Principal risks and uncertainties' section on pages 22 to 25. Crystallisation of such risks, to the extent not fully mitigated, would lead to a negative impact on the Group's financial results but none are deemed sufficiently material to prevent the Group from continuing as a going concern for the next 12 months.

Report of the Audit Committee



Paul Murray
Audit Committee Chairman

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

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Dear shareholder,

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

The main responsibilities of the Committee are set out in this report. In addition to reviewing the Group’s financial reporting processes and external audit effectiveness, two key areas that the Committee considered during the year were (i) a review of the process for risk management and reporting, in conjunction with the Risk & CSR Committee, in response to the outcome from last year’s review of the effectiveness of the Board and its Committees. Further details are set out in the report of the Risk & CSR Committee on page 66 and the Committee reviewed the new process/format at its March 2017 meeting; and (ii) to initiate and oversee an audit tender process for the appointment of the external auditor, of which further details can be found in this report. After the successful conclusion of the tender, the Board approved the appointment of PricewaterhouseCoopers LLP as the external auditor for the financial year ending 31 March 2018, to succeed KPMG LLP. I would like to thank all of the audit firms for their professionalism and work in the audit tender process, and also the team at KPMG who have worked closely with the Committee over many years.

As noted on page 51, an internal review of the effectiveness of the Board and its Committees was carried out during the year. The outcome of the review in respect of the Audit Committee is set out on page 62.

Paul Murray
Audit Committee Chairman

The Audit Committee is chaired by Paul Murray. The Board considers him to have recent and relevant financial experience. He was formerly Group Finance Director of Carlton Communications plc and LASMO plc, and he is currently Audit & Risk Committee Chairman at Royal Mail Group plc. The Board considers the members of the Committee to be independent. They bring extensive experience of corporate management in senior executive positions to the Company. Details of their background and experience can be found on pages 48 and 49. The CEO, CFO, Group Financial Controller, Group Internal Audit Manager and representatives of the external auditor normally attend Audit Committee meetings.

Main responsibilities

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

The Committee’s full terms of reference can be found in the Governance section of the QinetiQ website at www.QinetiQ.com/about-us/corporate-governance.

The Audit Committee meets as necessary and at least four times a year. During the financial year ended 31 March 2017, the Committee met on six occasions.

The external auditor has the right to request that a meeting of the Audit Committee be convened. During the past financial year, and in accordance with its terms of reference, the Committee met with each of QinetiQ’s external auditor and the Group Internal Audit Manager on two separate occasions, without Executive Directors present, to discuss the audit process and assure itself regarding resourcing, auditor independence and objectivity.

Activities during the year

The Committee has an annual calendar of activities, in addition to which it identifies particular areas of focus during the year. During the course of its meetings, the Committee received presentations, reports and analyses from the CFO, the Group Financial Controller, the Group Internal Audit Manager and the external auditor.

The key activities during the year were as follows:

- a) Internal controls (page 60);
- b) Financial reporting: the significant issues considered by the Committee in relation to the preparation and reporting of the full and half-year financial statements, and how these issues were addressed (page assessment of the ‘fair, balanced and understandable’ requirement (page 61);
- c) Audit Committee effectiveness review (page 62); and
- d) External audit:
 - Effectiveness of external audit process (page 62);
 - External auditor independence and the provision of non-audit services (page 63);
 - Review of the effectiveness and the independence of the external auditor (page 63); and
 - External audit tender and the appointment of auditor (page 63).

Code Principle C – Accountability continued

Report of the Audit Committee continued

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During the year under review, the Committee monitored the effectiveness of the systems of internal control to gain assurance that an effective control framework was maintained.

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Other matters considered during the year:

The following matters are examples of items which the Committee considered during the year under review as part of its annual cycle:

- External audit strategy for FY17: The external auditor presented a paper on their FY17 audit strategy. Significant risks to be reviewed included, among others, timing and recognition of revenue and profit, value of goodwill, tax treatments and accounting, and pensions accounting.
- Audit tender process: The Committee was kept informed on the work of the working group it had set up to carry out the audit tender process. A meeting of the Committee was held in January 2017 solely for the purpose of considering the final two candidates and for making a recommendation to the Board. Details of the audit tender process and its outcome can be found on page 63.
- Group tax policy review: The CFO presented a paper to update the Committee on the Group's tax priorities and issues. Various aspects of the Group's R&D expenditure credit claims were discussed. The tax policy was considered to be cautious and the Company was up to date with its tax compliance.
- Annual review of the Committee's Terms of Reference and annual schedule of activities: No changes were made to the Terms of Reference. The annual schedule of activities was updated to reduce the number of meetings in May from two to one.

a) Internal controls:

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

During the year under review, at four meetings, reports on the operation of internal controls and risk management processes, including the confidential reporting process, were received from the internal auditor.

Particular attention was given to the timely and effective implementation of remedial actions, either identified by the business directly, or by the internal audit function, with updates on improvement actions being scheduled for follow-up at a later meeting during the year. The internal audit function's risk based strategic and annual plan was presented to, and scrutinised twice during the year by, the Committee, to provide assurance that resources were adequate and directed towards key risk areas.

The annual plan is structured to ensure that all significant financial and non-financial risks are reviewed within a rolling three-year strategic plan. The audits include the review of financial systems, programmes and projects, as well as the management of specific risks identified through the Group's risk management processes. During the year under review, the internal audit function audited constituent parts of the Group's transformation programme, in line with a programme to support adherence to plans and achievement of outcomes. Other areas of focus during the year were anti-bribery and corruption processes and I.T. risk and control.

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

The Committee also regularly reviews the effectiveness of the financial risk management framework, including reviewing key financial risks and assessing the effectiveness of management's remedial action plans. During the year, the Committee undertook a detailed review of the financial risk register, noting (i) risks being actively managed through internal mitigation activity, including the timeframe for current mitigation to improve the risk position, (ii) risks managed at post-mitigation levels but heavily influenced by external factors and/or that require ongoing monitoring, and (iii) retired risks.

As noted on page 50, following on from the Board effectiveness review, the format for the Group Risk Register and for risk reporting was reviewed by the Board at its September and March meetings respectively. The Board approved a revised and updated Group Risk Register at its September meeting, and the effectiveness of the register will be considered during the financial year ended 31 March 2018.

The process in respect of QinetiQ North America is adjusted to take into account the Proxy arrangements referred to on page 57. The executive management function has regular contact with the Chair of the Proxy Board and with US executive management, and the Group's internal controls have been applied as far as possible within the requirements of the Proxy regime.

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

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

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...the Committee was satisfied that the accounting disclosures and assumptions were reasonable and appropriate for a business of the Group's size and complexity...

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b) Financial Reporting – the significant issues considered by the Committee in relation to the preparation and reporting of the full and half year financial statements, and how these issues were addressed:

The Committee reviewed whether suitable accounting policies had been adopted, whether management had made the appropriate estimates and judgements, and sought support from the external auditor to assess them. To facilitate this process, the Committee received presentations from the CFO and the Group Financial Controller in respect of goodwill, accounting provisions for key contracts, litigation, trade controls and the treatment for taxation. It also received a report from the external auditor on the outcome of the audit.

The Committee reviewed the following main issues for the periods ended 30 September 2016 and 31 March 2017:

- the basis for, and judgements made by management in determining, the liabilities recorded for litigation, onerous contracts, potential claims and other disputes;
- the carrying values of the Group's cash generating units (CGUs), specifically goodwill associated with the US Global Products CGU which had been impaired in the prior year. The major assumptions impacting on the net present value of future expected cash flows were also discussed. Certain discount rate assumptions and market growth forecasts are advised by external consultants;
- assumptions used to value the net pension asset of £156.0m (as advised by the Company's external actuaries);
- a quality of earnings analysis prepared by management;
- the disclosures in the preliminary announcement and annual report and accounts, in particular those relating to non-recurring items (specifically, the £5.2m relating to the release of engine servicing obligations), risk, goodwill and tax;
- the implications of delays to the BEPI-Colombo mission to Mercury programme; and
- the process for making the longer-term viability statement and the assessment of different scenarios that could arise, to enable the Committee to make a recommendation to the Board at its May meeting. Further details can be found on page 22.

The reviews were carried out by way of papers presented by the CFO, the Group Financial Controller, the external auditor and the internal auditor, and through discussions with management. Based upon the business assurance process and discussions with management and the external auditor, the Committee was satisfied that the accounting disclosures and assumptions were reasonable and appropriate for a business of the Group's size and complexity, that the external auditor had fulfilled its responsibilities in scrutinising the financial statements for any material misstatements and that the disclosures were satisfactory.

c) Assessment of the 'fair, balanced and understandable' requirement:

The Committee was required to provide advice to the Board to meet with the requirements of the Code on whether the annual report and accounts, taken as a whole, provide a fair, balanced and understandable assessment of the Company's financial position and future prospects and provide all information necessary to a shareholder to assess the Group's performance, business model and strategy. To enable it to do so, the CFO and members of management presented to the Committee details of the processes followed by management in preparing the accounts. In particular, the Committee noted:

- the Group has developed a clear strategy, which has been presented to the Board for review during the year by business leaders, with updates on progress at each Board meeting;
- monthly business reviews are undertaken by senior management which include monitoring business progress against budget;
- business performance is monitored by the Board as detailed on page 44;
- key individuals from appropriate business divisions and functions contribute to, or are involved in the verification of, the content of the Annual Report;
- the Company has an Annual Report working group, comprising individuals from the Finance, Investor Relations, Assurance, HR, Group Strategy, Company Secretariat and Communications functions, which adheres to a timetable of actions for the production and review of the Annual Report;
- the Annual Report working group is aware of the fair, balanced and understandable requirements and is tasked with ensuring that the Annual Report takes account of those requirements;
- a checklist of considerations to ensure the requirements were met was completed by the working group and presented to the Committee in order to provide assurance to the Committee (and to the Board). The checklist includes areas such as ensuring what must be included to satisfy regulatory requirements, consulting with relevant experienced people to contribute and review each section, avoiding where possible the use of boiler-plate language and jargon, ensuring that all matters are discussed and all issues reported at an appropriate level of aggregation, with tables of reconciliations supported by and consistent with the accompanying narrative. There is an opportunity for contributors to provide comments on areas where there were difficulties or details of specific issues that have been considered; and
- that 'Alternative Performance Measures' are appropriately described and reconciled to 'statutory' measures in the Annual Report and Accounts.

The external auditor confirmed their satisfaction with the standard achieved. The Board's statement in this respect can be found on page 58.

Code Principle C – Accountability continued

Report of the Audit Committee continued

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The transition to a new CFO and external auditor was identified as a key priority for the Committee in the coming year...

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d) Audit Committee effectiveness review:

The Committee's September meeting considered the processes to be followed for the various governance reviews. With regard to the Audit Committee effectiveness review, as reported on page 50, the most recent external effectiveness evaluation of the Board and its Committees took place during 2016 and it was agreed therefore that for 2017, the evaluation of the effectiveness of the Committee would be taken alongside the Board effectiveness review and carried out by way of an externally provided questionnaire-based process.

The following actions had been noted from the 2016 effectiveness review:

- A review of risk management and reporting processes, led by the Chairs of the Audit Committee and the Risk & CSR Committee;
- An update on the processes for the risk management and controls of the US business; and
- To continue with Committee training to keep appraised of legislative evolution and best practice.

These items were covered during the year under review. Details of the risk review can be found in the Report of the Risk & CSR Committee on page 66. The processes for risk management and control of the US business were covered in reports from the internal audit function, and the Committee received updates from the external auditor in respect of financial matters.

As detailed on page 51, the 2017 Board and Committee effectiveness reviews were carried out by way of an externally-provided questionnaire. The Audit Committee questionnaire covered time management and composition, Committee processes and support, the work of the Committee and priorities for change.

The outcome of the review was considered at the Committee's March meeting. The effectiveness of the Committee continued to be rated highly. It was agreed that the Committee should continue with its process and discussion of items, with importance placed on focus and discipline. The transition to a new CFO and external auditor was identified as a key priority for the Committee in the coming year, along with obtaining more insight into any issues created by the ongoing transformation programme, improving the insight provided and ensuring that the reporting focuses the Committee on the key issues.

e) External Audit

Review of the effectiveness of the external audit process

The Committee's September meeting considered the approach for monitoring the effectiveness and independence of the external audit process in the light of the requirements of the Code and Financial Reporting Council guidance. In terms of timing, in previous years, the external audit had still been under way when the effectiveness questionnaire had been issued, with the results of the review being considered at the Committee's May meeting. As this timetable gave little opportunity for the external auditor to respond or correct any issues within the audit cycle, the Committee decided to change the timetable and to undertake the review around June time, by way of a questionnaire-based process, and to report the findings at the September Audit Committee meeting. This would provide an opportunity for any improvements to be put in place in time for the year-end audit. For the purpose of the 2017 year-end, an update was provided at the Committee's May meeting on the actions arising from the 2016 effectiveness review.

The 2016 review had been undertaken by way of questionnaire and had included the views of management and employees who were involved in supporting the external audit work, feedback from the CFO and Group Financial Controller and an open Committee discussion without the external auditor being present.

At the May 2017 meeting, a report was received detailing the improvement actions implemented during the 2017 financial year external audit process which had arisen from the detailed 2016 review questionnaire referred to above, as well as the output from an effectiveness review meeting held between KPMG, Group Finance and Group Internal Audit earlier in the 2017 financial year.

Review by the FRC's Audit Quality Review Team

During the year, the audit of the financial statements of the Group for the year ended 31 March 2016 was subject to a review by the Financial Reporting Council's ('FRC') Audit Quality Review Team ('AQRT'). The Committee did not consider any of the review findings to have a significant impact on KPMG's audit approach.

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The Committee concluded that PricewaterhouseCoopers LLP ('PwC') was the preferred firm to conduct the audit engagement, and that they would bring a fresh approach to the audit...

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**External auditor independence and the provision of non-audit services:
Policy on the regulation of non-audit work and safeguarding auditor independence**

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

The Company has a Code of Practice applicable to all employees which sets out the principles for regulating the award of non-audit work to the external auditor. The Code of Practice clearly articulates the non-audit services which are prohibited, the non-audit services which can be purchased and the key approvals that are necessary prior to the provision of non-audit work. Pursuant to the Code of Practice, any non-audit services conducted by the auditor require the prior consent of the CFO or the Chairman of the Audit Committee; any services exceeding £50,000 in value require the prior consent of the Audit Committee as a whole.

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

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

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

Review of non-audit work during the year

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

In the last financial year, the fees relating to non-audit services amounted to £9,000 (2016: £199,000), being approximately 1% of the audit fee and 1% of the total fees. The fees related to advisory services in respect of business risk assessments. The Committee had concluded, prior to engaging KPMG for the provision of these services, that there had not been any conflict of interest that might compromise the independence of KPMG's audit work. Details of the external auditor's remuneration can be found in note 5 on page 115.

Review of the effectiveness and the independence of the external auditor

At its May meeting, the Committee reviewed the effectiveness and the independence of the external auditor during the year. The members of the Committee have declared themselves satisfied with the performance of KPMG as the Company's auditor in the last financial year.

External audit tender and appointment of auditor

KPMG has been the auditor of the QinetiQ Group since its formation in 2001 pursuant to a competitive tender and is responsible for the audit of the financial statements for the year ended 31 March 2017, following their reappointment at the 2016 Annual General Meeting.

The Company stated in the previous Annual Report and Accounts that it was its intention to align the process for putting the external audit contract out to tender with the conclusion in 2017 of the five-year tenure of the audit partner. The tender process was managed by the Audit Committee and a sub-committee appointed, comprising the Audit Committee Chairman, two Non-executive Directors, the CFO and the Group Financial Controller. A three-stage process was designed and, in June 2016, a notification of interest document and an independence assessment document were issued to interested firms.

Stage 1 required submission of a 'summary information' document and an interview with the sub-committee. A number of audit firms requested one-on-one meetings with the Audit Committee Chairman prior to the Stage 1 submission. These meetings were held in September 2016.

Stage 2 required submission of a detailed, formal proposal document. A virtual data room was made available to the firms containing relevant QinetiQ information, in order to assist with preparation of their proposals. The audit firms were able to interview members of QinetiQ management, to understand the requirements of the role and the complexities of the organisation. This process took place from September to December 2016.

Stage 3 involved presentations and interviews with the sub-committee and took place in January 2017. Criteria considered by the sub-committee as part of the evaluation process included audit effectiveness and approach, commerciality and independence, insight and understanding, perspective on accounting judgements and sector experience.

Following Stage 3, the sub-committee made a recommendation as to first and second choice candidates, with reasons (as required by the regulations) to the Audit Committee at a meeting convened in January 2017 specifically to conclude the audit tender process. The Committee noted the evaluation bases made by the sub-committee and discussed them. The Committee concluded that PricewaterhouseCoopers LLP ('PwC') was the preferred firm to conduct the audit engagement, and that they would bring a fresh approach to the audit, and recommended to the Board that PwC be selected as the Group's external auditor for the year ending 31 March 2018. A resolution to appoint PwC as auditor will be put to shareholders at the Annual General Meeting on 19 July 2017. On behalf of the Committee, I would like to thank all of the audit firms for their professionalism and work in the audit tender process.

Statutory Audit Services Compliance

The Company confirms that, during the year under review, it has complied with the requirements of the Competition and Markets's Authority Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitor Tender Processes and Audit Committee Responsibilities) Order 2014, which relates to the frequency and governance of external audit tenders and the setting of a policy on the provision of non-audit services.

Code Principle C – Accountability continued

Report of the Risk & CSR Committee.



Admiral Sir James Burnell-Nugent
Risk & CSR Committee Chairman

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A series of deep dives are scheduled for the course of each year, to facilitate an in-depth review and discussion of key risks.

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Dear shareholder,

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

In response to the outcome from last year’s review of the effectiveness of the Board and its Committees, the Committee, in conjunction with the Audit Committee, reviewed the process for risk management and reporting. Further details are set out in this report on page 66. The effectiveness of the new process will be monitored during the coming year.

Admiral Sir James Burnell-Nugent
Risk & CSR Committee Chairman

Main responsibilities

The Committee has three primary functions:

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

The Committee’s full terms of reference can be found in the Governance section of the QinetiQ website at www.QinetiQ.com/about-us/corporate-governance.

The Committee meets as necessary, although normally not less than four times a year. During the financial year ended 31 March 2017, the Committee met on four occasions.

Activities during the year

The Committee has an annual calendar of activities, in accordance with which it carries out its core functions by way of regular reporting. In addition, it identifies particular areas of focus (‘deep dives’). The Committee continued to oversee health, safety and environment, trade controls, corporate responsibility, ethics and security through quarterly reports from the heads of those functions in the business. Details of key activities in respect of health, safety and environment and business ethics are set out in the People and relationships section on pages 30 to 33.

In addition, during the year under review, in response to the outcome of last year’s review of the effectiveness of the Board and its Committees, the Committee, in conjunction with the Audit Committee, oversaw a project to review the process for risk management and reporting. Details can be found on page 66.

At each meeting, an introductory note of the key issues for that particular meeting ensured that all relevant matters were considered and dealt with appropriately. In addition, a separate section of the Committee papers contained supplementary materials to ensure that there was sufficient detail for those Committee members who wished to have more in-depth information on a particular matter.

The key activities during the year were as follows:

- a) a review of the Group’s risk management activities (page 65);
- b) a review of the generic MOD compliance system (page 65); and
- c) the outcome of the Committee’s effectiveness review (page 66).

A series of deep dives are scheduled for the course of each year, to facilitate an in-depth review and discussion of key risks. Examples of the deep dives carried out by the Committee during the year can be found on page 65.

“
‘Red’ risks are made the subject of a report to the Committee or become the subject of a deep dive review as part of the Company’s risk management processes.
”

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

Each Committee meeting during the year was structured so that it received the following regular reports: a report from the Group Director, Safety and Governance, a report from the Group Director, Corporate Responsibility and an update from the Group Head of Internal Audit.

The report from the Group Director, Safety and Governance covered key areas of risk management activity, including health and safety and international trade controls. It included a high level summary of changes to non-financial risks, and an overview of assurance activity. In July 2016, an air accident involving a contracted-in Yak aircraft operating in support of the Empire Test Pilots’ School sadly resulted in the death of an RAF pilot and serious injury to the contractor pilot. The Company is actively supporting the subsequent official enquiries, and we will respond to all recommendations made. As part of its work, the Committee has considered, and will continue to consider, the procedural and risk management aspects of this incident. The report from the Group Director, Corporate Responsibility covered areas including business ethics training, emerging reputational risks, anti-bribery and corruption, diversity and inclusion, stakeholder engagement, trading policy and Modern Slavery Act reporting. The report from the Group Head of Internal Audit provided an update on internal audit activity since the last meeting, details of progress with audit recommendations and details of any overdue recommended actions from internal audits.

Details of the principal risks and uncertainties can be found in the Strategic report on pages 22 to 25. ‘Red’ risks are made the subject of a report to the Committee or become the subject of a deep dive review as part of the Company’s risk management processes.

b) Generic MOD compliance system:

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

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

The Board nominates two senior executives to act as Compliance Implementation Director and Compliance Audit Director. Currently those roles are held by the Group Director, Safety and Governance and the Company Secretary and Group General Counsel respectively.

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

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

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

– **Cyber security/I.T. improvement programme**

The Group Director, I.T. presented to the Committee on two occasions during the year. He updated the Committee on the Company’s I.T. security arrangements, including system controls for high security networks, responsibilities for information systems across the Group, details of cyber security-related projects currently under way and steps being taken to improve I.T. systems across the Group. The format for a cyber security dashboard was considered and agreed by the Committee, detailing critical areas of focus, their status and actions or mitigations.

– **Competition law and anti-bribery and corruption**

The Company Secretary and Group General Counsel set out the framework for compliance (including perceived gaps and proposed remedial actions) with respect to each area of legislation. The Head of Business Assurance advised of actions being taken on anti-bribery and corruption compliance within the Group in accordance with an established timetable.

– **Recruitment and retention**

The Group Director, Human Resources updated the meeting on engagement with staff on changes being brought about by the new organisational design programme and the focus being applied to graduate retention and career development.

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

Code Principle C – Accountability continued

Report of the Risk & CSR Committee continued

“

The new reporting process and risk register format were reviewed in conjunction with the Audit Committee in March 2017 and approved.

”

c) Effectiveness review:

As reported on page 50, the most recent external effectiveness evaluation of the Board and its Committees took place during 2016 and it was agreed therefore that for 2017, the evaluation of the effectiveness of the Committee would be taken alongside the Board effectiveness review to be carried out by way of an externally-provided questionnaire-based process.

The following actions had been noted from the 2016 effectiveness review:

- A review of risk management and reporting processes, led by the Chairs of the Audit Committee and the Risk & CSR Committee;
- To continue to focus on the big risk areas;
- To continue with the practice of having a more focused discussion on fewer items, aided by executive summaries;
- To work closely with the Executive Committee and management in respect of risk management activity;
- To continue the practice of deep dives into subject risk areas; and
- To review the Committee's focus on Corporate Responsibility in the light of best practice.

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

The outcome of the 2017 review was considered at the Committee's May meeting and was as follows:

The Risk & CSR Committee was rated highly and the continued separation of financial and non-financial risk into the Audit Committee and Risk & CSR Committee respectively was considered to be working well and created appropriate time to focus on key issues.

The following actions were also agreed for the coming year:

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

Special Project: a review of the risk register and risk management reporting:

The review of the risk register is a standing item on the Committee's agenda, with amendments being made to reflect changes in the Group's business and strategy.

Following the results of the Board and Committee effectiveness reviews, the action to revise and clarify risk management and reporting was carried out jointly by the Chairmen of the Audit Committee and Risk & CSR Committee, in conjunction with the Executive Committee. The Board had requested revisions to the Group Enterprise Risk Reporting document to make clear the changing nature of risks as new elements arise, and specific mitigations are implemented, and thereby highlight areas requiring focus.

A draft revised risk register was presented to the Committee at its July meeting and to the Executive Committee later in July, along with an implementation plan to roll out the new risk reporting format and process. The Executive Committee requested reassurance around briefings to risk owners and leadership teams around the new metrics to be used in the revised format. The Group Director, Safety and Governance confirmed that briefings and support would be provided. The Committee further reviewed the non-financial risk register in September 2016 and January 2017. The Audit Committee undertook a detailed review of the financial risk register in September 2016. In addition, the risk reporting format was updated. Amendments were made to the risk reporting document and the format approved by the Audit Committee and the Board at their September meetings. The Board requested revisions to the Group Enterprise Risk reporting, to convey a dynamic sense of progress and identify areas requiring focus. KPMG were engaged to provide consultation on good practice risk reporting.

The new format was used for the November Audit and Risk & CSR Committee meetings. The new reporting process and risk register format were reviewed in conjunction with the Audit Committee in March 2017 and approved. It was noted that the improvements made to risk management had resulted in a new reporting template, an Executive Committee focused risk review and risk appetite review and new resource to improve tactical risk management.

Report of the Security Committee

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

Membership and attendance during the year

The Security Committee is chaired by Admiral Sir James Burnell-Nugent and the other Committee members during the year were Michael Harper, Ian Mason, David Mellors (until 31 December 2016), Paul Murray, Susan Searle, David Smith (from 1 March 2017) and Steve Wadey.

Main responsibilities

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

Code Principle E – Relations With Shareholders

“Further investor activity included an investor event attended by over 30 analysts and investors at the Farnborough International Airshow in July, and investor visits to QinetiQ sites on request.”

Understanding the views of shareholders

The Chairman proactively offers to attend meetings with key shareholders, and their corporate governance teams, on a regular basis. The Chairman, the Senior Independent Director and Non-executive Directors routinely attend key financial calendar events such as presentations of interim and preliminary results and make themselves available to meet shareholders as required.

The Board as a whole is informed on a regular basis about the views of key shareholders including their concerns. The Group Director Investor Relations and Communications provides regular updates to the Chairman and Non-executive Directors by way of face-to-face briefings, email updates and a section in the Executive Directors' report which is included in the Board papers as a standing item. The following information is included in these reports:

- Investor relations activity (including background information on investor relations activity, share price performance, analyst expectations);
- Shareholder feedback; and
- Peer group news.

Investor relations activity during the year under review

In June 2016, the Chairman wrote to investors offering a meeting with himself and the Senior Independent Director. Subsequent meetings took place with investors and topics covered included both the external context, such as Brexit, and QinetiQ's strategy. Further direct communication was made with investors later in 2016 with regard to the transition to the new CFO, and meetings were held between the new CFO and investors as a result. In 2017, the Senior Independent Director wrote to shareholders as part of the consultation on the renewal of the Company's remuneration policy and has met with investors on this subject.

Investor roadshows were held in London in June and November. Further investor activity included an investor event attended by over 30 analysts and investors at the Farnborough International Airshow in July, and investor visits to QinetiQ sites on request.

Telephone briefings were held with analysts and investors to explain the detail behind key market announcements, such as the amendment to the LTPA contract and the acquisition of the Target Systems business during the year.

The Company updates the market by way of continued quarterly trading updates, in conjunction with key financial announcements and the full year and half-year results. Telephone briefings for analysts and investors took place in conjunction with these dates. Live and post-event webcasts of key presentations are provided in respect of the full year and half-year results.

All shareholders were invited to attend the Company's Annual General Meeting which was held on 20 July 2016 in London, at which the full Board was in attendance.

Providing information to shareholders

The Company sets itself the target of providing information that is timely, clear and concise. Key means of communication are:

- the Annual Report, which sets out the business model and strategy, corporate governance arrangements and financial results;
- announcements made via the Company's website or a regulatory information service;
- responding to environment, social and governance questionnaires;
- results presentations and webcasts; and
- the Company's website, www.QinetiQ.com, and an app for smartphones and tablets. All shareholders and potential shareholders can gain access to the Annual Report, presentations to investors, Annual General Meeting documentation, key financial information, regulatory news, financial calendar, share and dividend data and other significant information about QinetiQ in the 'Investors' section of the Company's website, www.QinetiQ.com. The site also provides contact details for any investor-related queries, by telephone and by email.

The Company continues to look at ways of improving the quality of its engagement with shareholders and to explore with investors any additional practical means by which it can give effect to the requirements of the Financial Reporting Council's UK Stewardship Code for institutional investors, and of the Code.

Details of the Company's share capital, which are required to be disclosed in accordance with rule 7.2.6 of the Financial Conduct Authority's Disclosure Guidance and Transparency Rules, and the Directors' powers in relation to issuing and buying back shares can be found on pages 92 and 94 in the Directors' report section of this Annual Report.

➞ **Further information for shareholders**
can be found on pages 152 to 153 of this Annual Report

Code Principle D – Remuneration

Directors' Remuneration Report (DRR)

Chairman's statement



Michael Harper

Remuneration Committee Chairman

Committee Members

Lynn Brubaker, Admiral Sir James Burnell-Nugent, Mark Elliott, Ian Mason, Paul Murray and Susan Searle.

Chair's statement;
pages 68 to 69.

At a glance; pages 70 to 71.

Remuneration Policy; pages
72 to 81.

Annual Report on
Remuneration; pages
82 to 91.

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

During 2017 the Committee
met five times (detailed
summary of attendance
and activities are provided
on pages 46 and 84).

Dear Shareholder

On behalf of the Board, I am pleased to present the Directors' remuneration report for the financial year ending 31 March 2017.

As the Chairman has outlined in his statement on page 4, the Board has been encouraged by the progress made by the CEO and his new Executive Committee during the year and by the momentum the CEO in particular has given to the development and implementation of our new growth strategy. The progress is evident from the growth in our share price and our improved total shareholder return performance.

Overall, the Remuneration Committee believes that good progress has been made during the year with increased orders and profitability. Overall, the annual contribution to the Bonus Banking Plan pool remains consistent with 2016 – see page 71.

The business context in 2017

Governments across the globe are increasingly seeking to protect their citizens against a variety of security threats. Our expertise in science and technology is particularly relevant in this environment and we play a vital role in linking different technologies and making connections across supply chains and internationally. The implementation of our new strategy, which represents significant change in direction and approach in the complex market of defence is challenging and will take time.

The essence of the business strategy is to grow the Company sustainably over the next five years through transformation which continues at pace, partnering with our customers and investing in organic growth. This organic investment includes internal research and development, complemented by bolt-on acquisitions where there is a strong strategic fit.

Short-term operational excellence is critical and the Remuneration Committee has spent a great deal of time during the year considering the incentive arrangements of the Executive Directors and the top 200 leaders in the Company with a view to ensuring the right balance between rewarding short-term performance and long-term growth. A sharp focus on annual performance will continue to be critical to delivering sustained, longer-term shareholder value.

The new Directors' Remuneration Policy

At the heart of the new policy, the Remuneration Committee is proposing a new approach to incentives which balances reward for incremental annual performance and long-term sustainable shareholder value creation as measured by share price appreciation and a progressive dividend policy. It is the Committee's view that the new five-year strategy requires a bespoke and innovative approach to remuneration.

The approach is designed to:

- Provide a clear link to strategy implementation
- Link short-term and sustained long-term performance; and
- Align the interests of our shareholders and leadership team.

The proposed incentive arrangements are built on the key performance indicators and performance targets which are integral to the five-year Integrated Strategic Business Plan.

During the year we embarked on an extensive consultation exercise with our largest shareholders and their representatives and we have listened carefully to the views we have received. The proposals which we are asking shareholders to vote on at the Annual General Meeting incorporate several design features which some of our shareholders requested during the engagement process. In summary the new policy:

- Reduces the total incentive opportunity from 425% to 325% of salary;
- Reduces the maximum award under the Bonus Banking Plan from 225% to 200% of salary. As now, half the award is deferred into shares and delivered over a four-year period;
- Introduces a new annual Deferred Share Plan equal to 125% of salary all of which is deferred into equity and subject to a three-year performance underpin with a further two-year holding period. This will be used in place of the performance share plan;
- Increases the minimum shareholding requirement for the CEO to 300% of salary and 200% for the CFO from 200% and 150% of salary respectively; and
- Reduces the pension contribution for new Executive Directors to 15% of salary from 25% of salary.

There are no other material changes to the Directors' Remuneration Policy.

“

A number of checks and balances have been incorporated into the incentive arrangements to ensure that they will not reward short-term performance which is not sustained over the longer-term.

”

Aligning the interests of our shareholders and QinetiQ's leadership team

The Remuneration Committee has sought to ensure that the new approach to incentives aligns the interests of our shareholders with those of the top 200 leaders in QinetiQ. A number of checks and balances have been incorporated into the incentive arrangements to ensure that they will not reward short-term performance which is not sustained over the longer term.

The key features of the arrangements which prevent this are:

- The measurement of multi-year performance in respect of shares awarded under the Bonus Banking Plan through the annual forfeiture mechanism;
- The mix of cash and shares awarded in the year is heavily weighted towards shares (circa 70% equity at maximum);
- The long-term performance underpin which will determine whether the Deferred Share Plan shares vest in full at the end of three years;
- The additional 'holding period' in respect of the Deferred Share Plan shares which may only be traded five years after the initial award;
- The stretch of the performance targets – so the performance targets for the Deferred Share Plan are based on our strategic growth plan;
- The transparent disclosure of the performance measures and targets; and
- Increased share ownership requirements.

In summary, the proposed incentive arrangement comprise two elements: the existing Bonus Banking Plan (Element A) and a new Deferred Share Plan (Element B) which replaces the Performance Share Plan. The Bonus Banking Plan (Element A) targets are based on the annual budget whilst the Deferred Share Plan (Element B) targets are based on strategic growth measures. For 2018, the performance measure for the Deferred Share Plan (Element B) is based on improving underlying profit over the previous years outturn with a stretching maximum.

We are aware that the use of operational financial measures and non-financial measures which drive long-term shareholder value is somewhat different from the more standard measures such as Earnings

per Share and Total Shareholder Return performance measures. The design of the incentive arrangements are based on annual and multi-year performance assessment. We believe that we have succeeded in developing arrangements which will reward both short-term performance and sustained, long-term shareholder value.

Employee engagement and reward

All QinetiQ's employees are key to the delivery of the strategy. The CEO and the Group HR Director have introduced regular consultations with our Employee Engagement Group on reward matters including Executive Directors' pay. I have met the Chair of the Employee Engagement Group and it is our intention to meet again prior to the AGM and at appropriate intervals thereafter.

Conclusion

The Committee is presenting a revised Remuneration Policy for shareholder approval at the 2017 AGM and is included in full on pages 72-81. It is also available to view in full on the Company's website www.QinetiQ.com. Further details on the new Deferred Share Plan (Element B) are set out in the Notice of the Annual General Meeting together with a summary description of the Plan's terms and conditions.

I hope that we can rely on your vote in favour of the Annual Report on Remuneration and Remuneration Policy at the AGM on 19 July 2017. I am very grateful for the time shareholders and their representative bodies have given us throughout the consultation process. If you would like to discuss any aspect of this report, I would be happy to hear from you. You may contact me through Jon Messent, Company Secretary and Group General Counsel.

Michael Harper

Remuneration Committee Chairman
25 May 2017

Directors' Remuneration Report continued

At a glance

“
...a year of immense
change delivered
with pace and
determination...
”

How have we performed against our corporate performance objectives?

Embedding our strategy, in tandem with transforming our Company through reorganisation and people development, has seen a year of immense change delivered with pace and determination across the Group.

The diverse challenges and opportunities we face in our markets, our unique heritage, and the deep transformation our organisation is working through, means that we continue to evolve our strategy in a very deliberate way.

Exceeding targets on orders and achieving stretch on operating profit and cash flow is regarded by the Committee as a good result in such a challenging year. The Committee believe that incentivising strategic and operational objectives, which support the financial KPIs, has ensured the Company has progressed both in terms of what was delivered but also how it was delivered.

The collective objectives have seen the CEO, supported by an engaged Executive Committee and Leadership Community, lead on communicating our vision and purpose. The CEO has been visible to both customers and employees alike and he has been a personal sponsor of the Leadership Development Programme which every member of the Executive Committee and Leadership Community has undertaken with hugely positive results. The CEO has also worked very closely with the Board in developing an Integrated Strategic Business Plan which provides the challenge and direction over the next five years.

We set five collective objectives, summarised below, based on securing contracts in certain markets and transforming the organisation. Of the five collective objectives, two were achieved in full, two partially achieved and one not achieved.

The Group Chairman takes responsibility for setting the personal objectives of the CEO and the two critical objectives, summarised below, relate to the development of the five-year Integrated Strategic Business Plan and Leadership Development. The Board is pleased with the excellent progress made against these two objectives.

The following table highlights the performance and remuneration outcomes for the year ended 31 March 2017 with more detail provided in Part 3 of the Remuneration Report.

Annual Incentive	Weighting (%)	Target performance	Stretch performance	Actual performance (excluding acquisitions)	% of maximum reward received
QinetiQ orders*	25	£600.0m	£750.0m	£671.4m	73.8%
QinetiQ underlying operating profit*	25	£105.0m	£115.0m	£115.1m	100.0%
QinetiQ underlying operating cash flow* (Excluding LTPA and MSCA capital expenditure)	25	£80.0m	£96.0m	£100.0m	100.0%
Collective Objectives:					
Strategic					
– Lead and modernise the UK Defence 'Test & Evaluation Enterprise'					
– Build the Company internationally	12.5	60%	100%	65%	56.3%
– Innovate for customer advantage					
Operational					
– Transformation programme					
– Organisation development					
CEO Personal Objectives:					
Growth:					
– Develop a five-year Integrated Strategic Business Plan	12.5	60%	100%	90%	87.5%
Leadership:					
– Develop Leadership Community competence					

David Smith did not participate in the 2017 Bonus Banking Plan following his recruitment on 1 March 2017.

Long-term incentive

Neither of the Executive Directors were participants in the Performance Share Plan awards granted in 2014 and therefore no long-term incentives with a performance period to 31 March 2017 are due to vest for the Executive Directors.

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

Share price growth

22.4%
over the last 12 months

How does reward earned in 2017 relate to Company performance?

Underlying EPS has grown by 11.0% in 2017 against a 10.6% reported increase in CEO annual variable reward. The CEO's 2016 annual variable reward was pro-rated for his hire date of 27 April 2015 therefore a like-for-like annual comparison is 2.7%. Results for 2017 represent a strong alignment between performance and reward over the last 12 months.

2017 Actual	1,105	EPS 18.1p
2016 Full Year Equivalent	1,076	EPS 16.3p
2016 Actual	999	EPS 16.3p

● Bonus Banking Plan Annual Contribution (£'000)

The share price has grown by 22.4% over the last 12 months benefiting both shareholders and Bonus Banking Plan participants alike. The Bonus Banking Plan annual contribution is added to the existing pool.

The pool has grown in value reflecting the growth in share price, building close alignment between Executive Directors and shareholders. Half of the restated pool is paid as cash with the remaining half deferred until the end of 2018 when it will be paid in shares. The following chart summarises the 2017 breakdown and detailed calculations are provided on page 87.

2017 Bonus Banking Pool Build-Up	538	60	12	1,105	1,715
2017 Bonus Banking Pool Cash Payment and Retained Equity Value	857.5			857.5	1,715

- Bonus Banking Pool Opening Equity Value (£'000)
- Increase in Equity Value (£'000)
- Dividend Equivalent Payment (£'000)
- Bonus Banking Pool Annual Contribution (£'000)
- 2017 Annual Payment (£'000)
- Bonus Banking Pool Closing Equity Value (£'000)

How does the reward earned in 2017 align with current policy?

CEO remuneration is above target performance and in line with our financial results achieved in challenging operating conditions. The Bonus Banking Plan annual contribution for 2017 is £1,104,687, half of which is treated as equity.

CEO (£'000)

Minimum	714			714
Target	714	320	632	1,666
Maximum	714	639		1,776
Actual	714	552.5	552.5	1,819

- Fixed
- Linked to Annual Performance
- Linked to Performance over more than 1 year

Executive Director Shareholding

The following charts show the relatively small shareholdings of both Executive Directors due to their short length of service. One of the objectives of the new Incentive Plan is to facilitate the rapid build-up of material shareholdings by the Executive Directors provided performance is delivered.

CEO shareholding as a percentage of salary

Shareholding requirement	300
Value of beneficially Owned shares & Deferred shares	10
Value of Conditional Shares Subject to performance conditions	399

CFO shareholding as a percentage of salary

Shareholding requirement	200
Value of Beneficially Owned shares & Deferred shares	0
Value of Conditional Shares Subject to performance conditions	0

Principles of the proposed Remuneration Policy

Incentivising sustained performance and growth, the key policy principles are highlighted below.

Continuity and effectiveness

Base salary

Robust and transparent governance with a clear link to pay conditions across the Group.

Incentives

Clear link to growth and transformation underpinned by substantial deferral in equity and risk of forfeiture ensuring a focus on long-term sustainable performance.

Rewarding long-term sustainable value while still driving immediate business objectives.

Performance related reward

Incentives

Pay mix focuses on variable pay and correlates reward opportunity with business performance. In turn maximising shareholder value through measurement in terms of financial and non-financial KPIs.

Alignment

Incentives

Reflecting shareholder value creation, incentives retain and lock-in new executive team by incentivising what is right for the Company while ensuring quick alignment through the build-up and retention of earned equity.

Shareholding requirements

Alignment of the new executive team with the shareholder experience over the period.

Directors' Remuneration Report continued

Part 2: Remuneration Policy

“

The policy will be put forward for binding vote at the AGM on 19 July 2017 and will be effective from that date.

”

Introduction

The Directors' Remuneration Policy was last approved in 2014 and the Company therefore seeks approval for the new policy at the AGM on 19 July 2017.

Scope of policy

The policy applies to Executive Directors, the Group Chairman and Non-executive Directors. Reference may also be made to the Executive Committee who, while not Directors, fall within the Committee's remit, although the policy is not binding for these individuals.

Duration of policy

The policy will be put forward for binding vote at the AGM on 19 July 2017 and will be effective from that date. The Policy is expected to remain in effect until the 2020 AGM.

Discretion

The Committee has discretion in several areas of policy as set out in this report. The Committee may also exercise operational and administrative discretions under relevant plan rules as set out in those rules. In addition, the Committee has the discretion to amend the Remuneration Policy with regard to minor or administrative matters where it would be, in the opinion of the Committee, disproportionate to seek or await shareholder approval and commits to communicating to shareholders when discretion is used.

Key changes in the Directors' Remuneration Policy

The Committee conducted an extensive review of the Remuneration Policy taking into account the following factors:

- The Company vision-led strategy launched at the beginning of FY17 aiming to establish the conditions for growth;
- The new executive team, including both Executive Directors and Executive Committee members, established to deliver the strategy; and
- The current suitability of the incentive arrangements for the Group incorporating insight from our Leadership Community and Employee Engagement Group.

This has resulted in the Committee proposing to introduce new incentive arrangements (collectively the Incentive Plan), if approved by shareholders, made up of two elements:

- Bonus Banking Plan (Element A) with no change to the current terms and conditions other than a reduction in the maximum opportunity from 225% to 200% of salary

- Deferred Share Plan (Element B) to be used in place of the current Performance Share Plan – maximum opportunity is reduced from 200% (current maximum granted to CEO in 2016 for two years) to 125% of salary.

Awards under the Deferred Share Plan (Element B) will be earned based on challenging strategic financial growth objectives set by the Committee each year in line with the Company's Integrated Strategic Business Plan.

Shares earned under the Deferred Share Plan (Element B) are subject to a three-year vesting period, during which the participant must remain employed by the Company, and also cannot be sold for five years from the date of award irrespective of employment status.

The rationale for the change to incentive provision is to:

- provide a simple cohesive design, that incentivises delivery of the Integrated Strategic Business Plan;
- recognise that the Integrated Strategic Business Plan will evolve, therefore providing the Board with the opportunity to manage the incentives annually to ensure the evolution continues to be incentivised;
- reward participants as shareholders by the build-up of a long-term retained shareholding; and
- ensure a focus on long-term sustainable performance through the deferral in equity. Based on the maximum incentive opportunity of 325%, half of the Bonus Banking Plan (Element A) opportunity (100%) and all of the Deferred Share Plan (Element B) opportunity (125%) is treated as equity.

There will be an increase in minimum shareholding requirement for the CEO to 300% of salary (previously 200% of salary) and for the CFO 200% of salary (previously 150% of salary). This increases the alignment of Executive Directors' remuneration with shareholder value.

The pension contribution for any new Executive Director will be reduced to a maximum of 15% of salary. The change will bring pension provision for Executive Directors more closely in line with the provision for the broader employee base.

Otherwise, the operation of the policy is in line with the previous policy in force.

Executive Directors' Remuneration Policy

The Executive Directors' Remuneration Policy is put forward for approval at the AGM on 19 July 2017. This policy covers the three year period commencing 1 April 2017 and complies with the Large and Medium-sized Companies and Groups (Accounting and Reports) (Amendment) Regulations 2013.

Element	Purpose and link to strategy	Operation and performance measures	Maximum opportunity
Base salary	To attract and retain the talent needed to lead our business.	<p>An Executive Director's basic salary is set on appointment and reviewed annually or when there is a change in position or responsibility.</p> <p>When determining an appropriate level of salary, the Committee considers:</p> <ul style="list-style-type: none"> – general salary rises to employees; – remuneration practices within the Group; – any change in scope, role and responsibilities; – the general performance of the Group; – the experience of the relevant Director; – the economic environment; and – when the Committee determines a benchmarking exercise is appropriate salaries within the ranges paid by the companies in the comparator groups used for remuneration benchmarking. <p>Individuals who are recruited or promoted to the Board may, on occasion, have their salaries set below the targeted policy level until they become established in their role. In such cases subsequent increases in salary may be higher than the general rises for employees until the target positioning is achieved.</p>	<p>Typically, the base salaries of Executive Directors in post at the start of the policy period and who remain in the same role throughout the policy period will be increased by a similar percentage to the average annual percentage increase in salaries of all other employees in the Group. The exceptions to this rule may be where:</p> <ul style="list-style-type: none"> – an individual is below market level and a decision is taken to increase base pay to reflect proven competence in the role; or – there is a material increase in scope or responsibility to the Executive Director's role. <p>The Committee ensures that maximum salary levels are positioned in line with companies of a similar size to QinetiQ and validated against other companies in the industry, so that they are competitive against the market.</p> <p>The Committee intends to review the comparators periodically and may add or remove companies from the group as it considers appropriate. Any changes to the comparator groups will be set out in the section headed Implementation of Remuneration Policy, in the following financial year.</p>
Pension	To ensure that Executive Directors' total remuneration remains attractive and competitive.	<p>The Company provides a pension contribution allowance in line with practice relative to its comparators to enable the Company to recruit and retain Executive Directors with the experience and expertise to deliver the Group's strategy.</p> <p>This allowance will be a non-consolidated allowance and will not impact any incentive calculations.</p>	<p>The maximum policy pension contribution allowance will be reduced to 20% for existing Executive Directors in line with current provision; however, any new Executive Directors will have a maximum contribution of 15%.</p> <p>The Company will set out in the section headed Implementation of Remuneration Policy, in the following financial year the pension contributions for that year for each of the Executive Directors.</p>
Benefits	To ensure that Executive Directors' total remuneration remains attractive and competitive.	<p>Benefits include car allowance, health insurance, life assurance, income protection and membership of the Group's employee Share Incentive Plan which is open to all UK employees (the Executive Directors will also be eligible to participate in any other all employee plan operated by the Company from time to time).</p> <p>The Committee recognises the need to maintain suitable flexibility in the benefits provided to ensure it is able to support the objective of attracting and retaining personnel in order to deliver the Group strategy. Additional benefits may therefore be offered such as relocation allowances on recruitment.</p>	<p>The maximum is the cost of providing the relevant benefits.</p>

Directors' Remuneration Report continued

Part 2: Remuneration Policy continued

Element	Purpose and link to strategy	Operation and performance measures	Maximum opportunity
Incentive Plan	<p>The Incentive Plan provides a significant incentive to the Executive Directors linked to achievement of delivering goals that are closely aligned with the Company's strategy and the creation of value for shareholders.</p> <p>In particular, the Incentive Plan supports the Company's objectives by:</p> <ul style="list-style-type: none"> – allowing the setting of annual targets based on the businesses' strategic objectives at that time, meaning that a wider range of performance metrics can be used that are relevant and suitably stretching whilst also providing sufficient incentive linked to potential to be achievable; and – providing substantial deferral in shares and ongoing adjustment by requiring a threshold level of performance to be achieved during the deferral period. Amounts deferred in shares are also forfeitable on a director's voluntary cessation of employment which provides an effective lock-in. 	<p>An award under the Incentive Plan is subject to satisfying financial and strategic/operational performance/personal performance conditions and targets measured over a period of one financial year.</p> <p>A minimum of 50% of the incentive shall be based on financial performance measures.</p> <p>The Incentive Plan consists of two elements (Element A and Element B).</p> <p>Bonus Banking Plan (Element A). Annual Company contributions will be earned based on the satisfaction of the performance conditions. Contributions will be made for three years with payments made over four years. 50% of the value of a participant's bonus account will be paid out annually for three years with 100% of the residual value paid out at the end of year four. 50% of the unpaid balance of a participant's bonus account will be at risk of annual forfeiture.</p> <p>Deferred Share Plan (Element B). Deferred share-based element earned based on the satisfaction of pre-grant annual performance assessment, which is subject to a three-year vesting period and a further two-year holding period. A minimum 50% (Remuneration Committee have discretion to increase subject to performance) of the unvested award will be at risk forfeiture after three years.</p> <p>Malus and clawback provision apply to the Incentive Plan (both Elements).</p> <p>The Committee has discretion to provide dividend equivalents on Element A and Element B shares.</p> <p>The Committee is of the opinion that given the commercial sensitivity arising in relation to the detailed financial targets used for the incentive, disclosing precise targets for the Incentive Plan in advance would not be in shareholder interests. Targets, performance achieved and awards made will be published at the end of the annual performance period so shareholders can fully assess the basis for any pay-outs under the Plan.</p>	<p>Maximum 325% of salary (200% of salary under Element A and 125% of salary under Element B).</p> <p>Bonus Banking Plan (Element A) Maximum = 200% of salary. Target = 80%–120% of salary. Threshold = 0% of salary.</p> <p>Deferred Share Plan (Element B) Maximum = 125% of salary. Target = 30%–75% of salary. Threshold = 0% of salary.</p>

Element	Purpose and link to strategy	Operation and performance measures	Maximum opportunity
Incentive Plan continued		<p>In exceptional circumstances the Committee retains the discretion to:</p> <p>Change the performance measures and targets and the weighting attached to the performance measures and targets part way through a performance year if there is a significant and material event which causes the Committee to believe the original measures, weightings and targets are no longer appropriate; for example adjustments for:</p> <ul style="list-style-type: none"> – Acquisitions and disposals; – Restructuring costs; – Business structure changes; – Restated corporate allocations; – Foreign currency exchange rates; and – Board approved budget adjustments. <p>Make downward or upward adjustments to the amount of incentive earned resulting from the application of the performance measures, if the Committee believe that the incentive outcomes are not a fair and accurate reflection of business performance. Any adjustments or discretion applied by the Committee will be fully disclosed in the following year's Directors' remuneration report.</p>	
Minimum shareholding requirements	To align Executive Directors' interests with those of shareholders through the build-up and retention of a personal holding in QinetiQ shares.	<p>Executives have five years to accumulate the required shareholding.</p> <p>300% of base salary for the CEO.</p> <p>200% of base salary for the CFO.</p>	<p>The Committee has adopted formal shareholding requirements that will encourage the Executive Directors to build up over a five-year period and then subsequently hold a shareholding equivalent to a percentage of base salary. Adherence to these guidelines is a condition of continued participation in the equity incentive arrangements. This policy ensures that the interests of Executive Directors and those of shareholders are closely aligned.</p> <p>In addition, Executive Directors will be required to retain 50% of the post-tax amount of vested shares from the Company incentive plans until the minimum shareholding requirement is met and maintained.</p> <p>The Committee retains the discretion to increase the shareholding requirements.</p>

Elements of existing policy that will continue to apply

Element	Purpose and Link to strategy	Operation and performance measures	Maximum opportunity
Bonus Banking Plan and Performance Share Plan (PSP)	To align Executive Directors' interests with those of shareholders.	<p>The outstanding awards under the Bonus Banking Plan and PSP will continue to form part of the Remuneration Policy until vesting.</p> <p>Details on how these plans operate can be found in the Directors' remuneration report for the year of grant.</p> <p>These plans vest on terms set out in the Plan rules which have previously been approved by shareholders.</p>	<p>Bonus Banking Plan – Number of shares in participants' bonus pool as at 31 March 2017.</p> <p>Performance Share Plan – Number of shares outstanding as detailed in this report.</p>

Directors' Remuneration Report continued

Part 2: Remuneration Policy continued

Notes to the policy tables

Performance measures and targets

The performance measures and targets, financial and non-financial, are determined annually based on the Company's strategy. The Committee is of the opinion that the specific performance targets for the Incentive Plan are commercially sensitive and that it would be detrimental to the interests of the Company to disclose them. The targets will be disclosed after the end of the relevant financial year in that year's remuneration report.

However, the Committee is of the opinion that certain elements of the collective objectives may remain commercially sensitive beyond the end of the relevant financial year and will therefore be disclosed once they cease to be commercially sensitive which is anticipated to be within two years of the relevant financial year.

Remuneration policy for all employees

All employee of QinetiQ are entitled to base salary, benefits and pension.

The link between performance and reward cascades down from the Executive incentive plans with the Leadership and Business Development Communities typically invited to participate in the Company's formal annual incentive arrangements. All other employees may receive a discretionary bonus based on Company and individual performance. Participation in long-term incentive plans is available to Executive Directors, Executive Committee members, Leadership Community and selected other employees. Share ownership is further encouraged via the QinetiQ Share Incentive Plan.

Recruitment policy

The Company's principle is that the remuneration of any new recruit will be assessed in line with the same principles as for the current Executive Directors. The Committee is mindful that it wishes to avoid paying more than it considers necessary to secure a preferred candidate with the appropriate calibre and experience needed for the role. In setting the remuneration for new recruits, the Committee will have regard to guidelines and shareholder sentiment regarding one-off or enhanced short-term or long-term incentive payments as well as giving consideration for the appropriateness of any award. The Company's detailed policy when setting remuneration for the appointment of new Directors is summarised in the table below:

Remuneration element	Recruitment policy
Salary, benefits and pension	These will be set in line with the policy for existing Executive Directors.
Incentive Plan	Maximum annual participation will be set in line with the Company's policy for existing Executive Directors and will not exceed 325% of salary.
Maximum variable remuneration	The maximum variable remuneration which may be granted is 325% of salary (excluding any buy-outs).
'Buy Out' of incentives forfeited on cessation of employment	<p>Where the Committee determines that the individual circumstances of recruitment justifies the provision of a buyout, the equivalent value of any incentives that will be forfeited on cessation of an Executive Director's previous employment will be calculated taking into account the following:</p> <ul style="list-style-type: none"> – The proportion of the performance period completed on the date of the Executive Director's cessation of employment; – The performance conditions attached to the vesting of these incentives and the likelihood of them being satisfied; and – Any other terms and condition having a material effect on their value ('Lapsed value'). <p>The Committee may then grant up to the same value as the lapsed value, where possible, under the Company's incentive plan. To the extent that it was not possible or practical to provide the buyout within the terms of the Company's existing incentive plan, a bespoke arrangement would be used.</p>
Relocation policies	In instances where the new Executive Director is required to relocate or spend significant time away from their normal residence, the Company may provide one-off compensation to reflect the cost of relocation for the Executive Director. The level of the relocation package will be assessed on a case-by-case basis but will take into consideration any cost of living differences/housing allowance and schooling.

Where an existing employee is promoted to the Board, the policy set out above would apply from the date of promotion but there would be no retrospective application of the policy in relation to subsisting incentive awards or remuneration arrangements. Accordingly, prevailing elements of the remuneration package for an existing employee would be honoured and form part of the ongoing remuneration of the person concerned. These would be disclosed to shareholders in the remuneration report for the relevant financial year.

Loss of office and change of control policy

When determining any loss of office payment for a departing Director the Committee will always seek to minimise the cost to the Company while complying with the contractual terms and seeking to reflect the circumstances in place at the time. The Committee reserves the right to make additional payments where such payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation); or by way of settlement or compromise of any claim arising in connection with the termination of an Executive Director's office or employment.

Remuneration element	Approach	Application of Committee discretion
Salary and benefits	<p>In the event of termination by the Company, there will be no compensation for loss of office due to misconduct or normal resignation.</p> <p>In other circumstances, Executive Directors may be entitled to receive compensation for loss of office which will be a maximum of 12 months' salary.</p> <p>Such payments will be equivalent to the monthly salary and benefits that the Executive Director would have received if still in employment with the Company. These will be paid over the notice period. Executive Directors will be expected to mitigate their loss within a twelve month period of their departure from the Company.</p>	The Company has discretion to make a lump sum payment in lieu.
Pension	Pension contributions or payments in lieu of pension contribution will be made during the notice period.	The Company has discretion to make a lump sum payment in lieu.
Bonus Banking Plan (Element A of the Incentive Plan)	<p>For the year of cessation</p> <p>Good leavers: Performance conditions will be measured at the measurement date. The Company bonus contribution will normally be pro-rated for the period worked during the financial year.</p> <p>Other leavers: No Company bonus contribution payable for year of cessation.</p> <p>Deferred balances in participant's Plan Account</p> <p>Good leavers: The balance in the participants' Plan account will be payable on cessation of employment.</p> <p>Other leavers: The balance in the Participants' Plan account will be forfeited on cessation of employment.</p>	<p>For the year of cessation</p> <p>Discretion: the Remuneration Committee has the following elements of discretion:</p> <ul style="list-style-type: none"> – To determine that an Executive Director is a good leaver. It is the Committee's intention to only use this discretion in circumstances where there is an appropriate business case which will be explained in full to shareholders; and – To determine whether to pro-rate the Company bonus contribution to time. The Remuneration Committee's normal policy is that it will pro-rate for time. It is the Remuneration Committee's intention to only use discretion to not pro-rate in circumstances where there is an appropriate business case which will be explained in full to shareholders. <p>Deferred balances in participant's Plan Account</p> <p>Discretion: the Remuneration Committee has the following elements of discretion:</p> <ul style="list-style-type: none"> – To determine that an Executive Director is a good leaver. It is the Remuneration Committee's intention to only use this discretion in circumstances where there is an appropriate business case which will be explained in full to shareholders; – To determine whether the payment of the balance of the participant's Plan Account should be in cash or shares or a combination of both; – To determine whether to pro-rate the balance of the participant's Plan Account payable on cessation. The Committee's normal policy is that it will not pro-rate. The Remuneration Committee will determine whether to pro-rate based on the circumstances of the Executive Directors's departure.

Directors' Remuneration Report continued

Part 2: Remuneration Policy continued

Remuneration element	Approach	Application of Committee discretion
Bonus Banking Plan (Element A of the Incentive Plan) (change of control)	<p>For the year of the change of control Performance conditions will be measured at the date of the change of control. The Company bonus contribution will normally be pro-rated to the date of the change of control.</p> <p>Deferred balances in participant's Plan Account The balance in the participant's Plan Account will be payable on the change of control.</p>	<p>For the year of the change of control Discretion: the Remuneration Committee has the following element of discretion:–</p> <ul style="list-style-type: none"> – to pro-rate the Company bonus contribution to time. The Remuneration Committee's normal policy is that it will pro-rate for time. It is the Remuneration Committee's intention to only use discretion to not pro-rate in circumstances where there is an appropriate business case which will be explained in full to shareholders. <p>Deferred balances in participant's Plan Account Discretion: the Remuneration Committee has the following elements of discretion:</p> <ul style="list-style-type: none"> – to determine whether the payment of the balance of the participant's Plan Account should be in cash or shares or a combination of both; – to determine whether to pro-rate the balance of the participant's Plan Account payable on change of control. The Committee's normal policy is that it will not pro-rate. The Remuneration Committee will determine whether to pro-rate based on the circumstances of change of control.
Deferred Share Plan (Element B of the Incentive Plan) (cessation of employment)	<p>For the year of cessation Good leavers: Performance conditions will be measured at the measurement date. The Deferred Share Plan (Element B) award will normally be pro-rated for the period worked during the financial year.</p> <p>Other leavers: No Deferred Share Plan (Element B) award for year of cessation.</p> <p>Subsisting Element B awards Good leavers: Deferred Share Plan (Element B) awards will vest on their original vesting dates and remain subject to the sale restrictions.</p> <p>Other leavers: Deferred Share Plan (Element B) awards will be forfeited on cessation of employment.</p>	<p>For the year of cessation Discretion: the Remuneration Committee has the following elements of discretion:–</p> <ul style="list-style-type: none"> – to determine that an Executive Director is a good leaver. It is the Committee's intention to only use this discretion in circumstances where there is an appropriate business case which will be explained in full to shareholders; – to determine whether to pro-rate the Company award to time. The Remuneration Committee's normal policy is that it will pro-rate for time. It is the Remuneration Committee's intention to only use discretion to not pro-rate in circumstances where there is an appropriate business case which will be explained in full to shareholders; and – to determine whether the Deferred Share Plan (Element B) award will vest on the date of cessation or the original vesting date. The Remuneration Committee will make its determination based amongst other factors on the reason for the cessation of employment; and to determine whether to provide the Deferred Share Plan (Element B) award in the form of cash or shares.

Remuneration element	Approach	Application of Committee discretion
Deferred Share Plan (Element B of the Incentive Plan) (cessation of employment) continued		<p>Subsisting Deferred Share Plan (Element B) awards</p> <p>Discretion: the Remuneration Committee has the following elements of discretion:</p> <ul style="list-style-type: none"> – To determine that an Executive Director is a good leaver. It is the Remuneration Committee's intention to only use this discretion in circumstances where there is an appropriate business case which will be explained in full to shareholders; – To determine whether to pro-rate the Deferred Share Plan (Element B) award to the date of cessation. The Committee's normal policy is that it will pro-rate. It is the Remuneration Committee's intention to only use discretion to not pro-rate in circumstances where there is an appropriate business case which will be explained in full to shareholders; – To determine whether the Deferred Share Plan (Element B) award will vest on the date of cessation or the original vesting date. The Remuneration Committee will make its determination based amongst other factors on the reason for the cessation of employment.
Deferred Share Plan (Element B of the Incentive Plan) (Change of Control)	<p>For the year of the change of control</p> <p>Performance conditions will be measured at the date of the change of control. The Element B award will normally be pro-rated to the date of the change of control.</p> <p>Subsisting Element B awards</p> <p>The awards will vest on the date of the change of control and the sale restrictions will fall away.</p>	<p>For the year of the change of control</p> <p>Discretion: the Remuneration Committee has the following element of discretion:–</p> <ul style="list-style-type: none"> – To determine whether to pro-rate the Deferred Share Plan (Element B) award to time. The Remuneration Committee's normal policy is that it will pro-rate for time. It is the Remuneration Committee's intention to only use discretion to not pro-rate in circumstances where there is an appropriate business case which will be explained in full to shareholders. <p>Subsisting Deferred Share Plan (Element B) awards</p> <p>Discretion: the Remuneration Committee has the following elements of discretion:</p> <ul style="list-style-type: none"> – To determine whether the satisfaction of Deferred Share Plan (Element B) awards should be in cash or shares or a combination of both; and – To determine whether to pro-rate Deferred Share Plan (Element B) awards on change of control. The Committee's normal policy is that it will not pro-rate. The Remuneration Committee will determine whether to pro-rate based on the circumstances of change of control.
Other contractual obligations	There are no other contractual provisions other than those set out above agreed that could impact quantum of the payment.	None.

A good leaver is a person whose cessation of employment is for one of the following reasons:

- Death;
- Ill-health;
- Injury or disability;
- Redundancy;
- Retirement;
- Employing company ceasing to be a Group company;
- Transfer of employment to a company which is not a Group company; and
- Where the person is designated a good leaver at the discretion of the Committee (as described above).

A person who ceases employment in circumstances other than those set out above is designated as an 'other leaver'.

Directors' Remuneration Report continued

Part 2: Remuneration Policy continued

Malus and clawback

Malus provisions apply to both the Bonus Banking Plan (Element A) and the Deferred Share Plan (Element B). Malus is the adjustment of Element A bonus contributions or the balance in a participant's bonus account or unvested Deferred Share Plan (Element B) awards because of the occurrence of one or more circumstances. The adjustment may result in the value being reduced to nil.

Clawback is the recovery of payments made under the Bonus Banking Plan (Element A) or vested Deferred Share Plan (Element B) awards as a result of the occurrence of one or more circumstances. Clawback may apply to all or part of a participant's payment under the Deferred Share Plan (Element A) or Deferred Share Plan (Element B) award and may be effected, among other means, by requiring the transfer of shares, payment of cash or reduction of awards or bonuses.

The circumstances in which malus and clawback could apply are as follows:

- Discovery of a material misstatement resulting in an adjustment in the audited accounts of the Group or any Group company;
- The assessment of any performance condition or condition in respect of a payment or award under the Incentive Plan was based on error, or inaccurate or misleading information;
- The discovery that any information used to determine the Bonus Banking Plan (Element A) or Deferred Share Plan (Element B) award was based on error, or inaccurate or misleading information;
- Action or conduct of a participant which amounts to fraud or gross misconduct; or
- Events or the behaviour of a participant have led to the censure of a Group company by a regulatory authority or have had a significant detrimental impact on the reputation of any Group company provided that the Board is satisfied that the relevant participant was responsible for the censure or reputational damage and that the censure or reputational damage is attributable to the participant.

The following table sets out the periods during which malus and clawback may be effected.

	Bonus Banking Plan (Element A)	Deferred Share Plan (Element B)
Malus	Up to the date of a payment.	Any time prior to vesting.
Clawback	Three years post the date of any payment.	Three years from the date of vesting.

Pay and performance scenario analysis

The proposed Executive Remuneration Policy is illustrated in the following charts showing what each Director could expect to receive in FY18 under different performance scenarios, based on the following definitions:

Scenario	Fixed	Linked to annual performance	Linked to performance over more than 1 year
Stretch		50% of Element A Opportunity (100% of salary)	50% of Element A opportunity (100% of salary)
	FY18 base salary	50% of Element B (62.5% of salary)	50% of Element B (62.5% of salary)
Target	Car allowance	25% of Element A opportunity (50% of salary)	25% of Element A opportunity (50% of salary)
	Pension allowance	17.5% of Element B (21.875% of salary)	17.5% of Element B (21.875% of salary)
	Benefits		
Minimum		No variable pay	No variable pay

CEO (£'000)

Stretch	28%	36%	36%	2,587
Target	46%	27%	27%	1,547
Minimum		100%		722

- Fixed
- Linked to annual performance
- Linked to performance over more than 1 year

CFO (£'000)

Stretch	28%	36%	36%	1,984
Target	46%	27%	27%	1,187
Minimum		100%		554

- Fixed
- Linked to annual performance
- Linked to performance over more than 1 year

Based on the maximum incentive opportunity of 325%, half of the Bonus Banking Plan (Element A) opportunity (100%) and all of the Deferred Share Plan (Element B) opportunity (125%) is treated as equity. At both target and stretch performance 69% of variable pay is treated as equity.

Policy for Non-executive Directors

The Company's policy when setting fees for the appointment of new Non-executive Directors is to apply the policy which applies to current Non-executive Directors.

Element	Purpose and link to strategy	Operation and performance measures	Maximum opportunity
Non-executive Directors			
Fees	To attract and retain Non-executive Directors of the calibre required to assist the Company in setting and delivering its strategy.	<p>The Executive Directors and the Group Chairman are responsible for setting the remuneration of the Non-executive Directors. The Board, minus the Chairman, is responsible for setting the Chairman's fees.</p> <p>Non-executive Directors are paid an annual fee and additional fees for chairmanship of committees, and the Company retains the flexibility to pay fees for the membership of committees. The Chairman does not receive any additional fees for membership of committees.</p> <p>Fees are reviewed annually based on equivalent roles in the comparator group used to review salaries paid to the Executive Directors.</p> <p>An annual accommodation allowance may be payable to the Group Chairman and as deemed appropriate for individuals who are not UK resident.</p> <p>Excluding the Group Chairman, an additional fee is payable to those Non-executive Directors attending meetings outside of their country of residence.</p> <p>Non-executive Directors and the Group Chairman do not participate in any variable remuneration or benefits arrangements.</p>	<p>The fees for Non-executive Directors and the Group Chairman are broadly set at a competitive level against the comparator group.</p> <p>In general the level of fee increase for the Non-executive Directors and the Group Chairman will be set taking account of any change in responsibility and the general rise in salaries across employees.</p> <p>The Company will pay reasonable expenses incurred by the Non-executive Directors and Group Chairman and may settle any tax incurred in relation to these.</p>

Consideration of shareholder and employee views

The Chair of the Committee and the Group Chairman consult with key shareholders on remuneration matters from time to time, and particularly where changes to the Remuneration Policy are under consideration. The Chair reports any concerns expressed by shareholders to the Committee and these are taken into account as the Committee develops and implements its policy. Any comments received from shareholders outside these consultation exercises are also reported to the Committee, and the Committee takes account of general views on remuneration expressed by shareholders or representative bodies.

The Committee consulted with its principal shareholders in relation to the proposal to revise the policy and took into account views expressed during the consultation when agreeing the final design. The Remuneration Committee is grateful for shareholders' comments and engagement during the consultation process. At the end of this process, the Remuneration Committee was pleased that the majority of the shareholders consulted expressed support for the policy.

The Committee has not formally consulted with employees and has not used any specific all-employee comparison metrics in forming this policy. However, the Committee has regularly consulted with the Company's Employee Engagement Group on other reward matters.

Directors' Remuneration Report continued

Part 3: Annual Report on Remuneration

Introduction

The Remuneration Committee presents the Annual Remuneration Report showing how the Remuneration Policy has been implemented for the year ended 31 March 2017.

The Committee presents the Annual Report on Remuneration to shareholders at the AGM on 19 July 2017. This report was compiled in accordance with Schedule 8 of the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2013 as well as the Companies Act 2006.

Remuneration Committee Structure

The Committee is chaired by Michael Harper, and is composed of the members set out on page 68.

Effectiveness review

In 2017, the effectiveness review was undertaken internally, and it rated the effectiveness of the Committee highly overall. Considerations for 2017 include continuing the productive dialogue with the Executive team and, subject to policy approval, ensuring incentive targets are stretching enough in the context of the strategy, as it plays out.

Consideration by the Directors of matters relating to Directors' remuneration

Members of the Committee are appointed by the Board. The Committee comprises at least three members (not counting the Group Chairman), all of whom are independent Non-executive Directors. The Group Chairman of the Board also serves on the Committee as an additional member as he was considered independent on appointment as Chairman.

Only members of the Committee have the right to attend Committee meetings. However, external advisors and other internal advisors such as the Chief Executive Officer and the Group Human Resources Director are invited to attend for all or part of any meeting, as and when appropriate.

The Board appoints the Committee Chairman who is an independent, Non-executive Director. In the absence of the Committee Chairman and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting who would qualify under these terms of reference to be appointed to that position by the Board. The Chairman of the Board is not permitted to be Chairman of the Committee.

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

Service Contracts/Letters of Appointment

The Company's policy is that Executive Directors have rolling contracts which are terminable by either party giving 12 months' notice. Non-executive Directors do not have service contracts but are appointed under letters of appointment. All service contracts and letters of appointment are available for viewing at the Company's registered office and at the AGM. Non-executive Directors typically serve two three-year terms but may be invited by the Board to serve for an additional period (see table in the Nominations Committee report on page 53).

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

The Committee has appointed PwC, an independent firm of remuneration consultants, to provide advice on market practice, corporate governance and institutional stakeholder views. Fees paid during the year for these services were £111,500 which included advice relating to the policy and shareholder consultation.

PwC provided the following additional services during the year:

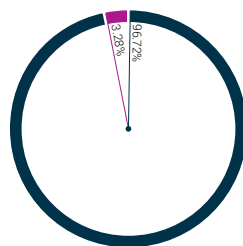
- Implementation support for the Company on Executive reward plans;
- Consultancy and advice to Group Tax; and
- Consultancy and advice in relation to Group Pensions.

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

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

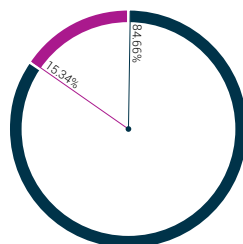
Statement of voting

Remuneration Report – 2016



Votes for	404,652,873 (96.72%)
Votes against	13,714,402 (3.28%)
Total votes cast	418,367,275 (71.86% share capital)
Abstained	1,781,755

Remuneration Policy – 2014



Votes for	422,740,088 (84.66%)
Votes against	76,602,719 (15.34%)
Total votes cast	499,342,807 (76.68% share capital)
Abstained	4,877,598

As in previous years, details on the voting on all resolutions at the 2017 AGM will be announced via the RNS and posted on the QinetiQ website following the AGM.

Directors' Remuneration Report continued

Part 3: Annual Report on Remuneration continued

Remuneration Committee meetings, activities and decisions 2017

Executive Directors changes during 2017

David Mellors (CFO) resigned from the Company on 31 December 2016 and was replaced by David Smith on 1 March 2017. Following David Mellors' decision to leave the Committee agreed that all shares subject to performance conditions would lapse and that there would be no annual variable reward paid under the Bonus Banking Plan. However, given that David Mellors had built up equity in the Bonus Banking Plan when he made a positive contribution to stabilising the business through CEO change and transition to his successor, the Committee felt it was important that he stay incentivised during his notice period, therefore the decision was taken for David to remain eligible to receive the balance of his accrued and earned Bonus Banking Plan account. Details can be found on page 87.

Performance condition adjustments during 2017

In March 2015 the Committee agreed a set of adjustment principles to enable consistent and fair review in the event of an accounting decision impacting on incentives.

Underlying Operating Profit in 2017 included a credit of £5.2m following the LTPA contract amendment in December 2016. The contract amendment will see QinetiQ procure a new fleet of aircraft for the Empire Test Pilots' School and QinetiQ is, as a result, released from the commitment to fulfill the previously expected level of servicing obligations of the existing fleet. The Committee, following review with the Audit Committee, viewed this as neutral for the purposes of remuneration as the original charges reduced profit, and therefore incentive outturns, in prior years.

As in 2015 and 2016, the Committee again adjusted the performance conditions for the Performance Share Plan and Deferred Annual Bonus Matching Plan to reflect continuing operations and share buyback.

Neither Executive Director participated in the long-term incentives impacted by these changes owing to their respective hire dates with only the CEO participating in the annual incentive. The annual incentive paid to the CEO was £1,104,687 (86.4% of maximum) as detailed on page 86.

The following table provides a summary of all the key activities during the year. There was full attendance at each meeting except for March 2017 when Ian Mason was unable to be present.

	Base salary	Incentives	Equity	Governance	Resourcing
May 2016	Executive Remuneration market review	FY16 final results	2013 PSP/DAB vesting approval	Approve Directors' Remuneration Report	Iain Farley recruitment
July 2016	Executive Director and Executive Committee salary review			Shareholder feedback on Directors' Remuneration Report	David Mellors resignation
November 2016	Trends in Executive Remuneration Non-executive Group Chairman fees	FY17 half year forecast Draft Executive incentive design	Review of Executive Team shareholdings	Draft Executive Remuneration Policy review	David Smith recruitment
January 2017				Shareholder consultation arrangements	Miles Adcock resignation
March 2017		FY17 provisional results FY18 target setting	2014 PSP/DAB provisional vesting	Draft Directors' Remuneration Report Review of Committee remit and effectiveness	

Executive Director single figure remuneration

The auditor is required to report on the information in this table. Executive Director remuneration is shown as a single figure to provide an annual comparison between the actual remuneration for the performance year ended 31 March 2017 and the preceding year.

Element of remuneration (£'000)

	Salary/Fees (£'000)		Benefits (£'000)		Annual Incentives (£'000)		Long-Term Incentives (£'000)		Pension (£'000)		Single Figure (£'000)	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Executive Director												
Steve Wadey	568	520	33	31	1,105	999	–	–	113	104	1,819	1,654
David Mellors	332	456	21	26	645	850	–	–	66	91	1,064	1,423
David Smith	40	–	3	–	–	–	–	–	15	–	58	–

Additional supporting information for each Executive Director

To support the single figure, this section documents each element of remuneration and how the figure was calculated for the performance year ended 31 March 2017.

Salary/fees

The increase in the CEO's base salary reflects his first full year in post and a 2.5% (£14,000) per annum increase effective from 1 July 2016, in line with the typical 2016 salary increase across the Group.

The new CFO has commenced employment on the same base salary as his predecessor (£440,000).

Benefits

Benefits comprise of car allowance, healthcare, life assurance and income protection

Annual incentive

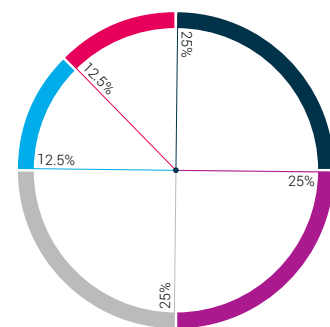
For the year ended 31 March 2017 achievement of on-target performance provides a payment equal to 112.5% of base salary, rising on a linear scale to 225% of base salary for achievement of stretch performance.

For FY17 and FY16, the scheme begins to pay out once threshold performance measures have been achieved. For the year ended 31 March 2017, financial performance measures make up 75% of the annual incentive opportunity with collective objectives and personal objectives accounting for the remaining 25%. For the year ended 31 March 2016, financial

performance measures and personal objectives were weighted at 80%/20% of the annual incentive opportunity.

The CEO/CFO were measured against the targets as shown below:

% of base salary



- Orders
- Underlying Operating Profit
- Underlying Cash Flow
- Collective Objectives
- Personal Objectives

Directors' Remuneration Report continued

Part 3: Annual Report on Remuneration continued

The auditor is required to report on the information in this table which summarises the key steps in the calculation of the annual incentive. Definitions of underlying measures of performance can be found in the glossary on page 157.

CEO/CFO financial performance measures	Weighting (%)	Threshold	Target	Stretch	Actual (excluding acquisitions)	% of maximum reward achieved	Plan contribution
Orders	25	£540.0m	£600.0m	£750.0m	£671.4m	73.8	235,846
Underlying operating profit	25	£95.0m	£105.0m	£115.0m	£115.1m	100.0	319,574
Underlying cash flow (Excluding LTPA and MSCA Capital Expenditure)	25	£72.0m	£80.0m	£96.0m	£100.0m	100.0	319,754
Collective objectives	12.5	40%	60%	100%	65%	56.3	89,880
CEO personal objectives	12.5	40%	60%	100%	90%	87.5	139,813
Overall result						86.4	1,104,687

Collective Objectives

At the beginning of the performance period five collective objectives were set by the Remuneration Committee and communicated to the Executive Directors, Executive Committee and Leadership Community. Three of the objectives focus on delivering our strategy and the remaining two focused on operational transformation so that we are organised effectively to succeed.

Lead and modernise the UK Defence 'Test & Evaluation enterprise'

The objective provided a focus on securing agreements for the modernisation of Boscombe Down and provision of future Test and Evaluation needs with key prime contractors. The objective was partially met.

Build the Company internationally

Significant progress was made, due to circumstances outside our control, the specifics of the objective were not delivered but remain live and therefore continue to be commercially sensitive and not disclosed. The objective was judged to be not delivered.

Innovate for customer advantage

The objective provided a focus on investing in new product capability opportunities. A number of these delivered contracts during the year but remain commercially sensitive and are not disclosed. The objective was measured as partially met.

Transformation programme

The objective provided a focus on generating a five-year Integrated Strategic Business Plan and delivering recurring savings of £20m for future growth investment. The objective was successfully met.

Organisation development

The objective focussed on establishing a matrix organisation, designed to support our new business model and strategy, and completion of the Leadership Development Programme for over 200 of our senior leaders. The objective was successfully met.

Personal objectives

At the beginning of the performance period two personal objectives were set by the Group Chairman and communicated to the CEO.

Growth

The objective provided a focus on developing a five-year business plan, generating a pipeline of potential acquisitions and building shareholder confidence. The five-year plan has been approved by the Board and the pipeline for potential acquisitions has already produced two successes via QinetiQ Target Systems and RubiKon Group Pty Limited. Positive shareholder feedback has shown that confidence is growing therefore the objective is judged to have been met.

Leadership

The objective provided a focus on forming the business leadership into an inspired, self-motivated winning group. Progress was to be shared with the Board at two reviews incorporating a clear focus on succession planning. Through organisation redesign, focused recruitment and development interventions and culture programmes the progress made has been positively received by the Board. The objective is judged to have been met.

The Bonus Banking Plan operates as follows:

- The Plan operates on a fixed four-year cycle. Year one of the Plan commenced on 1 April 2014, year two commenced 1 April 2015, year three commenced 1 April 2016, and year four commenced on 1 April 2017.
- Performance conditions are set at the beginning of each Plan year.
- At the end of each of the first three Plan years the performance against targets is assessed and the level of the incentive earned is determined and paid into the Plan account.
- At the end of each of the first three Plan years, 50% of the account balance will be paid and the balance retained and held in the Plan as notional shares.
- At the end of the fourth year, any remaining balance in the Plan account is paid out in shares.

The auditor is required to report on the information in this table. The measurement date for the CEO is 31 March 2017 and the Bonus Banking Plan annual contribution for 2017 is as reported in the single figure. Through the operation of the Plan the CEO received a cash payment of £857,475. The CEO retains 305,913 notional shares in his plan account.

	Notional shares on account at beginning of plan year 3 (31 March 2016)	30 Day average share price as at measurement Date (£)	Share value as at measurement date (£)	Bonus plan contribution for plan year 3 (£)	Dividend equivalent payment (£) (5.8p)	Bonus pool total value as at measurement date (£)	Gross cash payment for plan year 3 (£)	Bonus pool total value following cash payment (£)	Notional shares on account at beginning of plan year 4 (31 March 2017)
CEO	213,304	2.803	597,891	1,104,687	12,372	1,714,950	857,475	857,475	305,913
CFO	311,153	2.523	785,163	–	–	785,163	785,163	–	–

David Mellors resignation (measurement date 31 December 2016)

Following David Mellors' resignation, he was ineligible to receive the annual contribution due from the Bonus Banking Plan. However he retained the balance in his Bonus Banking Account.

Forfeiture

The CEO retained notional shares in his Plan account of which 50% were subject to forfeiture. Forfeiture would have been enacted if Group Underlying Operating Profit was less than £85.0m for FY17. FY17 Group Underlying Operating Profit was £115.1m (excluding contribution from acquisitions) therefore no notional shares were forfeited.

Discretion

For the year ended 31 March 2017, no discretion was applied to the calculated results; therefore, £1,104,687 has been reported in the single figure calculation.

For the year ended 31 March 2016, financial targets were exceeded providing a contribution of 85.4% of base salary for the CEO and 82.9% of base salary for the CFO. £999,117 and £849,917 has been reported in the single figure table. No discretion was applied to these contributions.

Long-term incentive summary

Deferred Annual Bonus Matching Plan

Following David Mellor's resignation any award due under the 2014 Deferred Annual Bonus Matching Award lapsed. The CEO did not participate in this award.

Performance Share Plan

Following David Mellor's resignation any award due under the 2014 Performance Share Plan lapsed. The CEO did not participate in this award.

A figure of zero has been reported in the single figure for Steve Wadey, David Mellors and David Smith respectively.

Long-term incentive plan results

The 2014 Performance Share Plan achieved 50.3% vesting and the 2014 Deferred Annual Bonus Matching Plan achieved 41.4% vesting.

Scheme interests awarded during the financial year ended 31 March 2017

The auditor is required to report on the information in this table. Performance conditions under the PSP are; EPS growth between 3% – 10% per annum; and TSR performance between median and upper quartile when compared to the FTSE250. The following awards were made to Executive Directors.

	Plan name	Performance measure	Grant date	Award as percentage of salary	Face value of award (£'000)	Share price at date of grant (£)	No. of shares granted	Performance period from – to	Percentage of award vesting at threshold
CEO	PSP 2016	EPS	1 Jul 16	95.0%	534	2.24	238,095	1 Apr 16 31 Mar 19	25%
CEO	PSP 2016	TSR	1 Jul 16	95.0%	534	2.24	238,095	1 Apr 16 31 Mar 19	30%

Between the approval date and grant date share price movement resulted in a revised award as a percentage of salary.

Pension

No Directors participate in the QinetiQ Pension Scheme. Pension figure represents cash in lieu of pension equating to 20% of base salary for both years.

The auditor is required to report on the information shown here over payments to past Directors.

Payments to past Directors and payment for loss of office

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

Directors' Remuneration Report continued

Part 3: Annual Report on Remuneration continued

Single figure remuneration for each Non-executive Director

The auditor is required to report on the information in this table. Non-executive Director remuneration is shown as a single figure to provide an annual comparison between the actual remuneration awarded during the financial year ended 31 March 2017 and the preceding year.

Non-executive Director	Salary/fees (£'000)		Benefits (£'000)		Committee Chair fees (£'000)		US/UK attendance fee (£'000)		Single figure (£'000)	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Lynn Brubaker	46	8	–	–	–	–	15	3	61	11
Admiral Sir James Burnell-Nugent	46	45	–	–	9	9	2	–	57	54
Mark Elliott	238	236	75	75	–	–	–	–	313	311
Michael Harper	46	45	–	–	19	19	2	–	67	64
Ian Mason	46	45	–	–	–	–	–	–	46	45
Paul Murray	46	45	–	–	9	9	2	–	56	54
Susan Searle	46	45	–	–	–	–	2	–	48	45

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

Statement of Directors' shareholding and share interests

The auditor is required to report on the information in this table. Set out below are the Directors' shareholdings as at 31 March 2017.

In relation to the revised Executive Shareholding Policy adopted on 1 April 2017 the Company requires Executive Directors to hold shares equivalent to 300% (CEO) and 200% (CFO) of base salary.

The CEO does not currently meet the minimum shareholding requirement; with a current holding equivalent to 10% of base salary using a share price of £2.726 (three-month average to 31 March 2017). This reflects his recent appointment as CEO and the lack of any opportunity for share-based awards to vest.

The CFO does not currently meet the minimum shareholding requirement; with a current holding equivalent to 0% of base salary using a share price of £2.726 (three-month average to 31 March 2017). This reflects his recent appointment as CFO and the lack of any opportunity for share-based awards to vest.

	Shares beneficially owned	Shares subject to performance conditions	Shares not subject to performance conditions	Total shares held at 23 May 2017
Steve Wadey	21,925	839,826	–	861,751
David Smith	–	–	–	–
Mark Elliott	125,000	–	–	125,000
Michael Harper	30,000	–	–	30,000
Admiral Sir James Burnell-Nugent	11,419	–	–	11,419
Paul Murray	74,942	–	–	74,942
Susan Searle	17,500	–	–	17,500
Ian Mason	10,000	–	–	10,000
Lynn Brubaker	12,000	–	–	12,000

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

Shares subject to performance conditions comprise awards made under the Performance Share Plan for 2016 and 2015.

Total scheme interests summary

The auditor is required to report on the information in this table. Total scheme interests, including those awarded during the financial year ended 31 March 2017, are as follows.

Steve Wadey

Plan name	Date of grant	Number 1 April 2016	Granted in year (maximum potential of awards)	Exercised/ vested in year	Lapsed in year	Number 31 March 2017	Market price on date of grant	Earliest vest date	Latest vest date
PSP 2015	28 Jul 15	363,636	–	–	–	363,636	231.0	28 Jul 18	28 Jul 18
PSP 2016	1 Jul 16	–	476,190	–	–	476,190	224.4	1 Jul 19	1 Jul 19
		363,636	476,190	–	–	839,826			

David Mellors

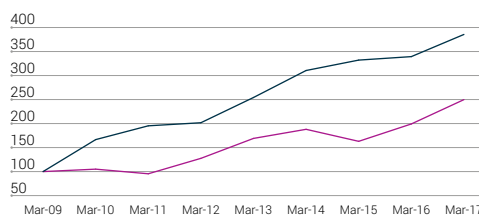
Plan name	Date of grant	Number 1 April 2016	Granted in year (maximum potential of awards)	Exercised/ vested in year	Lapsed in year	Number 31 March 2017	Market price on date of grant	Earliest vest date	Latest vest date
PSP 2013	28 Jun 13	300,000	–	–	300,000	–	180.4	28 Jun 16	28 Jun 16
DAB Match 2013	28 Jun 13	157,196	–	–	157,196	–	180.4	28 Jun 16	28 Jun 16
PSP 2014	28 May 14	293,550	–	–	293,550	–	200.0	28 May 17	28 May 17
DAB Match 2014	1 Jul 14	108,779	–	–	108,779	–	207.7	1 Jul 14	1 Jul 17
PSP 2015	28 Jul 15	285,714	–	–	285,714	–	231.0	28 Jul 18	28 Jul 18
		1,145,239	–	–	1,145,239	–			

PSP awards are subject to two equally weighted performance conditions; EPS growth between 3% – 10% per annum; and TSR performance between median and upper quartile when compared to the FTSE250. DAB Match is subject to the same EPS condition as the PSP. The price of a QinetiQ share at 31 March 2017 was 279.0p. The highest and lowest prices of a QinetiQ share during the year ended 31 March 2017 were 217.5p and 285.0p. There have been no changes to the interests shown above between 31 March 2017 and 23 May 2017.

Performance review

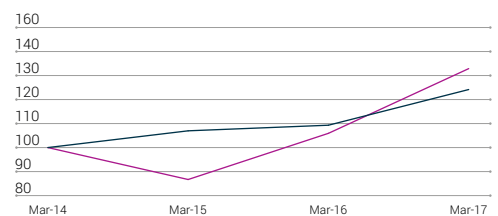
The eight-year and three-year charts show the Company's Total Shareholder Return over the period from 31 March 2009 to 31 March 2017 and 31 March 2014 to 31 March 2017 compared with the FTSE 250 (excluding investment trusts) over the same period based on spot values. The Committee has chosen to demonstrate the Company's performance against these indices as it is an appropriate sector comparison within the index in which the Company is listed. This comparator group is also used to measure TSR performance in the PSP.

Eight-year comparator chart



- QinetiQ
- FTSE 250 (excluding investment trusts)

Three-year comparator chart



- QinetiQ
- FTSE 250 (excluding investment trusts)

Directors' Remuneration Report continued

Part 3: Annual Report on Remuneration continued

CEO remuneration

The table below shows the CEO's remuneration over the same performance period as the Total Shareholder Return chart (31 March 2009 to 31 March 2017):

Year ended 31 March	Salary/fees	Single figure	Annual Bonus (% of maximum)	Long-Term Incentives (% of maximum vesting)
2017 Steve Wadey	568,132	1,819,177	86.42%	–
2016 Steve Wadey	520,219	1,654,546	85.36%	–
2016 David Mellors	455,885	1,423,382	82.86%	–
2015 David Mellors	501,227	1,725,960	88.55%	13.91%
2015 Leo Quinn	469,776	673,979	–	–
2014 Leo Quinn	610,844	2,177,742	76.97%	15.43%
2013 Leo Quinn	593,050	3,992,001	100.00%	40.27%
2012 Leo Quinn	580,000	1,495,284	100.00%	–
2011 Leo Quinn	580,000	1,327,156	100.00%	–
2010 Leo Quinn	217,872	886,564	–	–
2010 Graham Love	266,667	1,246,320	–	–

Percentage change in CEO remuneration

The following table compares change in CEO remuneration with an employee comparator group (averaged per capita). The comparison group (4,000 employees) represents the UK principal businesses in service between 1 April 2016 and 31 March 2017. For comparison purposes, the CEO's full year equivalent figures have been used for 2016 (CEO joined on 27 April 2015).

	CEO			Comparison group		
	2017	2016	% change	2017	2016	% change
Base salary	£568,132	£560,000	1.5%	£39,694	£38,591	2.9%
Benefits	£32,725	£34,939	-6.3%	£1,138	£1,173	-3.1%
Annual bonus	£1,104,687	£1,075,520	2.7%	£1,506	£912	65.1%

Remuneration Policy for all employees

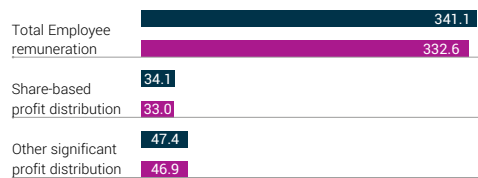
All employees of QinetiQ are entitled to base salary, benefits and pension. UK and Australia based employees are entitled to participate in the QinetiQ Share Incentive Plan. The maximum incentive opportunity available is based on the seniority and responsibility of the role. Participation in the PSP is available to Executive Directors; senior managers and selected employees throughout the organisation are also invited to participate. The Committee is advised of the general reward policy for other employees and of any significant changes proposed.

Gender related pay

QinetiQ is subject to gender pay reporting and will be publicising information during the coming year.

Relative importance of spend on pay

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



- (£m) 2017
- (£m) 2016

Implementation of policy for the year ending 31 March 2018

Salary/fees

Non-executive Director fees were last increased on 1 July 2015, resulting in an increase in base fees from £43,000 to £46,000 per annum. Non-executive Director fees will be reviewed again in July 2017. The Non-executive Group Chairman's fees were last increased on 1 December 2016 resulting in an increase to £242,000. Salaries and fees are reviewed in line with Policy.

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

The CEO does not hold any non-executive directorships in other companies. David Smith was appointed non-executive director of Motability Operations Group plc on 1 July 2010. Non-executive director fees, as reported in the 2016 Motability Operations Group plc annual report were £43,000 per annum.

	Fees effective as at 1 April 2017 £
Non-executive Group Chairman	£242,000
Accommodation allowance for Non-executive Group Chairman	£75,000
Basic fee for UK Non-executive Director	£46,000
Additional fee for chairing a Committee	£9,000
Additional fee to Deputy Chairman/Senior Independent Non-executive Director	£10,000
Additional fee for attendance at a Board meeting held in US by UK resident Non-executive Director	£2,500
Additional fee for attendance at a Board meeting held in UK by US resident Non-executive Director	\$4,000

Incentives for Executives

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

	Performance measure (excluding 2018 acquisitions)	Relative weighting (%)
Bonus Banking Plan (Element A) (target performance 100% of base salary, stretch performance 200% of base salary)	Underlying Operating Profit	25.0%
	Underlying Net Cash from Operations (Pre-Capex)	25.0%
	Orders	25.0%
	Collective Objectives	12.5%
	Personal Objectives	12.5%

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

The Deferred Share Plan (Element B) will award a maximum of 125% of base salary for achieving Stretch performance with 35% of maximum payable at Target performance. The 2018 performance measure will be Underlying Operating Profit but with different performance targets compared to the Bonus Banking Plan. Awards will be made in July 2018 based on 2018 performance. Details of specific performance targets for the Deferred Share Plan (Element B) have not been provided as they are deemed commercially sensitive. They will be disclosed retrospectively in next year's Annual Report on Remuneration.

Michael Harper

Remuneration Committee Chairman
25 May 2017

Directors' report

“

In accordance with the Investment Association's guidelines, the effect of the share buyback has been neutralised in incentive schemes

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Statutory information contained elsewhere in the Annual Report

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

Information	Page
Corporate Governance Statement	40
Directors' details	48
Directors' interests in shares	88
Employees	30
Financial instruments: Information on the Group's financial risk management objectives and policies, and its exposure to credit risk, liquidity risk, interest rate risk and foreign currency risk	129
Greenhouse gas emissions	33
Likely future developments in the business of the Company or its subsidiaries	2 to 37
Results and dividends	34

Management report

The Strategic report on pages 2 to 37 and the Directors' report, as detailed on pages 92 to 95, including information which has been incorporated into those sections by reference, comprise the management report specified by rules 4.1.5R (2) and 4.1.8R of the FCA's Disclosure Guidance and Transparency Rules.

Research and development

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

The majority of R&D-related expenditure is incurred in respect of specific research contracts placed by customers. R&D costs are included within operating costs in the income statement and R&D income is reflected within revenue. In the financial year, the Group recorded £306.4m (2016: £300.8m) of total R&D-related expenditure, of which £272.8m (2016: £277.6m) was customer-funded work and £33.6m (2016: £23.2m) was internally funded. Additionally, £0.4m (2016: £0.4m) of late-stage development costs was capitalised and £1.3m (2016: £1.2m) of capitalised development costs was amortised in the year.

Political donations

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

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

Branches

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

Share capital

As at 31 March 2017, the Company had allotted and fully paid up share capital of 571,757,121 ordinary shares of 1p each with an aggregate nominal value of £5.7m and one Special Share with a nominal value of £1. The ordinary share total includes 4,515,868 shares held exclusive of voting rights in treasury and 2,622,180 shares held by employee share trusts.

Details of the shares in issue during the financial year are shown in note 28 on page 135.

Share buyback activity

The Company announced at the half year in November 2015 that it intended to carry out a return of capital to shareholders of up to £50m over 12 months, consistent with the Company's capital allocation policy, by way of an on-market buyback, subject to prevailing equity market conditions. This was a continuation of buyback activity which began in 2014 when a £150m return of capital was carried out between 2014 and 2016. The Board considers the buyback process to be a flexible distribution method which is simple to execute, easily understood by the market and provides shareholders with a choice as to whether to participate. During the financial year under review, the Company completed this buyback.

As a result of the share buyback activity detailed above, during the year under review, 19,439,947 ordinary shares with a nominal value of 1p each in the capital of the Company (representing 3.4% of the issued ordinary share capital as at 31 March 2017) were purchased at an average price of 243.6 pence per share. Of these shares, 4,515,868 shares are held in treasury and the remainder have been cancelled.

In the financial year, the impact of the share buyback has been to increase basic underlying earnings per share from 16.3p to 16.7p, for total shareholder return to remain unchanged and for net asset value to reduce by £46.7m. In accordance with the Investment Association's guidelines, the effect of the share buyback has been neutralised in incentive schemes, such that for calculation purposes the number of shares in issue is regarded as the same at the end of the three-year performance period as at the beginning. Accordingly, no benefit has accrued under the incentive schemes as a consequence of the share buyback.

Rights of ordinary shareholders

The rights of ordinary shareholders are set out in the Articles of Association. The Articles of Association can be found on the Company's website at www.QinetiQ.com in the Corporate Governance section. The holders of ordinary shares are entitled to receive the Company's Reports and Accounts, to attend and speak at general meetings of the Company, to exercise voting rights in person or by appointing a proxy, and to receive a dividend where declared or paid out of profits available for that purpose.

“

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

”

Rights of special shareholder

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

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

The Special Share carries no financial and economic value and the Special Shareholder is not entitled to vote at a general meeting of the Company. At any time the Special Shareholder may require QinetiQ to redeem the share at par and, if wound up, the Special Shareholder would be entitled to be repaid at its nominal value before other shareholders. Any variation of the rights attaching to the Special Share requires the written approval of the MOD. Further details can be found in note 28 on page 135.

Restrictions on the transfer of shares

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

Employee share schemes

The QinetiQ Group plc Employee Benefit Trust (the Trust) holds shares in connection with QinetiQ's employee share schemes, excluding the Share Incentive Plan. As at 31 March 2017, the Trust held 2,622,180 ordinary shares of 1p each (the Trust Shares). The Trustees of the Trust have agreed to waive their entitlement to dividends payable on the Trust Shares. The Trust holds further ordinary shares in respect of deferred shares held on behalf of participants in the Company's Deferred Annual Bonus Plan. Dividends received by the Trust in respect of the deferred shares are paid direct to the plan participants on receipt and are not retained in the Trust.

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

Corporate sponsored nominee

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

Major shareholdings

The Company has been notified of the following interests of 3% or more in the issued ordinary share capital of the Company (being voting rights over such share capital) pursuant to Rule 5.1 of the Disclosure Guidance and Transparency Rules:

Name of shareholder	At 31 March 2017 % of issued share capital*	At 17 May 2017* % of issued share capital
Schroders	9.984%	9.984%
BlackRock, Inc.	8.63%	8.63%
Investec	4.95%	4.95%
Norges Bank	3.94%	3.94%

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

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

Employees

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

Directors' conflicts of interest

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

Directors' interests in contracts

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

Indemnities

The Articles of Association of the Company entitle the Directors of the Company, to the extent permitted by law, to be indemnified out of the assets of the Company in the event that they suffer any expenses in connection with certain proceedings relating to the execution of their duties as Directors of the Company.

In addition, the Company purchases Directors' and officers' liability insurance. Where it is not possible for Directors and officers to be indemnified by the Company, such Directors and officers of the Company benefit from the Directors' and officers' liability insurance cover in

Directors' report continued

“ KPMG LLP will be retiring as the Company's external auditor at the Annual General Meeting. PricewaterhouseCoopers LLP has expressed their willingness to act as auditor and a resolution to appoint them will be proposed at the Annual General Meeting ”

respect of legal actions brought against them. This insurance protection is also provided to the Company and its subsidiaries where they have provided an indemnity.

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

Change of control – significant agreements

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

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

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

Disclosures in accordance with Listing Rule 9.8.4

There are no matters requiring disclosure under Listing Rule 9.8.4. For completeness, details of the waiver of dividends by the Employee Benefit Trust have been included in the note on Employee Share Schemes on page 93 notwithstanding that the waiver is in respect of less than 1% of the total value of any dividend.

Articles of Association

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

Appointment and replacement of Directors

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

Powers of the Directors: allotment/purchase of own shares

At the Company's Annual General Meeting held in July 2016, the shareholders passed resolutions which authorised the Directors to allot relevant securities up to an aggregate nominal value of £3,910,816 (£1,955,408 pursuant only to a rights issue), to disapply pre-emption rights (up to 5% of the issued ordinary share capital) and to purchase ordinary shares (up to 10% of the issued ordinary share capital). The authorities will remain valid until the 2017 Annual General Meeting.

Resolutions in respect of the allotment of relevant securities, the disapplication of pre-exemption rights and the purchase of own shares will be laid before the 2017 Annual General Meeting.

Annual General Meeting

The Company's Annual General Meeting will be held on Wednesday, 19 July 2017 at 11.00am, at the offices of Ashurst LLP, Broadwalk House, 5 Appold Street, London EC2A 2HA. Details of the business to be proposed and voted on at the meeting are contained in the Notice of Annual General Meeting, which is sent to all shareholders and is also published on the Company's website, www.QinetiQ.com in the 'Investors' section.

Auditor

Following the completion of the external audit tender process, as noted on page 63, KPMG LLP will be retiring as the Company's external auditor at the Annual General Meeting. PricewaterhouseCoopers LLP has expressed their willingness to act as auditor and a resolution to appoint them will be proposed at the Annual General Meeting.

Directors' responsibilities in respect of the Annual Report and 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 IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. 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;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and 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 2006. 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 Strategic report, Directors' report, Directors' remuneration report and Corporate Governance Statement that comply with that 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 jurisdictions.

Statement of disclosure of information to the auditor

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

Responsibility statement of the Directors in respect of the Annual Report

The Directors in office as at the date of this report confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company, and the undertakings included in the consolidation taken as a whole; and
- the management report (which includes the Strategic report and the Directors' report) includes a fair review of the development and performance of the business, and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Jon Messent

Company Secretary and Group General Counsel
25 May 2017

Independent auditor's report to the members of QinetiQ Group plc only

Opinions and conclusions arising from our audit

1. Our opinion on the financial statements is unmodified

We have audited the financial statements of QinetiQ Group plc for the year ended 31 March 2017 set out on pages 102 to 146. In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2017 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with UK Accounting Standards, including FRS 101 Reduced Disclosure Framework; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Overview

Materiality: Group financial statements as a whole	£5.5m (2016: £5.2m) 4.7% (2016: 4.8%) of profit before tax from continuing operations normalised for specific adjusting items
Coverage	87% (2016: 90%) of Group profit before tax

Risks of material misstatement

Recurring risks	Revenue from services US Global Products goodwill Other Payables, provisions and contingent liabilities Tax provisioning New: Retirement Benefits
-----------------	--

2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements, the risks of material misstatement that had the greatest effect on our audit, in decreasing order of significance, were as follows:

Recurring risks

Revenue from services – £682.4 million (2016: £679.0 million)

Refer to page 61 (Report of Audit Committee), page 106 (accounting policy note) and page 112 (financial disclosures).

The risk:

Subjective estimate

A significant proportion of the Group's revenues and profits derives from long-term contracts. These contracts can include complex technological and commercial risks and often specify performance milestones to be achieved throughout the contract period. This results in estimates and assumptions having to be made to forecast the margin on each contract after making appropriate allowances for these technical and commercial risks related to performance milestones yet to be achieved. The risk of misstatement is that the accounting for the Group's significant contracts does not accurately reflect the status and the associated cost to complete of the relevant contract.

Our response:

Our procedures included:

Control design: Assessing the design and testing the operating effectiveness of controls in place to manage the financial aspects of the Group's long-term contracts, taking into account commercial and technical risks;

Personnel reviews: For a sample of significant contracts, determined on the basis of technical and commercial complexity, financial significance and profitability, we obtained an understanding of the status of the contract through discussions with contract project teams and management at a Group and divisional level, attendance at project teams' contract review meetings and examining externally available evidence, such as customer correspondence, where relevant;

Historical comparison and sector experience:

On a sample basis we examined the assumptions behind estimated costs to complete, challenging the reasonableness of these in light of supporting evidence including past experience of the contracts and the extent of technical or commercial risk identified;

Assessing disclosures: We also assessed the Group's disclosures on revenue, including its accounting policies.

**US Global Products goodwill –
£43.4 million (2016: £37.9 million)**

Refer to page 61 (Report of the Audit Committee), page 107 (accounting policy note) and page 121 (financial disclosures).

The risk:

Forecast based valuation

The carrying value of goodwill associated with the US Global Products business was written down to its recoverable amount in the year ended 31 March 2016. As a result, any deterioration in these projections or an increase in the discount rate applied may result in a further write down being required. The carrying value of the US Global Products goodwill has been reassessed in 2017 based on the discounted projected cash flows of this business, which are inherently uncertain due to the variability of future sales and product mix, and selection of an appropriate discount rate used for the purposes of the impairment calculations. Whilst the projections anticipate future growth based on 2017 performance, there remains uncertainty around the impact of new revenue streams and demand for the current portfolio of products.

Our response:

Our procedures included:

Assessing methodology: Testing the principles and mathematical integrity of the Group's discounted cash flow model;

Benchmarking assumptions: With the assistance of our valuation specialists, we assessed the growth and discount rate used in the impairment calculation by comparing the Group's assumptions to external data;

Our sector experience: Challenging the cash flow projections by reviewing the timing of new revenue streams and product mix against market conditions and the current level of sales;

Sensitivity analysis: Testing the sensitivity of the impairment calculation to changes in the underlying assumptions;

Assessing disclosures: Assessing whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions properly reflected the risks inherent in the valuation of goodwill.

Other payables, provisions and contingent liabilities – included within other payables of £157.6 million (2016: £163.3 million), provisions of £24.0 million (2016: £19.1 million) and contingent liabilities of £Nil (2016: £Nil)

Refer to page 61 (Report of the Audit Committee), page 109 (accounting policy note) and page 127 (financial disclosures).

The risk:

Subjective estimates

The Group holds provisions in respect of contractual, legal and regulatory issues. The Group operates in regulated environments and a failure to comply with particular regulations could result in fines and/or penalties. There is judgement required in determining the significance of any instances of potential non-

compliance and potential liability based on management's assessment of the most likely outcome. The financial statements should disclose any contingent liabilities in respect of contractual, regulatory or legal issues which have not been provided for on the basis that they are not considered to qualify for recognition as provisions. This is one of our key areas of audit focus.

Our response:

Our procedures included:

Our sector experience: Critical assessment of the extent to which the Directors' estimates take into account a balanced assessment of the latest available information and the accuracy and reliability of the sources of that information;

Benchmarking assumptions: We corroborated the appropriateness of the Directors' assumptions by reference to third party confirmations and legal advice, where available;

Historical comparison and sector experience: We considered whether our understanding of the business gained throughout the audit process corroborated the provisions recorded. We challenged the Directors' estimates of the most likely outcomes based on the range of possible outcomes to determine if the amounts provided are appropriate;

Assessing disclosures: We considered the adequacy of the Group's disclosures in respect of other payables, provisions and contingent liabilities.

Tax provisioning – current tax payable £43.7 million (2016: £39.9 million), deferred tax asset £5.4 million (2015: £4.1 million)

Refer to page 61 (Report of the Audit Committee), page 107 (accounting policy note) and pages 124 and 127 (financial disclosures).

The risk:

Subjective estimates

The Group is subject to income taxes in the UK, USA and a number of other overseas jurisdictions. The level of current tax and deferred tax recognised requires judgements as to the likely outcome of decisions to be made by the tax authorities. This includes those related to specific tax allowances, such as the UK Research and Development tax credit. There is a risk that the judgements on which the provisions are based do not take into account or do not properly reflect the latest available, reliable information or an appropriate application of relevant tax legislation, and are either under or overstated as a result.

Our response:

Our procedures included:

Our expertise: Challenging the appropriateness of the Directors' assumptions and estimates in relation to tax assets and liabilities, by critically assessing the range of possible amounts that may be assessed under tax laws, likely settlements based on the latest correspondence with the relevant tax authorities and the complexity of the relevant tax legislation. We involved our own tax specialists in analysing and challenging the assumptions used to determine tax provisions based on our knowledge and experience of the application of the legislation by the relevant authorities and courts.

Independent auditor's report to the members of QinetiQ Group plc only continued

Assessing disclosures: Assessing whether the Group's tax disclosures are appropriate and in accordance with relevant accounting standards.

Retirement benefits – surplus £156.0 million (2016: deficit £37.7 million)

Refer to page 61 (Report of the Audit Committee), page 109 (accounting policy note) and page 138 (financial disclosures).

The risk:

Subjective valuation

Significant estimates are made in valuing the Group's retirement obligation included in the net surplus in respect of the pension scheme, including mortality, price inflation and discount rates. Small changes in the assumptions and estimates used to value the net pension surplus would have a significant effect on the Group's financial position.

Our response:

Our procedures included:

Benchmarking assumptions: Challenging, with the support of our own actuarial specialists, the key assumptions applied being the discount rate, inflation rate and life expectancy assumptions used against externally derived data;

Assessing disclosures: Considered the adequacy of disclosures in respect of the sensitivity of the surplus to changes in the key assumptions.

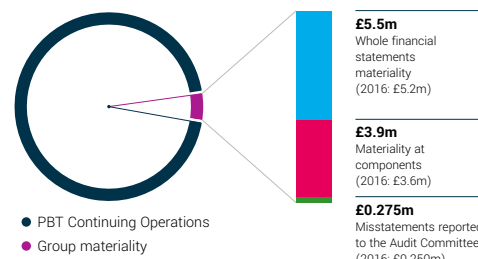
3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £5.5 million (2016: £5.2 million), determined with reference to a benchmark of Group profit before taxation, normalised to exclude this year's specific adjusting items as disclosed in note 4, of £116.1 million (2016: £108.7 million), of which it represents 4.7% (2016: 4.8%). The Group audit team performed procedures on those items excluded from normalised Group profit before taxation.

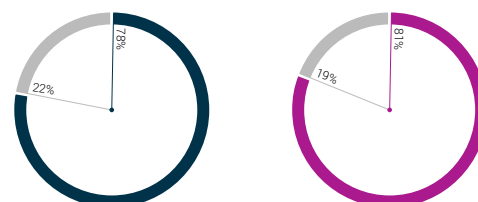
We reported to the Audit Committee any corrected or uncorrected misstatements exceeding £0.275 million (2016: £0.250 million), in addition to other identified misstatements that warranted reporting on qualitative grounds. The audit of QinetiQ Limited, the main UK trading company, and goodwill arising on consolidation accounted for the following percentages of the Group's results: 78% of total Group revenue (2016: 81%); 87% of the total profits and losses that made up the Group's underlying profit before taxation (2016: 90%); and 81% of total Group assets (2016: 69%). For the remaining components, we performed analysis at an aggregate Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

PBT Continuing Operations £116.1m (2016: £108.7m)

Materiality £5.5m (2016: £5.2m)



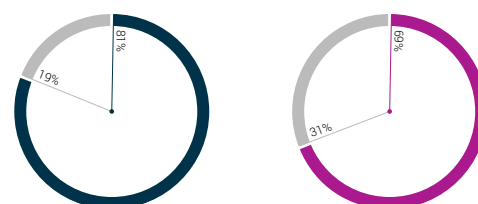
Group revenue



Group profit before tax



Group total assets



- Full scope for Group audit purposes 2017
- Full scope for Group audit purposes 2016
- Residual components

4. Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Strategic Report and Directors' Report for the financial year is consistent with the financial statements; and
- based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic Report and the Directors' Report:
 - we have not identified material misstatements in those reports; and
 - in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

5. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the Directors' confirmation of longer-term viability on page 22, concerning the principal risks, their management, and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the three years to 31 March 2020; or
- the disclosures in note 1 of the financial statements concerning the use of the going concern basis of accounting.

6. We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us;
- parent company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit

Under the Listing Rules we are required to review:

- the Directors' statements in relation to longer-term viability and going concern set out on pages 22 and 58 respectively; and
- the part of the Corporate Governance Statement on pages 41 to 67 relating to the Company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope of report and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 95, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the Company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Anthony Sykes (Senior Statutory Auditor)

for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square London, E14 5GL
25 May 2017

Paul Meekums, a QinetiQ graduate, adjusting elements on an optical table for a multi-channel laser design. The high-powered laser technology will be used for the UK MOD's Laser Directed Energy Weapons Capability Demonstrator Programme awarded to the Dragonfire consortium consisting of MBDA, QinetiQ and other industry partners.





Financial statements

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Consolidated income statement for the year ended 31 March

all figures in £ million	Note	2017			2016		
		Underlying	Specific adjusting items*	Total	Underlying	Specific adjusting items*	Total
Revenue	2, 3	783.1	–	783.1	755.7	–	755.7
Operating costs excluding depreciation, amortisation and impairment		(647.0)	17.4	(629.6)	(630.5)	0.3	(630.2)
Other income	2	9.2	–	9.2	9.5	–	9.5
EBITDA (earnings before interest, tax, depreciation and amortisation)		145.3	17.4	162.7	134.7	0.3	135.0
Depreciation and impairment of property, plant and equipment	3, 15	(26.4)	–	(26.4)	(23.0)	–	(23.0)
Impairment of goodwill	4	–	–	–	–	(31.9)	(31.9)
Amortisation and impairment of intangible assets	3, 14	(2.6)	(1.0)	(3.6)	(2.8)	(2.0)	(4.8)
Operating profit/(loss)	3	116.3	16.4	132.7	108.9	(33.6)	75.3
Gain on business divestments	4	–	–	–	–	16.2	16.2
Finance income	6	1.0	–	1.0	1.0	–	1.0
Finance expense	6	(1.2)	(1.0)	(2.2)	(1.2)	(1.1)	(2.3)
Profit/(loss) before tax	5	116.1	15.4	131.5	108.7	(18.5)	90.2
Taxation (expense)/income	8	(12.3)	4.1	(8.2)	(12.8)	21.2	8.4
Profit for the year from continuing operations		103.8	19.5	123.3	95.9	2.7	98.6
Discontinued operations							
Profit after tax – discontinued operations	4	–	–	–	–	7.5	7.5
Profit for the year from discontinued operations		–	–	–	–	7.5	7.5
Profit for the year attributable to equity shareholders		103.8	19.5	123.3	95.9	10.2	106.1
Earnings per share							
Basic – continuing operations	12	18.1p		21.5p	16.3p		16.8p
Basic – total Group	12	18.1p		21.5p	16.3p		18.1p
Diluted – continuing operations	12	17.9p		21.3p	16.2p		16.7p
Diluted – total Group	12	17.9p		21.3p	16.2p		18.0p

* For details of 'specific adjusting items' refer to note 4 to the financial statements.

Consolidated comprehensive income statement for the year ended 31 March

all figures in £ million

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

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

all figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Hedge reserve	Translation reserve	Retained earnings	Total	Non-controlling interest	Total equity
At 1 April 2016	5.9	40.6	147.6	–	(1.9)	132.4	324.6	0.2	324.8
Profit for the year	–	–	–	–	–	123.3	123.3	–	123.3
Other comprehensive income for the year, net of tax	–	–	–	–	12.2	151.7	163.9	–	163.9
Purchase of own shares	–	–	–	–	–	(0.7)	(0.7)	–	(0.7)
Purchase and cancellation of shares	(0.2)	0.2	–	–	–	(47.4)	(47.4)	–	(47.4)
Share-based payments	–	–	–	–	–	2.1	2.1	–	2.1
Dividends	–	–	–	–	–	(33.4)	(33.4)	–	(33.4)
At 31 March 2017	5.7	40.8	147.6	–	10.3	328.0	532.4	0.2	532.6
At 1 April 2015	6.1	40.4	147.6	0.1	(6.8)	110.6	298.0	0.1	298.1
Profit for the year	–	–	–	–	–	106.1	106.1	0.1	106.2
Other comprehensive income/(expense) for the year, net of tax	–	–	–	(0.1)	4.9	(9.1)	(4.3)	–	(4.3)
Purchase of own shares	–	–	–	–	–	(0.7)	(0.7)	–	(0.7)
Purchase and cancellation of shares	(0.2)	0.2	–	–	–	(46.9)	(46.9)	–	(46.9)
Share-based payments	–	–	–	–	–	4.7	4.7	–	4.7
Dividends	–	–	–	–	–	(32.3)	(32.3)	–	(32.3)
At 31 March 2016	5.9	40.6	147.6	–	(1.9)	132.4	324.6	0.2	324.8

Consolidated balance sheet as at 31 March

all figures in £ million	Note	2017	2016
Non-current assets			
Goodwill	13	107.8	73.1
Intangible assets	14	34.7	8.3
Property, plant and equipment	15	238.8	233.4
Other financial assets	24	0.5	0.6
Investments	16	1.5	0.9
Retirement benefit surplus	30	156.0	–
Deferred tax asset	17	5.4	4.1
		544.7	320.4
Current assets			
Inventories	18	28.9	19.0
Other financial assets	24	10.7	10.8
Trade and other receivables	19	175.6	156.2
Investments	20	1.3	1.7
Cash and cash equivalents	24	211.8	263.5
		428.3	451.2
Total assets		973.0	771.6
Current liabilities			
Trade and other payables	21	(322.1)	(338.7)
Current tax	22	(43.7)	(39.9)
Provisions	23	(6.2)	(5.3)
Other financial liabilities	24	(0.8)	(0.2)
		(372.8)	(384.1)
Non-current liabilities			
Retirement benefit obligation	30	–	(37.7)
Deferred tax liability	17	(37.0)	–
Provisions	23	(17.8)	(13.8)
Other financial liabilities	24	(0.3)	(0.2)
Other payables	21	(12.5)	(11.0)
		(67.6)	(62.7)
Total liabilities		(440.4)	(446.8)
Net assets		532.6	324.8
Capital and reserves			
Ordinary shares	28	5.7	5.9
Capital redemption reserve		40.8	40.6
Share premium account		147.6	147.6
Translation reserve		10.3	(1.9)
Retained earnings		328.0	132.4
Capital and reserves attributable to shareholders of the parent company		532.4	324.6
Non-controlling interest		0.2	0.2
Total shareholders' funds		532.6	324.8

The financial statements were approved by the Board of Directors and authorised for issue on 25 May 2017 and were signed on its behalf by:

Mark Elliott
Chairman

Steve Wadey
Chief Executive Officer

David Smith
Chief Financial Officer

Consolidated cash flow statement for the year ended 31 March

all figures in £ million	Note	2017	2016
Net cash inflow from operations	27	111.9	133.4
Tax (paid)/received		(3.0)	27.9
Interest received		1.0	0.9
Interest paid		(0.6)	(0.6)
Net cash inflow from operating activities		109.3	161.6
Purchases of intangible assets		(2.2)	(1.6)
Purchases of property, plant and equipment		(30.7)	(28.6)
Proceeds from sale of property, plant and equipment		14.3	0.4
Acquisition of businesses (net of cash acquired)	7	(65.7)	(0.6)
Sale of investment in subsidiary		–	28.0
Net cash outflow from investing activities		(84.3)	(2.4)
Purchase of own shares		(48.1)	(48.6)
Dividends paid to shareholders		(33.4)	(32.3)
Capital element of finance lease rental payments		–	(1.4)
Capital element of finance lease rental receipts		–	1.5
Net cash outflow from financing activities		(81.5)	(80.8)
(Decrease)/increase in cash and cash equivalents		(56.5)	78.4
Effect of foreign exchange changes on cash and cash equivalents		4.8	0.8
Cash and cash equivalents at beginning of the year		263.5	184.3
Cash and cash equivalents at end of the year	24	211.8	263.5

Reconciliation of movement in net cash for the year ended 31 March

all figures in £ million	Note	2017	2016
(Decrease)/increase in cash and cash equivalents in the year		(56.5)	78.4
Add back net cash flows not impacting net cash		–	(0.1)
Change in net cash resulting from cash flows	24	(56.5)	78.3
Other movements including foreign exchange	24	3.9	0.7
(Decrease)/increase in net cash as defined by the Group	24	(52.6)	79.0
Net cash as defined by Group at the beginning of the year	24	274.5	195.5
Net cash as defined by Group at the end of the year	24	221.9	274.5
Less: other financial assets and liabilities	24	(10.1)	(11.0)
Total cash and cash equivalents	24	211.8	263.5

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 that are considered material in relation to the Group's financial statements. In the income statement, the Group presents specific adjusting items separately. In the judgement of the Directors, for the reader to obtain a proper understanding of the financial information, specific adjusting items need to be disclosed separately because of their size and nature. Underlying measures of performance exclude specific adjusting items.

Specific adjusting items include:

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

Basis of preparation

The Group's financial statements, approved by the Directors, have been prepared on a going concern basis as discussed in the Directors' Report on page 58 and in accordance with International Financial Reporting Standards as adopted by the EU ('IFRS') and the Companies Act 2006 applicable to companies reporting under IFRS. The Company has elected to prepare its parent company financial statements in accordance with UK GAAP; these are presented on page 144. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and other relevant financial assets and liabilities. Non-current assets held for sale are held at the lower of carrying amount and fair value less costs to sell. The Group's reporting currency is sterling and unless otherwise stated the financial statements are rounded to the nearest £100,000.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings to 31 March 2017. The purchase method of accounting has been adopted. Those subsidiary undertakings acquired or disposed of in the period are included in the consolidated income statement from the date control is obtained to the date that control is lost (usually on acquisition and disposal respectively). An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. This is the IFRS 10 definition of 'control'.

The Group comprises certain entities that are operated under the management of a Proxy Board. Details of the Proxy Board arrangements and the powers of the proxy holders and QinetiQ management are set out in the Corporate Governance section of this Annual Report. IFRS 10 is the accounting standard now applicable in respect of consolidation of entities. This does not specifically deal with proxy situations. However, having considered the terms of the Proxy agreement, the Directors consider that the Group meets the requirements of IFRS 10 in respect of control over such affected entities and, therefore, consolidates these entities in the consolidated accounts.

An associate is an undertaking over which the Group exercises significant influence, usually from 20%–50% of the equity voting rights, in respect of financial and operating policy. A joint venture is an undertaking over which the Group exercises joint control. Associates and joint ventures are accounted for using the equity method from the date of acquisition to the date of disposal. The Group's investments in associates and joint ventures are held at cost including goodwill on acquisition and any post-acquisition changes in the Group's share of the net assets of the associate less any impairment to the recoverable amount. Where an associate or joint venture has net liabilities, full provision is made for the Group's share of liabilities where there is a constructive or legal obligation to provide additional funding to the associate or joint venture.

The financial statements of subsidiaries, joint ventures and associates are adjusted where necessary to ensure compliance with Group accounting policies.

On consolidation, all intra-Group income, expenses and balances are eliminated.

Revenue

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

Service contracts

The Group's service contract arrangements are accounted for under IAS 18 'Revenue' taking into account each party's enforceable rights regarding the services provided and expected manner of settlement. When the outcome of a contract involving the rendering of services can be reliably estimated, revenue associated with the transaction is recognised by reference to the stage of completion of the contract activity at the end of the reporting period and reflecting the probable economic benefits that will flow to the entity. This is normally measured by the proportion of contract costs incurred for work performed to date compared with the estimated total contract costs after making suitable allowances for technical and other risks related to performance milestones yet to be achieved. No profit is recognised on contracts until the outcome of the contract can be reliably estimated. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense. The Group generally does not undertake construction contracts.

Goods sold

Sales of goods are recognised in the income statement on delivery of the product or when the significant risks and rewards of ownership have been transferred to the customer and revenue and costs can be reliably measured.

Royalties and intellectual property

Royalty revenue is recognised over the period to which the royalty relates. Intellectual property revenue can be attributed either to perpetual licences or to limited licences. Limited licences are granted for a specified period and revenue is recognised over the period of the licence. Perpetual licences are granted for unlimited time frames and revenue is recognised when the risks and rewards of ownership are transferred to the customer.

Segmental information

Segmental information is presented according to the Group's internal management reporting structure and the markets in which it operates. Segmental results represent the contribution of the different segments to the profit of the Group. Corporate expenses are allocated to the corresponding segments. Unallocated items mainly comprise specific adjusting items. Specific adjusting items are referred to in note 4.

Segmental assets and liabilities information is not regularly provided to the chief operating decision maker.

Research and development expenditure

R&D costs incurred in respect of specific contracts placed by customers are recognised within operating costs and revenue is recognised in respect of the R&D services performed. Internally funded development expenditure is capitalised in the balance sheet where there is a clearly defined project, the expenditures are separately identifiable, the project is technically and commercially feasible, all costs are recoverable by future revenue and the resources are committed to complete the project. Such capitalised costs are amortised over the forecast period of sales resulting from the development. All other R&D costs are expensed to the income statement in the period in which they are incurred. If the research phase cannot be clearly distinguished from the development phase, the respective project-related costs are treated as if they were incurred in the research phase only and expensed.

Financing

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 finance income and finance expense. Financing also includes the net finance expense in respect of defined benefit pension schemes.

Taxation

The taxation charge is based on the taxable profit for the year and takes into account taxation deferred because of temporary differences between the treatment of certain items for taxation and accounting purposes. Current tax and deferred tax are charged or credited to the income statement, except where they relate to items charged or credited to equity, in which case the relevant tax is charged or credited to equity. Deferred taxation is the tax attributable to the temporary differences that appear when taxation authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated financial statements. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using rates enacted or substantively enacted at the balance sheet date.

Any changes in the tax rates are recognised in the income statement unless related to items directly recognised in equity. Deferred tax liabilities are recognised on all taxable temporary differences excluding non-deductible goodwill. Deferred tax assets are recognised on all deductible temporary differences provided that it is probable that future taxable income will be available against which the asset can be utilised. Deferred tax assets and liabilities are offset only where there is a legally enforceable right to offset and there is an intention to settle balances on a net basis.

Discontinued operation

A discontinued operation is a component of the Group's business, the operations and cash flows of which can be clearly distinguished from the rest of the Group and which:

- represents a separate major line of business or geographical area of operations;
- is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to re-sale.

Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held for sale. When an operation is classified as a discontinued operation, the comparative statement of profit and loss and other comprehensive income is re-presented as if the operation had been discontinued from the start of the comparative year.

Goodwill

Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of joint ventures and associates is included in the carrying value of equity accounted investments. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill related to the entity sold.

Notes to the financial statements continued

1. Significant accounting policies continued

Intangible assets

Intangible assets arising from business combinations are recognised at fair value and are amortised over their expected useful lives, typically between one and sixteen years. Internally generated intangible assets are recorded at cost, including labour, directly attributable costs and any third-party expenses.

The 'multi-period excess earnings' method and the 'relief-from-royalty' method are both used for fair valuing intangible assets arising from acquisitions. The multi-period excess earnings method considers the present value of net cash flows expected to be generated by customer relationships, by excluding any cash flows related to contributory assets. The relief-from-royalty method considers the discounted estimated royalty payments that are expected to be avoided as a result of the patents or trademarks being owned.

Purchased intangible assets are recognised at cost less amortisation. Intangible assets are amortised over their respective useful lives on a straight-line basis as follows:

Intellectual property rights	2–8 years
Customer relationships	1–16 years
Development costs	1–4 years
Other	1–9 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 costs and interest.

The useful lives, depreciation methods and residual values applied to property, plant and equipment are reviewed annually and, if appropriate, adjusted accordingly.

Impairment of goodwill and tangible, intangible and held for sale assets

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

Investments in debt and equity securities

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

The fair value of quoted financial instruments is their bid price at the balance sheet date. The fair value of unquoted equity investments is based on the price of the most recent investment by the Group or a third party, if available, or derived from the present value of forecast future cash flows.

Inventories

Inventory and work-in-progress are stated at the lower of cost and net realisable value. Work-in-progress and manufactured finished goods are valued at production cost. Production cost includes direct production costs and an appropriate proportion of production overheads. A provision is established when the net realisable value of any inventory item is lower than its cost. A 'market comparison' technique is used to fair value inventories acquired through a business combination. The fair value is determined based on the estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventories.

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, the costs are 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 are expensed in the income statement immediately, when it becomes likely that financial close will not be achieved.

Trade and other receivables

Trade and other receivables are stated net of provisions for doubtful debts. Amounts recoverable on contracts are included in trade and other receivables and represent revenue recognised in excess of amounts invoiced. Payments received on account are included in trade and other payables and represent amounts invoiced in excess of revenue recognised. Other receivables will also include insurance recoveries where we are virtually certain of recovery.

Cash and cash equivalents

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

Current and non-current liabilities

Current liabilities include amounts due within the normal operating cycle of the Group. Interest-bearing current and non-current liabilities are initially recognised at fair value and then stated at amortised cost with any difference between the cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis. Costs associated with the arrangement of bank facilities or the issue of loans are held net of the associated liability presented in the balance sheet. Capitalised issue costs are released over the estimated life of the facility or instrument to which they relate using the effective interest rate method. If it becomes clear that the facility or instrument will be redeemed early, the amortisation of the issue costs will be accelerated.

Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event which can be reliably estimated, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where appropriate, provisions are determined by discounting the expected cash flows at an appropriate discount rate reflecting the level of risk and the time value of money.

Financial instruments

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

Derivative financial instruments

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

Fair value hedging

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

Cash flow hedging

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

Leased assets

Leases are classified as finance leases when substantially all the risks and rewards of ownership are held by the lessee. 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 financial liabilities.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the lease.

Foreign currencies

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

The individual financial statements of each Group company are presented in its functional currency. On consolidation, assets and liabilities of overseas subsidiaries, associated undertakings and joint ventures, including any related goodwill, are translated to sterling at the rate of exchange at the balance sheet date. The results and cash flows of overseas subsidiaries, associated undertakings and joint ventures are translated to sterling using the average rates of exchange during the period. Exchange adjustments arising from the re-translation of the opening net investment and the results for the period to the period-end rate are taken directly to equity and reported in the statement of comprehensive income.

Post-retirement benefits

The Group provides both defined contribution and defined benefit pension arrangements. The liabilities of the Group arising from defined benefit obligations are determined using the projected unit credit method. Valuations for accounting purposes are carried out bi-annually. Actuarial advice is provided by external consultants. For the funded defined benefit plans, the excess or deficit of the fair value of plan assets less the present value of the defined benefit obligation are recognised as an asset or a liability respectively.

For defined benefit plans, the cost charged to the income statement consists of administrative expenses and the net interest cost. There is no service cost due to the fact the plans are closed to future accrual. The finance element of the pension charge is shown in finance expense and the administration cost element is charged as a component of operating costs in the income statement. Actuarial gains and losses and re-measurement gains and losses are recognised immediately in full through the statement of comprehensive income. Contributions to defined contribution plans are charged to the income statement as incurred.

Share-based payments

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

Notes to the financial statements continued

1. Significant accounting policies continued

Share capital

Ordinary share capital of the Company is recorded as the proceeds received, less issue costs. Company shares held by the employee benefit trusts are held at the consideration paid. They are classified as own shares within equity. Any gain or loss on the purchase, sale or issue of Company shares is recorded in equity.

Recent accounting developments

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

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

- **IFRS 11 Joint arrangements** – amendment to add guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business.
- **IAS 16 Property, plant and equipment** – amendments that change the financial reporting for bearer plants such as grape vines and rubber trees. Bearer plants should now be accounted for in the same way as property, plant and equipment. The produce growing on bearer plants will remain within the scope of IAS 41.
- **IAS 16 Property, plant and equipment and IAS 38 Intangible assets** – clarification of acceptable methods of depreciation and amortisation.
- **IAS 27(R) Separate financial statements** – amendment allowing entities to use the equity method to account for investment in subsidiaries, joint ventures and associates in their separate financial statements.
- **IAS 1 Presentation of financial statements** – amendment to improve presentation and disclosure in financial reports.
- **IFRS 10 Consolidated financial statements and IAS 28 Investments in Associates and joint ventures** – amendments to both applying the consolidation exemption and also on the sale or contribution of assets (note not yet endorsed for use in the EU).

Annual improvement 2012-2014 cycle:

- **IFRS 5 Non-current assets held for sale and discontinued operations** – amendment regarding methods of disposal.
- **IFRS 7 Financial instruments: Disclosures** – amendment regarding servicing contracts and the transfer of financial assets to a third party under conditions which allow the transferor to derecognise the asset but retain continuing involvement in them. A second amendment clarifies that some interim disclosures in IFRS 7 are not required.
- **IAS 19 Employee benefits** – amendments regarding discount rates; when determining the discount rate for post-employment benefit obligations, it is the currency that the liabilities are denominated in that is important and not the country where they arise.
- **IAS 34 Interim financial reporting** – amendment requiring 'information disclosed elsewhere in the interim financial report' to be cross-referenced from the interim financial statement to the location of that information.

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

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

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

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

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

Leases: The final Standard IFRS 16 'Leases' was published in January 2016. Under the new Standard, companies will recognise new assets and liabilities, bringing added transparency to the balance sheet. IFRS 16 eliminates the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead, there is a single, on-balance sheet accounting model that is similar to current finance lease accounting. Lessor accounting remains similar to current practice – i.e. lessors continue to classify leases as finance and operating leases. The Standard will be effective from 1 January 2019 for QinetiQ subject to EU endorsement.

IFRS 9 Financial Instruments – This new Standard on accounting for financial instruments will replace IAS 39 Financial Instruments: Recognition and Measurement. The Standard will be effective from 1 January 2018.

Developments expected in future periods with no material impact on the Group's financial statements

The Directors anticipate that the adoption of the following new, revised, amended and improved published standards and interpretations, which were in issue at the date of authorisation of these financial statements, will have no material impact on the financial statements of the Group when they become applicable in future periods:

- Amendments to IFRS 2, 4, 9 and 15;
- Amendments to IAS 7, 12 and 40.

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 judgment required includes assumptions and estimates about future events that are uncertain and the actual outcome of which may result in a materially different outcome from that anticipated.

Revenue and profit recognition

The estimation process required to evaluate the potential outcome of contracts and projects requires skill, knowledge and experience from a variety of sources within the business to assess the status of the contract, costs to complete, internal and external labour resources required and other factors. This process is carried out continuously throughout the business to ensure that project and contract assessments reflect the latest status of such work. No profit is recognised on a contract until the outcome can be reliably estimated.

Business combinations and related goodwill

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 has suffered any impairment. This process relies on the use of estimates of the future profitability and cash flows of its CGUs which may differ from the actual results delivered. In addition, the Group reviews whether identified intangible assets have suffered any impairment. Further details on the sensitivity of the carrying value of goodwill to changes in the key assumptions are set out in note 13.

Tax

In determining the Group's provisions for current tax and deferred tax, it is necessary to assess the likelihood and timing of recovery of tax losses created, and 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 current tax and deferred tax provisions held in the period the determination is made.

Other payables, provisions and contingent liabilities

The Group holds liabilities in respect of environmental and regulatory issues (see note 23). The Group operates in regulated environments and a failure to comply with particular regulations could result in fines and/or penalties. There is judgement required in determining the significance of any instances of potential non-compliance and potential liability based on management's assessment of the most likely outcome. The financial statements also disclose contingent liabilities in respect of legal claims and regulatory issues which have not been provided for on the basis that they are not considered to qualify for recognition as provisions. Judgement is required in these assessments.

Post-retirement benefits

The Group's defined benefit pension obligations and net income statement costs are based on key assumptions, including discount rates, mortality and inflation. Management exercises its best judgement, in consultation with actuarial advisors, in selecting the values for these assumptions that are the most appropriate to the Group. Small changes in these assumptions at the balance sheet date, individually or collectively, may result in significant changes in the size of the net surplus/deficit. Further details of these assumptions are set out in note 30.

Notes to the financial statements continued

2. Revenue and other income

Revenue and other income is analysed as follows:

Revenue by category

For the year ended 31 March

all figures in £ million	2017	2016
Sales of goods	90.6	66.0
Services	682.4	679.0
Royalties and licences	10.1	10.7
Revenue	783.1	755.7
Share of associates' profit after tax	0.5	0.5
Other income	8.7	9.0
Total other income	9.2	9.5

Revenue and profit after tax of associates was £8.2m and £1.0m respectively (2016: revenue of £7.3m and profit after tax of £1.0m). The figures in the table above represent the Group share of this profit after tax.

Other income is in respect of property rentals and the recovery of other related property costs.

Revenue by customer geographic location

For the year ended 31 March

all figures in £ million	2017	2016
United Kingdom	607.4	597.8
US	72.4	69.4
Other	103.3	88.5
Total	783.1	755.7

Revenue by major customer type

For the year ended 31 March

all figures in £ million	2017	2016
UK Government	538.4	531.0
US Government	61.8	53.0
Other	182.9	171.7
Total	783.1	755.7

'Other' does not contain any customers with revenue in excess of 10% of total Group revenue.

3. Segmental analysis

Operating segments

all figures in £ million	2017		2016	
	Revenue	Underlying operating Profit ¹	Revenue	Underlying operating Profit ¹
EMEA Services	613.5	92.7	616.4	93.8
Global Products	169.6	23.6	139.3	15.1
Total operating segments	783.1	116.3	755.7	108.9
Underlying operating margin*		14.9%		14.4%

No measure of segmental assets and liabilities is reported as this information is not regularly provided to the chief operating decision maker.

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

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

Reconciliation of segmental results to total profit

all figures in £ million	Note	2017	2016
Underlying operating profit*		116.3	108.9
Specific adjusting items operating profit/(loss)	4	16.4	(33.6)
Operating profit		132.7	75.3
Net finance expense	6	(1.2)	(1.3)
Gain on business divestments	4	–	16.2
Profit before tax		131.5	90.2
Taxation (expense)/income	8	(8.2)	8.4
Profit for the year from continuing operations		123.3	98.6
Profit from discontinued operations, net of tax	4	–	7.5
Profit for the year attributable to equity shareholders		123.3	106.1

¹ The measure of profit presented to the chief operating decision maker is operating profit stated before specific adjusting items ('underlying operating profit'). The specific adjusting items are detailed in note 4.

* Definitions of the Group's 'Alternative performance measures' can be found in the glossary on page 151.

Notes to the financial statements continued

3. Segmental analysis continued

Depreciation and amortisation by business segment – excluding specific adjusting items

For the year ended 31 March 2017

all figures in £ million	EMEA Services	Global Products	Total
Depreciation of property, plant and equipment	24.8	1.6	26.4
Amortisation of purchased or internally developed intangible assets	1.4	1.2	2.6
	26.2	2.8	29.0

For the year ended 31 March 2016

all figures in £ million	EMEA Services	Global Products	Total
Depreciation of property, plant and equipment	21.1	1.9	23.0
Amortisation of purchased or internally developed intangible assets	1.3	1.5	2.8
	22.4	3.4	25.8

Excludes specific adjusting items not included within the measure of operating profit reported to the chief operating decision maker.

Non-current assets* by geographic location

all figures in £ million	UK	Rest of World	Total
Year ended 31 March 2017	303.0	78.3	381.3
	UK	Rest of World	Total
Year ended 31 March 2016	264.3	50.5	314.8

* excluding deferred tax, financial instruments and retirement benefit surplus.

4. 'Specific adjusting items'

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

all figures in £ million	Note	2017	2016
Profit on disposal of property		18.4	0.3
Acquisition costs		(1.0)	–
Specific adjusting items before amortisation, depreciation and impairment		17.4	0.3
Impairment of goodwill	13	–	(31.9)
Amortisation of intangible assets arising from acquisitions		(1.0)	(2.0)
Specific adjusting items operating profit/(loss)		16.4	(33.6)
Gain on business divestments (sale of Cyveillance)		–	16.2
Defined benefit pension scheme net finance expense		(1.0)	(1.1)
Specific adjusting items profit/(loss) before tax		15.4	(18.5)
Specific adjusting items – tax	8	4.1	21.2
Specific adjusting items profit after tax – continuing operations		19.5	2.7
Profit on disposal of subsidiary – discontinued operations		–	7.5
Total specific adjusting items profit after tax		19.5	10.2
Reconciliation of underlying profit for the year to total profit for the year			
Underlying profit after tax – total Group		103.8	95.9
Total specific adjusting items profit after tax		19.5	10.2
Total profit for the year attributable to equity shareholders		123.3	106.1

5. Profit before tax

The following auditor's remuneration has been charged in arriving at profit before tax:

all figures in £ million	2017	2016
Fees payable to the auditor and its associates:		
Audit of the Group's annual accounts	0.4	0.4
Audit of the accounts of subsidiaries of the Company and its associated pension scheme	0.1	0.1
Audit-related assurance services	0.1	0.1
Total audit fees	0.6	0.6
All other non-audit services	–	0.2
Total non-audit fees	–	0.2
Total auditor's remuneration	0.6	0.8

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

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

6. Finance income and expense

For the year ended 31 March

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

Notes to the financial statements continued

7. Business combinations

Acquisitions in the year to 31 March 2017

all figures in £ million

Company acquired	Date acquired	Cash consideration ¹	Goodwill	Fair value of assets acquired ²	Contribution post-acquisition	
					Revenue	Operating profit
QinetiQ Target Systems	21 December 2016	60.3	(24.5)	35.8	6.6	1.0
RubiKon Group Pty Limited	31 January 2017	7.4	(3.9)	3.5	2.6	0.2
Total current year acquisitions		67.7	(28.4)	39.3	9.2	1.2
Less: deferred consideration		(1.3)				
Less: cash acquired		(1.7)				
Plus: transaction costs ³		1.0				
Net cash outflow in the year		65.7				

¹ Initial cash consideration includes price adjustments for working capital and net cash.

² Fair value of assets acquired are provisional.

³ Transaction costs have been included in 'Operating costs excluding depreciation and amortisation' as a specific adjusting item.

QinetiQ Target Systems (formerly Meggitt Target Systems)

On 21 December 2016, the Group acquired 100% of the issued share capital of Meggitt Target Systems for £60.3m. The company is a provider of unmanned aerial, naval and land-based target systems and services for test and evaluation ('T&E') and operational training and rehearsal. On the date of acquisition, the company changed its name to QinetiQ Target Systems and integrated into QinetiQ's international business.

QinetiQ Target Systems provides target systems to approximately 40 countries with operations in Alberta, Canada and Kent, UK. The acquisition of this company enhances QinetiQ's product portfolio, market position and ability to deliver global test and evaluation services. If the acquisition had occurred on the first day of the financial year, Group revenue for the period would have been £806.3m and the Group profit before tax would have been £136.6m.

Identifiable assets acquired and liabilities assumed

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

all figures in £ million	Note	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets	14	–	24.2	24.2
Property, plant and equipment	15	1.9	–	1.9
Inventory		8.6	1.6	10.2
Trade and other receivables		6.8	–	6.8
Cash and cash equivalents		1.5	–	1.5
Trade and other payables		(3.7)	–	(3.7)
Corporation tax		0.1	–	0.1
Deferred tax liability	17	–	(5.2)	(5.2)
Net assets acquired		15.2	20.6	35.8
Goodwill	13			24.5
				60.3
Consideration satisfied by:				
Cash				60.1
Deferred consideration				0.2
Total consideration				60.3

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

RubiKon Group Pty Limited

On 31 January 2017, the Group acquired 100% of the issued share capital of RubiKon Group Pty Limited from its founder management team for £7.4m (AUD\$12.6m). The company provides solutions to complex logistics, supply chain management and procurement projects in defence, aerospace, mining and government markets. RubiKon is now subsumed into the Australia business.

RubiKon's integrated logistics support services are complementary to the technical engineering advice and services that the Group provide. The acquisition is also expected to provide the Group with an increased share of 'strategic partner' style contracts in the growing Australian markets through access to RubiKon's customer base. If the acquisition had occurred on the first day of the financial year, Group revenue for the period would have been £790.5m and the Group profit before tax would have been £132.5m.

Identifiable assets acquired and liabilities assumed

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

all figures in £ million	Note	Book value	Fair value adjustment	Fair value at acquisition
Intangible assets	14	–	3.1	3.1
Property, plant and equipment	15	–	–	–
Trade and other receivables		2.4	–	2.4
Cash and cash equivalents		0.2	–	0.2
Trade and other payables		(1.0)	–	(1.0)
Other non-current liabilities		(0.1)	–	(0.1)
Deferred tax liability	17	(0.1)	(1.0)	(1.1)
Net assets acquired		1.4	2.1	3.5
Goodwill	13			3.9
				7.4
Consideration satisfied by:				
Cash				6.3
Deferred consideration				1.1
Total consideration				7.4

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

Notes to the financial statements continued

8. Taxation

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

* Details of specific adjusting items can be found in note 4.

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

Factors affecting future tax charges

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

9. Dividends

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

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

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

10. Analysis of employee costs and numbers

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

	As at 31 March		Monthly average	
	2017 Number	2016 Number	2017 Number	2016 Number
EMEA Services	5,301	5,514	5,375	5,595
Global Products	853	693	739	671
Total	6,154	6,207	6,114	6,266

The aggregate payroll costs of these persons were as follows:

all figures in £ million	Note	2017	2016
Wages and salaries		272.9	263.7
Social security costs		27.1	27.2
Pension costs		37.8	37.0
Share-based payments costs	29	3.3	4.7
Total employee costs		341.1	332.6

11. Directors and other senior management personnel

The Directors and other senior management personnel of the Group during the year to 31 March 2017 comprise the Board of Directors and the Executive Committee. The remuneration and benefits provided to Directors and the Executive Committee are summarised below:

all figures in £ million	2017	2016
Short-term employee remuneration including benefits	7.4	6.9
Post-employment benefits	0.1	0.1
Share-based payments costs	0.8	1.2
Total	8.3	8.2

Short-term employee remuneration and benefits include salary, bonus and benefits. Post-employment benefits relate to pension amounts.

Notes to the financial statements continued

12. Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the year. The weighted average number of shares used excludes those shares bought by the Group and held as own shares (see note 28). For diluted earnings per share the weighted average number of shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares arising from unvested share-based awards including share options.

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

Underlying basic earnings per share figures are presented below, in addition to the basic and diluted earnings per share, because the Directors consider this gives a more relevant indication of underlying business performance and reflects the adjustments to basic earnings per share for the impact of specific adjusting items (see note 4) and tax thereon.

Underlying EPS

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

Basic and diluted EPS – continuing operations

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

Basic and diluted EPS – total Group

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

13. Goodwill

all figures in £ million

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

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

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

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

Key assumptions

Cash flows

The value-in-use calculations generally use discounted future cash flows based on financial plans approved by the Board covering a two-year period. Discounted cash flows for the US Global Products CGU were based on a Board-approved three-year plan, reflecting increases in revenue from new product lines. Cash flows for periods beyond these periods are extrapolated based on the last year of the plans, with a terminal growth-rate assumption applied.

Terminal growth rates

The specific plans for each of the CGUs have been extrapolated using a terminal growth rate of 2.0% – 2.4% (2016: 2.0% – 2.4%). The US terminal growth rate was 2.0% (2016: 2.4%). Growth rates are based on management's estimates which take into consideration the long-term nature of the industry in which the CGUs operate and external forecasts as to the likely growth of the industry in the longer term.

Discount rates

The Group's weighted average cost of capital was used as a basis in determining the discount rate to be applied, adjusted for risks specific to the market characteristics of CGUs, as appropriate on a pre-tax basis. This is considered to appropriately estimate a market participant discount rate. The pre-tax discount rates applied for the two EMEA Services CGUs were 10.9% and 16.1%, for the UK Global Products CGU was 10.8% and for the US Global Products CGU was 11.2%.

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

Significant CGUs

US Global Products

The carrying value of the goodwill for the US Global Products CGU, which had been written down in the prior year, was £43.4m as at 31 March 2017 (2016: £37.9m). The recoverable amount of this CGU as at 31 March 2017, based on value in use and calculated using the assumptions noted above, is marginally higher than the carrying value of net operating assets (of £49.5m) and no further impairment is required in the year to 31 March 2017. The key sensitivity impacting on the value in use calculations is the terminal year cash flows. These cash flows include certain assumptions about revenue and profit in respect of new product lines still to be launched and the success of winning certain government contracts. An increase in the discount rate or a decrease in the terminal growth rate by 1% would not cause the net operating assets to exceed their recoverable amount. However, a reduction of £1.5m in the terminal year cash flows would lead to the recoverable amount no longer exceeding the carrying value. Any additional reduction in terminal year cash flows would result in an impairment of the goodwill of this CGU.

Other CGUs

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

Notes to the financial statements continued

14. Intangible assets

Year ended 31 March 2017

all figures in £ million	Acquired intangible assets					Total
	Customer relationships	Intellectual property	Brand names	Development costs	Other intangible assets	
Cost						
At 1 April 2016	31.9	52.7	2.1	18.5	42.2	147.4
Additions – internally developed	–	–	–	0.4	0.7	1.1
Additions – purchased	–	–	–	–	1.1	1.1
Additions – recognised on acquisitions	20.5	6.8	–	–	–	27.3
Disposals	–	–	–	(0.1)	(0.2)	(0.3)
Transfers	–	–	–	0.9	(0.9)	–
Foreign exchange	3.6	5.4	0.5	–	0.4	9.9
At 31 March 2017	56.0	64.9	2.6	19.7	43.3	186.5
Amortisation and impairment						
At 1 April 2016	31.2	51.1	1.5	16.5	38.8	139.1
Amortisation charge for year	0.4	0.6	–	1.3	1.3	3.6
Disposals	–	–	–	–	(0.2)	(0.2)
Foreign exchange	3.3	5.3	0.3	–	0.4	9.3
At 31 March 2017	34.9	57.0	1.8	17.8	40.3	151.8
Net book value at 31 March 2017	21.1	7.9	0.8	1.9	3.0	34.7

Intangible assets of £24.2m and £3.1m were acquired as part of the QinetiQ Target Systems and RubiKon acquisitions respectively. Further information on these acquisitions is given in note 7.

Year ended 31 March 2016

all figures in £ million	Acquired intangible assets					Total
	Customer relationships	Intellectual property	Brand names	Development costs	Other intangible assets	
Cost						
At 1 April 2015	39.0	58.9	4.1	17.0	42.3	161.3
Additions – internally developed	–	–	–	0.4	0.5	0.9
Additions – purchased	–	–	–	0.1	0.6	0.7
Disposals	–	–	–	–	(0.5)	(0.5)
Divestments	(7.7)	(7.3)	(2.2)	–	–	(17.2)
Transfers	–	–	–	1.0	(0.9)	0.1
Foreign exchange	0.6	1.1	0.2	–	0.2	2.1
At 31 March 2016	31.9	52.7	2.1	18.5	42.2	147.4
Amortisation and impairment						
At 1 April 2015	33.0	57.8	2.6	15.0	37.6	146.0
Amortisation charge for year	0.3	1.6	0.1	1.2	1.3	4.5
Impairments	–	–	–	0.3	–	0.3
Disposals	–	–	–	–	(0.2)	(0.2)
Divestments	(2.9)	(9.3)	(1.3)	–	–	(13.5)
Foreign exchange	0.8	1.0	0.1	–	0.1	2.0
At 31 March 2016	31.2	51.1	1.5	16.5	38.8	139.1
Net book value at 31 March 2016	0.7	1.6	0.6	2.0	3.4	8.3

15. Property, plant and equipment

Year ended 31 March 2017

all figures in £ million	Land and buildings	Plant, machinery and vehicles	Computers and office equipment	Assets under construction	Total
Cost					
At 1 April 2016	318.4	190.7	49.2	31.8	590.1
Additions – purchased	0.8	3.1	0.8	26.0	30.7
Additions – acquisitions	0.8	0.8	0.3	–	1.9
Disposals	(0.4)	(4.9)	(3.6)	(1.2)	(10.1)
Transfers	11.2	6.5	4.6	(22.3)	–
Foreign exchange	0.9	2.3	0.8	–	4.0
At 31 March 2017	331.7	198.5	52.1	34.3	616.6
Depreciation					
At 1 April 2016	162.4	156.4	37.9	–	356.7
Charge for year	12.1	9.9	4.4	–	26.4
Disposals	(0.4)	(4.9)	(3.6)	–	(8.9)
Foreign exchange	0.8	2.1	0.7	–	3.6
At 31 March 2017	174.9	163.5	39.4	–	377.8
Net book value at 31 March 2017	156.8	35.0	12.7	34.3	238.8

Year ended 31 March 2016

all figures in £ million	Land and buildings	Plant, machinery and vehicles	Computers and office equipment	Assets under construction	Total
Cost					
At 1 April 2015	312.6	174.3	41.5	37.1	565.5
Additions – purchased	2.2	2.9	1.9	21.6	28.6
Disposals	(0.2)	(1.0)	(0.4)	(1.2)	(2.8)
Divestments	(0.2)	–	(1.8)	–	(2.0)
Transfers	3.8	14.0	7.8	(25.7)	(0.1)
Foreign exchange	0.2	0.5	0.2	–	0.9
At 31 March 2016	318.4	190.7	49.2	31.8	590.1
Depreciation					
At 1 April 2015	152.3	147.0	36.2	0.4	335.9
Charge for year	10.2	9.7	3.5	–	23.4
Impairment	–	–	–	(0.4)	(0.4)
Disposals	(0.1)	(0.7)	(0.3)	–	(1.1)
Divestments	(0.1)	–	(1.6)	–	(1.7)
Foreign exchange	0.1	0.4	0.1	–	0.6
At 31 March 2016	162.4	156.4	37.9	–	356.7
Net book value at 31 March 2016	156.0	34.3	11.3	31.8	233.4

Divestments were in respect of the disposal of the Cyveillance business (see note 4).

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 31.

Notes to the financial statements continued

16. Non-current investments

As at 31 March

	2017		2016	
	Joint venture and associates financial results	Group net share of joint ventures and associates	Joint venture and associates financial results	Group net share of joint ventures and associates
all figures in £ million				
Non-current assets	0.3	0.1	0.2	0.1
Current assets	6.8	3.3	12.8	6.1
	7.1	3.4	13.0	6.2
Current liabilities	(4.2)	(2.0)	(11.2)	(5.4)
Net assets of joint ventures and associates	2.9	1.4	1.8	0.8
Other non-current investments		0.1		0.1
Total	2.9	1.5	1.8	0.9

During the year ended 31 March 2017 there were sales to associates of £3.4m (2016: £3.2m). At the year end there were outstanding receivables from associates of £0.4m (2016: £0.4m).

17. Deferred tax

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

Movements in the deferred tax assets and liabilities are shown below:

Year ended 31 March 2017

Deferred tax asset

	Pension liability	Short-term timing differences	Trading losses	Total
all figures in £ million				
At 1 April 2016	1.5	8.0	–	9.5
(Charged)/credited to income statement	(1.7)	1.1	3.7	3.1
Credited/(charged) to other comprehensive income	(31.2)	–	–	(31.2)
Transfer to current tax	–	(0.1)	–	(0.1)
Foreign exchange	–	1.0	–	1.0
Acquired in business combinations	–	(0.1)	–	(0.1)
Transfer to liability	31.4	–	–	31.4
Gross deferred tax asset at 31 March 2017	–	9.9	3.7	13.6
Less: liability available for offset				(8.2)
Net deferred tax asset at 31 March 2017				5.4

Deferred tax liability

	Pension surplus	Accelerated capital allowances	Amortisation	Total
all figures in £ million				
At 1 April 2016	–	(3.1)	(2.3)	(5.4)
Charged to income statement	–	(1.9)	(0.2)	(2.1)
Foreign exchange	–	0.1	(0.2)	(0.1)
Acquired in business combinations	–	–	(6.2)	(6.2)
Transfer from asset	(31.4)	–	–	(31.4)
Gross deferred tax liability at 31 March 2017	(31.4)	(4.9)	(8.9)	(45.2)
Less: asset available for offset				8.2
Net deferred tax liability at 31 March 2017				(37.0)

Deferred tax has been calculated using the enacted future statutory tax rates.

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

Year ended 31 March 2016**Deferred tax asset**

all figures in £ million	Pension liability	Short-term timing differences	Trading losses	Total
At 1 April 2015	1.6	7.6	25.2	34.4
(Charged)/credited to income statement	(2.3)	0.6	(25.2)	(26.9)
Credited/(charged) to other comprehensive income	2.2	(0.1)	–	2.1
Foreign exchange	–	0.1	–	0.1
Eliminated on disposal	–	(0.2)	–	(0.2)
Gross deferred tax asset at 31 March 2016	1.5	8.0	–	9.5
Less: liability available for offset				(5.4)
Net deferred tax asset at 31 March 2016				4.1

Deferred tax liability

all figures in £ million	Accelerated capital allowances	Amortisation	Total
At 1 April 2015	(17.7)	(3.8)	(21.5)
Credited to income statement	4.2	0.1	4.3
Eliminated on disposal	(0.1)	1.5	1.4
Foreign exchange	0.1	(0.1)	–
Transferred to current tax	10.4	–	10.4
Gross deferred tax liability at 31 March 2016	(3.1)	(2.3)	(5.4)
Less: asset available for offset			5.4
Net deferred tax liability at 31 March 2016			–

18. Inventories**As at 31 March**

all figures in £ million	2017	2016
Raw materials	12.1	10.0
Work in progress	6.1	4.0
Finished goods	10.7	5.0
	28.9	19.0

The increase in inventories reflects the acquisition of Meggitt Target Systems in the year (see note 7).

Notes to the financial statements continued

19. Trade and other receivables

As at 31 March

all figures in £ million	2017	2016
Trade receivables	75.6	64.8
Amounts recoverable under contracts	54.5	54.0
Other receivables	32.1	26.3
Prepayments	13.4	11.1
	175.6	156.2

In determining the recoverability of trade receivables, the Group considers any change in the credit quality of the trade receivable from the date credit was granted to the reporting date. Credit risk is limited as a result of the high percentage of revenue derived from UK and US government agencies. Accordingly, the Directors believe that no credit provision in excess of the allowance for doubtful debts is required. As at 31 March 2017 the Group carried a provision for doubtful debts of £2.0m (2016: £4.1m).

Ageing of past due but not impaired receivables

all figures in £ million	2017	2016
Up to three months	5.5	8.0
Over three months	3.7	1.4
	9.2	9.4

Movements in the doubtful debt provision

all figures in £ million	2017	2016
At 1 April	4.1	3.3
Created	0.2	2.1
Released	(1.4)	(0.2)
Utilised	(1.0)	(1.1)
FX	0.1	–
At 31 March	2.0	4.1

The maximum exposure to credit risk in relation to trade receivables at the reporting date is the fair value of trade receivables. The Group does not hold any collateral as security.

20. Current asset investments

As at 31 March

all figures in £ million	2017	2016
Current asset investments	1.3	1.7

At 31 March 2017, the Group held a 2.6% shareholding in pSivida Limited (31 March 2016: 2.6%), a company listed on NASDAQ and the Australian and Frankfurt Stock Exchanges. The investment is held at fair value using the closing share price at 31 March 2017 of AUS\$2.34 per share (31 March 2016: AUS\$3.56 per share).

21. Trade and other payables

As at 31 March

all figures in £ million	2017	2016
Trade payables	37.4	32.9
Other tax and social security	34.8	32.3
Deferred income	97.1	111.3
Accrued expenses and other payables	152.8	162.2
Total current trade and other payables	322.1	338.7
Payments received on account	7.7	9.9
Other payables	4.8	1.1
Total non-current trade and other payables	12.5	11.0
Total trade and other payables	334.6	349.7

22. Current tax

As at 31 March

all figures in £ million	2017	2016
Current tax liability	43.7	39.9

The current tax liability includes taxes due in the US following a court decision in respect of the tax treatment of the Group's acquisition of Dominion Technology Resources, Inc. in 2008. An insurance policy was taken out by the Group at the point of acquisition and, if the court's decision is final, then the funds required to settle this dispute will be provided by the insurers. Hence, an offsetting receivable is reported on the balance sheet as at 31 March 2017 (included within trade and other receivables).

23. Provisions

Year ended 31 March 2017

all figures in £ million	Property	Other	Total
At 1 April 2016	13.4	5.7	19.1
Created in year	1.5	6.0	7.5
Released in year	(0.3)	(0.2)	(0.5)
Unwind of discount	0.3	–	0.3
Utilised in year	(1.9)	(0.6)	(2.5)
Foreign exchange	–	0.1	0.1
At 31 March 2017	13.0	11.0	24.0
Current liability	3.1	3.1	6.2
Non-current liability	9.9	7.9	17.8
At 31 March 2017	13.0	11.0	24.0

Property provisions relate to under-utilised properties in the UK. The extent of the provision is affected by the timing of when properties can be sub-let and the proportion of space that can be sub-let. Based on current assessment the provision will be utilised within 10 years.

Other provisions relate to environmental and other liabilities, the magnitude and timing of utilisation of which are determined by a variety of factors.

Notes to the financial statements continued

24. Net cash

As at 31 March

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

At 31 March 2017, the Group held £1.5m (2016: £0.1m) of cash which is restricted in its use. The available-for-sale investment is a 'Libor-plus' investment fund investing in a portfolio of AAA and AA-rated asset backed securities and corporate floating rate notes.

Reconciliation of net cash flow to movement in net cash

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

25. Operating leases

Group as a lessor

The Group receives rental income on certain properties. Primarily these are properties partially occupied by Group companies, with vacant space sub-let to third-party tenants. The Group had contracted with tenants for the following future minimum lease payments:

all figures in £ million	2017	2016
Within one year	5.3	6.5
In the second to fifth years inclusive	8.8	13.6
Greater than five years	6.1	7.2
	20.2	27.3

Group as a lessee

all figures in £ million	2017	2016
Lease and sub-lease income statement expense for the year	6.7	5.3

The Group had the following total future minimum lease payment commitments:

all figures in £ million	2017	2016
Within one year	8.2	9.4
In the second to fifth years inclusive	17.5	8.1
Greater than five years	6.1	1.5
	31.8	19.0

Operating lease payments represent rentals payable by the Group on certain property, plant and equipment. Principal operating leases are negotiated for a term of approximately ten years.

26. Financial risk management

The Group's international operations expose it to financial risks that include the effects of changes in foreign exchange rates, interest rates, credit risks and liquidity risks.

Treasury and risk management policies, which are set by the Board, specify guidelines on financial risks and the use of financial instruments to manage risk. The instruments and techniques used to manage exposures include foreign currency derivatives. Group treasury monitors financial risks and compliance with risk management policies. There have been no changes in any risk management policies since the year end.

A) Fair values of financial instruments

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

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

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

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

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

all figures in £ million	Note	Level 1	Level 2	Level 3	Total
Assets					
Available-for-sale investments	24	10.4	–	–	10.4
Current other investments	20	1.3	–	–	1.3
Non-current other investments	16	–	–	0.1	0.1
Non-current derivative financial instruments	24	–	0.3	–	0.3
Liabilities					
Current derivative financial instruments	24	–	(0.8)	–	(0.8)
Non-current derivative financial instruments	24	–	(0.3)	–	(0.3)
Total		11.7	(0.8)	0.1	11.0

The following table presents the Group's assets and liabilities that are measured at fair value as at 31 March 2016:

all figures in £ million	Note	Level 1	Level 2	Level 3	Total
Assets					
Available-for-sale investments	24	9.9	–	–	9.9
Current other investments	20	1.7	–	–	1.7
Current derivative financial instruments	24	–	0.6	–	0.6
Non-current other investments	16	–	–	0.1	0.1
Non-current derivative financial instruments	24	–	0.1	–	0.1
Liabilities					
Current derivative financial instruments	24	–	(0.2)	–	(0.2)
Non-current derivative financial instruments	24	–	(0.2)	–	(0.2)
Total		11.6	0.3	0.1	12.0

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

Notes to the financial statements continued

26. Financial risk management continued

All financial assets and liabilities had a fair value that is identical to book value at 31 March 2017 and 31 March 2016. Detailed analysis is provided in the tables below:

As at 31 March 2017

all figures in £ million	Note	Available-for-sale	Loans and receivables	Financial liabilities at amortised cost	Derivatives used as hedges	Total carrying value	Total fair value
Financial assets							
Non-current							
Derivative financial instruments	24	–	–	–	0.3	0.3	0.3
Other investments	16	0.1	–	–	–	0.1	0.1
Current							
Trade and other receivables	19	–	175.6	–	–	175.6	175.6
Current asset investments	20	1.3	–	–	–	1.3	1.3
Available-for-sale investment	24	10.4	–	–	–	10.4	10.4
Cash and cash equivalents	24	–	211.8	–	–	211.8	211.8
Total financial assets		11.8	387.4	–	0.3	399.5	399.5
Financial liabilities							
Non-current							
Trade and other payables	21	–	–	(12.5)	–	(12.5)	(12.5)
Deferred financing costs	24	–	–	0.2	–	0.2	0.2
Derivative financial instruments	24	–	–	–	(0.3)	(0.3)	(0.3)
Current							
Trade and other payables	21	–	–	(322.1)	–	(322.1)	(322.1)
Derivative financial instruments	24	–	–	–	(0.8)	(0.8)	(0.8)
Deferred financing costs	24	–	–	0.3	–	0.3	0.3
Total financial liabilities		–	–	(334.1)	(1.1)	(335.2)	(335.2)
Total		11.8	387.4	(334.1)	(0.8)	64.3	64.3

As at 31 March 2016

all figures in £ million	Note	Available for sale	Loans and receivables	Financial liabilities at amortised cost	Derivatives used as hedges	Total carrying value	Total fair value
Financial assets							
Non-current							
Derivative financial instruments	24	–	–	–	0.1	0.1	0.1
Other investments	16	0.1	–	–	–	0.1	0.1
Current							
Trade and other receivables	19	–	156.2	–	–	156.2	156.2
Derivative financial instruments	24	–	–	–	0.6	0.6	0.6
Current asset investments	20	1.7	–	–	–	1.7	1.7
Available-for-sale investment	24	9.9	–	–	–	9.9	9.9
Cash and cash equivalents	24	–	263.5	–	–	263.5	263.5
Total financial assets		11.7	419.7	–	0.7	432.1	432.1
Financial liabilities							
Non-current							
Trade and other payables	21	–	–	(11.0)	–	(11.0)	(11.0)
Deferred financing costs	24	–	–	0.5	–	0.5	0.5
Derivative financial instruments	24	–	–	–	(0.2)	(0.2)	(0.2)
Current							
Trade and other payables	21	–	–	(338.7)	–	(338.7)	(338.7)
Derivative financial instruments	24	–	–	–	(0.2)	(0.2)	(0.2)
Deferred financing costs	24	–	–	0.3	–	0.3	0.3
Total financial liabilities		–	–	(348.9)	(0.4)	(349.3)	(349.3)
Total		11.7	419.7	(348.9)	0.3	82.8	82.8

B) Interest rate risk

The Group operates an interest rate policy designed to optimise interest costs and to reduce volatility in reported earnings. The Group's current policy is to require rates to be fixed for 30%–80% of the level of borrowings, which is achieved primarily through fixed-rate borrowings. Where there are significant changes in the level and/or structure of debt, policy permits borrowings to be 100% fixed, with regular Board reviews of the appropriateness of this fixed percentage. At 31 March 2017 and 31 March 2016 the Group had no borrowings.

Financial assets/(liabilities)**As at 31 March 2017**

all figures in £ million	Financial asset		Financial liability	
	Floating	Non-interest bearing	Floating	Non-interest bearing
Sterling	187.1	10.7	–	(1.1)
US dollar	12.7	0.1	–	–
Euro	2.7	–	–	–
Australian dollar	5.1	1.3	–	–
Other	4.2	–	–	–
	211.8	12.1	–	(1.1)

As at 31 March 2016

all figures in £ million	Financial asset		Financial liability	
	Floating	Non-interest bearing	Floating	Non-interest bearing
Sterling	246.6	10.6	–	(0.4)
US dollar	8.9	0.1	–	–
Euro	2.1	–	–	–
Australian dollar	3.6	1.7	–	–
Other	2.3	–	–	–
	263.5	12.4	–	(0.4)

Floating-rate financial assets attract interest based on the relevant national LIBID equivalent. Floating-rate financial liabilities bear interest at the relevant national LIBOR equivalent. Trade and other receivables/payables and deferred finance costs are excluded from this analysis.

Interest rate risk management

The revolving credit facility is floating-rate and undrawn as at 31 March 2017.

C) Currency risk**Transactional currency exposure**

The Group is exposed to foreign currency risks arising from sales or purchases by businesses in currencies other than their functional currency. It is Group policy that when such a sale or purchase is certain, the net foreign exchange exposure is hedged using forward foreign exchange contracts. Hedge accounting documentation and effectiveness testing are undertaken for all the Group's transactional hedge contracts.

The table below shows the Group's currency exposures, being exposures on currency transactions that give rise to net currency gains and losses recognised in the income statement. Such exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating company involved.

Functional currency of the operating company

all figures in £ millions	Net foreign currency monetary assets/(liabilities)				Total
	US\$	Euro	AUS\$	Other	
31 March 2017 – sterling	7.5	2.9	0.1	0.6	11.1
31 March 2016 – sterling	5.8	1.7	0.2	0.6	8.3

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

The Group enters into forward foreign currency contracts to hedge the currency exposures that arise on sales and purchases denominated in foreign currencies, as the transaction occurs. The principal contract amounts of the outstanding forward currency contracts as at 31 March 2017 against sterling are net US dollars bought of £29.1m (US\$37.7m), net Euros bought of £7.1m (€7.4m), net Swiss Francs bought of £24.7m (CHF 30.6m) and net Swedish Krona bought of £10.0m (SEK 113.6m)

Translational currency exposure

The Group has significant investments in overseas operations, particularly in the US. As a result, the sterling value of the Group's balance sheet can be affected by movement in exchange rates. The Group does not hedge against translational currency exposure to overseas net assets.

Notes to the financial statements continued

26. Financial risk management continued

D) Financial credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not currently expect any counterparties to fail to meet their obligations. Credit risk is mitigated by a Board-approved policy of only selecting counterparties with a strong investment grade long-term credit rating for cash deposits. In the normal course of business the Group operates notional cash pooling systems, where a legal right of set-off applies.

The maximum credit-risk exposure in the event of other parties failing to perform their obligations under financial assets, excluding trade and other receivables, totals £223.9m (2016: £275.9m). The Group held cash and cash equivalents of £211.8m at 31 March 2017 (2016: £263.5m), which represents the maximum credit exposure on these assets. The cash and cash equivalents were held with different financial institutions which were rated single A or better, although £122.9m (2016: £145.1m) was invested in AAA-rated money funds at the year end and nil (2016: £40m) was invested in deposits collateralised by security, where the security was UK gilts.

E) Liquidity risk

Borrowing facilities

As at 31 March 2017 the Group had a revolving credit facility (RCF) of US\$100m and £166m (2016: US\$100m and £166m). The RCF is contracted until 2019 and is un-utilised as shown in the table below:

	Interest rate: LIBOR plus	Total £m	Drawn £m	Undrawn £m
Committed facilities 31 March 2017	0.65%	245.7	–	245.7
Freely available cash and cash equivalents				210.3
Available funds 31 March 2017				456.0
Committed facilities 31 March 2016	0.65%	235.6	–	235.6
Freely available cash and cash equivalents				263.4
Available funds 31 March 2016				499.0

Gross contractual cash flows for borrowings and other financial liabilities

The following are the contractual maturities of financial liabilities, including interest payments. The cash flows associated with derivatives that are cash flow hedges are expected to have an impact on profit or loss in the periods shown.

As at 31 March 2017

all figures in £ million	Book value	Contractual cash flows	1 year or less	1–2 years	2–5 years	More than 5 years
Non-derivative financial liabilities						
Trade and other payables	(334.6)	(334.6)	(322.1)	(12.5)	–	–
Recapitalisation fee	0.5	–	–	–	–	–
Derivative financial liabilities						
Forward foreign currency contracts – cash flow hedges	(1.1)	(1.1)	(0.8)	(0.3)	–	–
	(335.2)	(335.7)	(322.9)	(12.8)	–	–

As at 31 March 2016

all figures in £ million	Book value	Contractual cash flows	1 year or less	1–2 years	2–5 years	More than 5 years
Non-derivative financial liabilities						
Trade and other payables	(349.7)	(349.7)	(338.7)	(11.0)	–	–
Recapitalisation fee	0.8	–	–	–	–	–
Derivative financial liabilities						
Forward foreign currency contracts – cash flow hedges	(0.4)	(0.4)	(0.2)	(0.1)	(0.1)	–
	(349.3)	(350.1)	(338.9)	(11.1)	(0.1)	–

F) Derivative financial instruments**As at 31 March**

all figures in £ million	2017			2016		
	Asset gains	Liability losses	Net	Asset gains	Liability losses	Net
Forward foreign currency contracts – cash flow hedges	0.3	(1.1)	(0.8)	0.7	(0.4)	0.3
Derivative assets/(liabilities) at the end of the year	0.3	(1.1)	(0.8)	0.7	(0.4)	0.3

As at 31 March

all figures in £ million	2017			2016		
	Asset gains	Liability losses	Net	Asset gains	Liability losses	Net
Expected to be recognised:						
In one year or less	–	(0.8)	(0.8)	0.6	(0.2)	0.4
Between one and two years	0.1	(0.3)	(0.2)	0.1	(0.1)	–
More than two years	0.2	–	0.2	–	(0.1)	(0.1)
Derivative assets/(liabilities) at the end of the year	0.3	(1.1)	(0.8)	0.7	(0.4)	0.3

G) Maturity of financial liabilities**As at 31 March 2017**

all figures in £ million	Trade and other payables	Bank borrowings and loan notes	Derivative financial instruments	Total
Due in one year or less	322.1	(0.3)	0.8	322.6
Due in more than one year but not more than two years	12.5	(0.2)	0.3	12.6
Due in more than two years but not more than five years	–	–	–	–
	334.6	(0.5)	1.1	335.2

As at 31 March 2016

all figures in £ million	Trade and other payables	Bank borrowings and loan notes	Derivative financial instruments	Total
Due in one year or less	338.7	(0.3)	0.2	338.6
Due in more than one year but not more than two years	11.0	(0.3)	0.1	10.8
Due in more than two years but not more than five years	–	(0.2)	0.1	(0.1)
	349.7	(0.8)	0.4	349.3

H) Sensitivity analysis

The Group's sensitivity to changes in foreign exchange rates and interest rates on financial assets and liabilities as at 31 March 2017 is set out in the following table. The impact of a weakening in sterling on the Group's financial assets and liabilities would be more than offset in equity and income by its impact on the Group's overseas net assets and earnings respectively. Sensitivity on the Group's assets other than financial assets and liabilities is not included in this analysis.

As at 31 March 2017

all figures in £ million	1% decrease in interest rates		10% weakening in sterling	
	Equity ¹	Profit before tax	Equity	Profit before tax
Sterling	–	(1.9)	–	–
US dollar	–	(0.1)	1.4	–
Other	–	(0.1)	1.5	–

all figures in £ million	1% increase in interest rates		10% strengthening in sterling	
	Equity ¹	Profit before tax	Equity	Profit before tax
Sterling	–	1.9	–	–
US dollar	–	0.1	(1.2)	–
Other	–	0.1	(1.2)	–

Notes to the financial statements continued

26. Financial risk management continued

As at 31 March 2016

all figures in £ million	1% decrease in interest rates		10% weakening in sterling	
	Equity ¹	Profit before tax	Equity	Profit before tax
Sterling	–	(2.5)	–	–
US dollar	–	(0.1)	1.0	–
Other	–	(0.1)	1.1	–

all figures in £ million	1% increase in interest rates		10% strengthening in sterling	
	Equity ¹	Profit before tax	Equity	Profit before tax
Sterling	–	2.5	–	–
US dollar	–	0.1	(0.8)	–
Other	–	0.1	(0.9)	–

¹ This relates to the impact on items charged directly to equity and excludes the impact on profit/loss for the year flowing into equity.

The amounts generated from the sensitivity analysis are forward-looking estimates of market risk assuming that certain market conditions occur. Actual results in the future may differ materially from those projected as a result of developments in global financial markets that may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the previous tables, which should not, therefore, be considered to be a projection of likely future events and losses.

The estimated changes for interest rate movements are based on an instantaneous decrease or increase of 1% (100 basis points) in the specific rate of interest applicable to each class of financial instruments from the levels effective at 31 March 2017, with all other variables remaining constant. The estimated changes for foreign exchange rates are based on an instantaneous 10% weakening or strengthening in sterling against all other currencies from the levels applicable at 31 March 2017, with all other variables remaining constant. Such analysis is for illustrative purposes only – in practice market rates rarely change in isolation.

The impact of transactional risk on the Group's monetary assets/liabilities that are not held in the functional currency of the entity holding those assets/liabilities is minimal. A 10% weakening in sterling would also result in a minimal increase in profit before tax.

27. Cash flows from operations

For the year ended 31 March

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

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

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

Underlying cash conversion ratio

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

28. Share capital and other reserves

Shares allotted, called up and fully paid:

	Ordinary shares of 1p each (equity)		Special Share of £1 (non-equity)		Total	
	£	Number	£	Number	£	Number
At 1 April 2015	6,086,100	608,610,004	1	1	6,086,101	608,610,005
Cancelled in the year	(219,288)	(21,928,804)	–	–	(219,288)	(21,928,804)
At 31 March 2016	5,866,812	586,681,200	1	1	5,866,813	586,681,201
Issued in the year	–	–	–	–	–	–
Cancelled in the year	(149,241)	(14,924,079)	–	–	(149,241)	(14,924,079)
At 31 March 2017	5,717,571	571,757,121	1	1	5,717,572	571,757,122

Except as noted below all shares in issue at 31 March 2017 rank pari-passu in all respects.

In May 2014, the Company initiated a £150m capital return to shareholders by way of a share buyback and this programme was complete at 31 March 2016. A further £50m share buyback was announced in November 2015 and was completed at 31 March 2017.

Rights attaching to the Special Share

QinetiQ carries out activities which are important to UK defence and security interests. To protect these interests in the context of the ongoing commercial relationship between the MOD and QinetiQ, and to promote and reinforce the Compliance Principles, the MOD holds a Special Share in QinetiQ. QinetiQ obtained MOD consent to changes in its Special Shareholder rights, which were approved by shareholders at the 2012 AGM. The changes to the Special Share were disclosed in the 2012 Annual Report. Subsequent to the changes approved at the 2012 AGM the Special Share confers certain rights on the holder:

- 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;
- to refer matters to the Board for its consideration in relation to the application of the Compliance Principles;
- to require the Board to obtain Special Shareholder's consent:
 - if at any time when the chairman is not a British Citizen, it is proposed to appoint any person to the office of chief executive, who is not a British Citizen; and
 - if at any time when the chief executive is not a British Citizen, it is proposed to appoint any person to the office of chairman, who is not a British Citizen;
- to require the Board to take action to rectify any omission in the application of the Compliance Principles, if the Special Shareholder is of the opinion that such steps are necessary to protect the defence or security interests of the United Kingdom; and
- to demand a poll at any of QinetiQ's meetings (even though it may have no voting rights except those specifically set out in the Articles).

The Special Shareholder has an option to purchase defined Strategic Assets of the Group in certain circumstances. The Special Shareholder has, inter alia, the right to purchase any Strategic Assets which the Group wishes to sell. Strategic Assets are normally testing and research facilities (see note 31 for further details).

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

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

The Special Share entitles the Special Shareholder to require certain persons who hold (together with any person acting in concert with them) a material interest in QinetiQ to dispose of some or all of their ordinary shares in certain prescribed circumstances on the grounds of national security or conflict of interest.

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

Other reserves

The translation reserve includes the cumulative foreign exchange difference arising on translation since the Group transitioned to IFRS. Movements on hedge instruments, where the hedge is effective, are recorded in the hedge reserve until the hedge ceases.

The capital redemption reserve, which was created following the redemption of preference share capital and the bonus issue of shares, cannot be distributed.

Own shares

Own shares represent shares in the Company that are held by independent trusts and include treasury shares and shares held by the employee share ownership plan. Included in retained earnings at 31 March 2017 are 8,957,048 shares (2016: 4,862,182 shares).

Notes to the financial statements continued

29. Share-based payments

The Group operates a number of share-based payment plans for employees. The total share-based payment expense in the year was £3.3m, of which £3.3m related to equity-settled schemes and nil related to cash-settled schemes (year to 31 March 2016: £4.7m, of which £4.7m related to equity-settled schemes and nil to cash-settled schemes). The share-based payment charged to equity is £2.1m consisting of the £3.3m charge to the income statement and a £1.2m cash payment relating to the Bonus Banking Plan.

Performance Share Plan (PSP)

In the year, the Group made awards of conditional shares to certain UK senior employees under the PSP. The awards vest after three years with 50% of the awards subject to TSR conditions and 50% subject to EPS conditions as detailed in the Report from the Remuneration Committee.

	2017 Number of shares	2016 Number of shares
Outstanding at start of year	8,914,560	9,457,408
Granted during year	3,225,611	3,842,409
Exercised during the year	(50,000)	(2,304,189)
Forfeited/lapsed during year	(3,507,014)	(2,081,068)
Outstanding at end of year	8,583,157	8,914,560

PSP awards are equity-settled awards and those outstanding at 31 March 2017 had an average remaining life of 1.4 years (2016: 1.4 years). There is no exercise price for these PSP awards. Monte Carlo modelling was used to fair value the TSR element of the awards at grant date. Assumptions used in the models included 23% (2016: 22%) for the average share price volatility of the FTSE comparator group and 57% (2016: 53%) for the average correlation to the comparator group. The weighted average fair value of grants made during the year was £1.72 (2016: £1.79). The weighted average share price at date of exercise was £2.68 (2016: £2.51). Of the options outstanding at the end of the year nil were exercisable (2016: nil).

Restricted Stock Units (RSU)

In prior years the Group granted RSU awards to certain senior US employees under the RSU plan. The awards vest over one, two, three and four years. Of the 2014 awards, and the awards granted before 2012, half are dependent on achieving QNA organic profit growth targets and half on a time-based criterion. The time-based criterion requires the employee to have been in continual service up to the date of vesting. QNA organic profit growth is measured over the most recent financial year compared with the previous financial year, with 125% of this element awarded at a QNA organic profit growth rate above 15%, 100% awarded at 12.5%, 75% awarded at 10% and 25% awarded at 5%. The 2012 grants are entirely dependent on achieving QNA organic profit growth targets. 67.5% of the 2013 grants are dependent on achieving QNA organic profit growth targets and 32.5% are dependent on a time-based criterion.

	2017 Number of shares	2016 Number of shares
Outstanding at start of year	24,375	175,187
Exercised during year	(20,625)	(9,375)
Forfeited/lapsed during year	–	(141,437)
Outstanding at end of year	3,750	24,375

RSUs are equity-settled awards; those outstanding at 31 March 2017 had an average remaining life of 0.3 years (2016: 0.4 years). There is no exercise price for these RSU awards. The weighted average share price at date of exercise was £2.27 (2016: £2.35). Of the awards outstanding at the end of the year nil were exercisable (2016: nil).

Group Share Incentive Plan (SIP)

Under the QinetiQ SIP the Group offers UK employees the opportunity of purchasing up to £150 worth of shares a month at the prevailing market rate. The Group will make a matching share award of a third of the employee's payment. The Group's matching shares may be forfeited if the employee ceases to be employed by QinetiQ within three years of the award of the shares. There is no exercise price for these SIP awards.

	2017 Number of matching shares	2016 Number of matching shares
Outstanding at start of year	805,785	647,821
Awarded during year	323,193	322,597
Exercised during year	(248,355)	(123,202)
Forfeited during year	(52,175)	(41,431)
Outstanding at end of year	828,448	805,785

SIP matching shares are equity-settled awards; those outstanding at 31 March 2017 had an average remaining life of 1.5 years (2016: 1.5 years). There is no exercise price for these SIP awards. Of the shares outstanding at the end of the year nil were exercisable (2016: nil).

Group Deferred Annual Bonus Plan (DAB)

Under the QinetiQ DAB Plan the Group requires certain senior executives to defer part of their annual bonus as shares and be entitled to matching awards to a maximum of 1:1 based on EPS performance. The number that will vest is dependent on the growth of EPS over the measurement period of three years as detailed in the Report from the Remuneration Committee.

	2017 Number of matching shares	2016 Number of matching shares
Outstanding at start of year	311,500	464,115
Forfeited during year	(294,247)	(152,615)
Outstanding at end of year	17,253	311,500

DAB matching shares are equity-settled awards; those outstanding at 31 March 2017 had an average remaining life of 0.3 years (2016: 0.7 years). There are no shares granted or expressed in the prior year or current year. There is no exercise price for these DAB awards. Of the shares outstanding at the end of the year nil were exercisable (2016: nil).

Cash Alternative Units (CAUs)

	2017 Number of awards	2016 Number of awards
Outstanding at start of year	35,000	290,022
Awarded during year	–	20,000
Exercised during the year	(35,000)	(135,352)
Forfeited during year	–	(139,670)
Outstanding at end of year	–	35,000

CAUs are cash-settled awards which vest over one, two, three and four years from the date of grant. The CAUs have no performance criteria attached, other than the requirement that the employee remains in employment with the Group. Those awards outstanding at 31 March 2017 had an average remaining life of nil years (2016: 0.5 years). There is no exercise price for these awards. The fair value of the grants made during the prior year was £2.28 being the Group's closing share price on that day. The weighted average share price on the date of exercise was £2.08 (2016: £2.34). The carrying amount of the liability of the grants at the balance sheet date was nil (2016: nil). Of the awards outstanding at the end of the year nil were exercisable.

Bonus Banking Plan (BBP)

During the year, the Group granted BBP awards to certain senior executives in the UK.

	2017 Number of awards	2016 Number of awards
Outstanding at start of year	814,778	330,725
Granted during the year	512,003	493,505
Exercised during the year	(534,818)	(5,711)
Forfeited during year	(5,768)	(3,741)
Outstanding at end of year	786,195	814,778

The BBP is a remuneration scheme that runs for four years with effect from 1 April 2014. Refer to the Directors' Remuneration Report for further details. Under the BBP a contribution will be made by the Company into the participant's plan account at the start of each plan year. 50% of the value of a participant's bonus account will be paid out annually for three years with 100% of the residual value paid out at the end of year four. 50% of the unpaid balance of a participant's bonus account will be at risk of forfeiture.

At 31 March 2017, the awards had an average remaining life of 1.8 years (2016: 2.3 years). There is no exercise price for these awards. The fair value of the awards at 31 March 2017 was £2.80 (2016: £2.34) being the Group's 30 day average share price in the period running up to 31 March. Of the awards outstanding at the end of the year nil were exercisable.

Share-based award pricing – other

Share-based awards that vest based on non-market performance conditions, including certain PSP, RSUs and DAB awards, have been valued at the share price at grant.

Notes to the financial statements continued

30. Post-retirement benefits

Defined contribution plans

In the UK the Group operates two defined contribution plans for the majority of its UK employees: a Group Personal Pension Plan (GPP) and a defined contribution section of the QinetiQ Pension Scheme. These are both defined contribution schemes managed by Zurich. A defined contribution plan is a pension plan under which the Group and employees pay fixed contributions to a third-party financial provider. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Defined benefit pension plans

In the UK the Group operates the QinetiQ Pension Scheme (the 'Scheme') for a significant proportion of its UK employees. The Scheme closed to future accrual on 31 October 2013. After this date, defined benefit members transferred to a defined contribution scheme. The Scheme is a final salary plan, which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on the members' length of service and their final pensionable earnings at closure to future accrual. In the Scheme, pensions in payment are generally updated in line with the Consumer Price Index (CPI). The benefit payments are made from Trustee-administered funds. Plan assets held in trusts are governed by UK regulations as is the nature of the relationship between the Group and the Trustees and their composition. Responsibility for the governance of the Scheme – including investment decisions and contribution schedules – lies jointly with the Company and the Board of Trustees. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the Scheme's regulations.

The asset/liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated bi-annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation. In countries where there is no deep market in such bonds, the market rates on government bonds are used.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

The Group has no further payment obligations once the agreed contributions have been paid. The expected employer cash contribution to the Scheme for the year ending 31 March 2018 is £13.0m.

Triennial funding valuation

The most recent completed full actuarial valuation of the Scheme was undertaken as at 30 June 2014 and resulted in an actuarially assessed surplus of £31.0m. The next triennial valuation will be performed as at 30 June 2017.

The agreed recovery plan requires £13.0m contributions per annum until 31 March 2018, the same annual funding level as previously in place. This includes £2.5m p.a. distributions to the Scheme, indexed by reference to CPI, from the Group's Pension Funding Partnership.

QinetiQ's Pension Funding Partnership structure

Following the 30 June 2011 valuation, a package of pension changes was agreed with the Trustees to provide stability to the Scheme. As part of the package of proposals, on 26 March 2012 QinetiQ established the QinetiQ PFP Limited Partnership (the 'Partnership') with the Scheme. Under this arrangement, properties to the capitalised value of £32.3m were transferred to the Partnership. The transfers were affected through a 20-year sale and leaseback agreement. The Scheme's interest in the Partnership entitles it to an annual distribution of approximately £2.5m for 20 years, indexed with reference to CPI. These contributions replaced part of the regular contributions made under the past deficit recovery payments plan. The Scheme's interest in the Partnership will revert back to QinetiQ Limited in 2032.

The Partnership is controlled by QinetiQ and its results are consolidated by the Group. Under IAS 19, the interest held by the Scheme in the Partnership does not qualify as a plan asset for the purposes of the Group's consolidated financial statements and is, therefore, not included within the fair value of plan assets. As a result, the Group's consolidated financial statements are unchanged by the Partnership. In addition, the value of the property transferred to the Partnership and leased back to QinetiQ remains on the balance sheet. QinetiQ retains the operational flexibility to substitute properties of equivalent value within the Partnership and has the option to settle outstanding amounts due under the interest before 2032 if it so chooses.

Other UK schemes

In the UK the Group has a small number of employees for whom benefits are secured through the Prudential Platinum Scheme. The net pension deficits of this scheme at 31 March 2017 amounted to £nil (2016: £nil). QinetiQ also offers employees access to a Group Self Invested Personal Pension Plan, but no Company contributions are paid to this arrangement.

QinetiQ Pension Scheme net pension asset/(liability)

The fair value of the QinetiQ Pension Scheme assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the Scheme's liabilities, which are derived from cash flow projections over long periods, and thus inherently uncertain, were:

all figures in £ million						
	2017			2016		
	Quoted	Not quoted in an active market	Total	Quoted	Not quoted in an active market	Total
Equities	284.0	71.4	355.4	347.9	66.1	414.0
LDI investment*	968.2	–	968.2	362.8	–	362.8
Corporate bonds	340.6	–	340.6	314.2	–	314.2
Alternative bonds**	132.3	–	132.3	176.6	–	176.6
Property fund	126.7	–	126.7	126.6	–	126.6
Cash and other	3.1	–	3.1	16.2	–	16.2
Total market value of assets	1,854.9	71.4	1,926.3	1,344.3	66.1	1,410.4
Present value of Scheme liabilities			(1,770.3)			(1,448.1)
Net pension asset/(liability) before deferred tax			156.0			(37.7)
Deferred (liability)/asset			(31.4)			1.5
Net pension asset/(liability) after deferred tax			124.6			(36.2)

The Scheme's assets do not include any of the Group's own transferable financial instruments, property occupied by, or other assets used by the Group.

* The Scheme has assets invested in a Liability Driven Investment portfolio. As at 31 March 2017 this hedges against 63% of the interest rate and 100% of the inflation rate risk, as measured on the Trustees' gilt-funding basis. The increase in the year of £605.4m is split between performance of the LDI funds, with valuation gains of £355.2m, and asset reallocations of £250.2m, with £179.8m switched out of equities and £70.4m out of alternative bonds.

**Includes allocations to high-yield bonds, secured loans and emerging market debt.

Per the Scheme rules, the Company has an unconditional right to a refund of any surplus that may arise on cessation of the Scheme in the context of IFRIC14 paragraphs 11(b) and 12 and therefore the full net pension asset can be recognised on the Group's balance sheet and the Group's minimum funding commitments to the Scheme do not give rise to an additional balance sheet liability.

Changes to the fair value of Scheme assets

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

Changes to the present value of the defined benefit obligation

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

Changes to the net pension asset/(liability)

all figures in £ million		
	2017	2016
Opening net pension liability	(37.7)	(39.4)
Net finance cost	(1.0)	(1.1)
Administrative expenses	(1.5)	(1.2)
Net actuarial gain/(loss)	183.3	(10.6)
Contributions by the employer	12.9	14.6
Closing net pension asset/(liability)	156.0	(37.7)

Notes to the financial statements continued

30. Post-retirement benefits continued

Total expense recognised in the income statement

all figures in £ million

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

Assumptions

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

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

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, because of the timescale covered, may not necessarily be borne out in practice. It is important to note that these assumptions are long term and, in the case of the discount rate and the inflation rate, are measured by external market indicators. The mortality assumptions as at 31 March 2017 and 31 March 2016 were 90% of S2PMA for males and 90% of S2PFA for females, based on year of birth making allowance for improvements in mortality in line with CMI_2013 Core Projections and a long-term rate of improvement of 1.5% per annum.

The balance sheet net pension liability is a snapshot view which can be significantly influenced by short-term market factors. The calculation of the surplus or deficit depends, therefore, on factors which are beyond the control of the Group – principally the value at the balance sheet date of equity shares (and other assets) in which the Scheme has invested and long-term interest rates which are used to discount future liabilities. The funding of the Scheme is based on long-term trends and assumptions relating to market growth, as advised by qualified actuaries and investment advisors.

The weighted average duration of the defined benefit obligation is approximately 20 years.

Sensitivity analysis of the principal assumptions used to measure the defined benefit obligation

Assumption	Change in assumption	Indicative impact on Scheme liabilities (before deferred tax)
Discount rate	Increase/decrease by 0.1%	Decrease/increase by £35m
Rate of inflation	Increase/decrease by 0.1%	Increase/decrease by £34m
Life expectancy	Increase by one year	Increase by £46m

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

Risks

Through its defined benefit pension plan, the Group is exposed to a number of risks, the most significant of which are detailed below:

Volatility in market conditions	Results under IAS 19 can change dramatically depending on market conditions. The defined benefit obligation is linked to yields on AA-rated corporate bonds, while many of the assets of the Scheme are invested in other assets. Changing markets in conjunction with discount rate volatility will lead to volatility in the net pension liability on the Group's balance sheet and in other comprehensive income. To a lesser extent this will also lead to volatility in the IAS 19 pension finance expense in the Group's income statement.
Choice of accounting assumptions	The calculation of the defined benefit obligation (DBO) involves projecting future cash flows from the Scheme many years into the future. This means that the assumptions used can have a material impact on the balance sheet position and profit and loss charge. In practice future experience within the Scheme may not be in line with the assumptions adopted. For example, members could live longer than foreseen or inflation could be higher or lower than allowed for in the DBO calculation.

The accounting assumptions noted above are used to calculate the year end net pension asset/liability in accordance with the relevant accounting standard, IAS 19 (revised) 'Employee benefits'. Changes in these assumptions have no impact on the Group's cash payments into the Scheme. The payments into the Scheme are reassessed after every triennial valuation. The next triennial valuation will be performed as at 30 June 2017.

The triennial valuations are calculated on a funding basis and use a different set of assumptions, as agreed with the pension Trustees. Given the current extremely low gilt yields, a funding valuation of the Scheme would probably have resulted in a smaller surplus than the IAS 19 methodology if one had been performed at the year end.

31. Transactions with the MOD

The MOD continues to own its Special Share in QinetiQ which conveys certain rights as set out in note 28. Transactions between the Group and the MOD are disclosed as follows:

Freehold land and buildings and surplus properties

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

Restrictions on transfer of title

The title deeds of those properties with strategic assets (see below) include a clause that prevents their transfer without the approval of the MOD. The MOD also has the right to purchase any strategic assets in certain circumstances.

MOD's generic compliance regime

Adherence to the generic compliance system is monitored by the Risk & CSR Committee. Refer to the Committee's report within the Corporate Governance Statement on page 64.

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 2017 was £6.3m (2016: £7.2m).

Long Term Partnering Agreement

On 27 February 2003 QinetiQ Limited entered into a Long Term Partnering Agreement (LTPA) to provide Test and Evaluation (T&E) facilities and training support services to the MOD. This is a 25-year contract with a total revenue value of up to £5.6bn, dependent on the level of usage by the MOD, under which QinetiQ Limited is committed to providing T&E services with increasing efficiencies through cost saving and innovative service delivery.

Other contracts with MOD

The LTPA is the most significant contract QinetiQ has with the MOD. In total approximately 70% of the Group's revenue comes directly from contracts with the MOD.

32. Contingent liabilities and assets

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

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

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

33. Capital commitments

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

all figures in £ million	2017	2016
Contracted	155.3	35.5

Capital commitments at 31 March 2017 include £155.1m (2016: £30.8m) in relation to property, plant and equipment that will be wholly funded by a third-party customer under long-term contract arrangements. These primarily relate to investments under the LTPA contract.

Notes to the financial statements continued

34. Subsidiaries

The full list of companies which were part of the Group as at 31 March 2017 is detailed below:

Name of company	Country of incorporation	Registered office
Subsidiaries^{1,2,3}		
BJ Trustee Limited	England & Wales	Farnborough ⁵
Boldon James Holdings Limited	England & Wales	Farnborough ⁵
Boldon James Inc	US	Corporation Trust Center, 1209 Orange Street, Wilmington, New Castle, USA
Boldon James Limited	England & Wales	Farnborough ⁵
Cody US Limited	England & Wales	Farnborough ⁵
Commerce Decisions Limited	England & Wales	Farnborough ⁵
Commerce Decisions Pty Ltd	Australia	Level 33, 101 Collins Street, Melbourne, VIC 3000, Australia
CueSim Limited	England & Wales	Farnborough ⁵
Foster-Miller Canada Limited	Canada	318 Roxton Drive, Waterloo, Ontario, N2T 1R6, Canada
Foster-Miller Inc	US	350 2 nd Avenue, Waltham, Massachusetts, MA 02451 1104, USA
Graphics Research Corporation Limited	England & Wales	Farnborough ⁵
Gyldan 1 Limited	England & Wales	Farnborough ^{5,6}
Gyldan 2	England & Wales	Farnborough ^{5,6}
Gyldan 3 Limited	England & Wales	Farnborough ^{5,6}
Gyldan 4 Limited	England & Wales	Farnborough ^{5,6}
Leading Technology Limited	England & Wales	Farnborough ⁵
Metrix UK Limited	England & Wales	Farnborough ⁵
Optasense Canada Limited	Canada	4 Robert Speck Parkway, Suite 1600, Mississauga ON LAZ 1S1, Canada
Optasense Holdings Limited	England & Wales	Farnborough ⁵
Optasense Inc	US	5885 Trinity Parkway, Suite 130, Centreville, Virginia 20120-1969, USA
Optasense Limited	England & Wales	Farnborough ⁵
Precis (2187) Limited	England & Wales	Farnborough ⁵
Precis (2188) Limited	England & Wales	Farnborough ⁵
Q Shelf Limited	England & Wales	Farnborough ⁵
QinetiQ Aerostructures Pty Ltd	Australia	Level 3, 210 Kings Way, South Melbourne, VIC 3205, Australia
QinetiQ Australia Pty Ltd	Australia	Level 3, 210 Kings Way, South Melbourne, VIC 3205, Australia
QinetiQ Canada Operations Limited	Canada	5300 Commerce Court West, 199 Bay Street, Toronto ON T0L 0X0, Canada ⁷
QinetiQ Consulting Pty Ltd	Australia	Unit 5 (Level 1), 8 Brindabella Circuit, Brindabella Business Park, Majura NSW 2609, Australia
QinetiQ Corporate Finance Limited	England & Wales	Farnborough ⁵
QinetiQ Defence Training Limited	England & Wales	Farnborough ⁵
QinetiQ Target Services Limited	England & Wales	Farnborough ⁵
QinetiQ Estates Limited	England & Wales	Farnborough ⁵
QinetiQ GP Limited	Scotland	50 Lothian Road, Festival Square, Edinburgh, EH3 9WJ, Scotland
QinetiQ Group Holdings Limited	England & Wales	Farnborough ⁵
QinetiQ Holdings Limited	England & Wales	Farnborough ⁵
QinetiQ Inc	US	5885 Trinity Parkway, Suite 130, Centreville, Virginia 20120-1969, USA
QinetiQ Insurance PCC Limited	Guernsey	JLT Risk Solutions (Guernsey) Limited, 5St James Street, St Peter Port, GY1 2NZ Guernsey
QinetiQ Investments Limited	England & Wales	Farnborough ⁵
QinetiQ Limited	England & Wales	Farnborough ⁵
QinetiQ Novare Pty Ltd	Australia	Petrie House, level 6, 80 Petrie Terrace, Brisbane QLD 400, Australia
QinetiQ Overseas Holdings (2) Limited	England & Wales	Farnborough ⁵
QinetiQ Overseas Holdings Limited	England & Wales	Farnborough ⁵
QinetiQ Overseas Trading Limited	England & Wales	Farnborough ⁵
QinetiQ Partnership Finance Limited	England & Wales	Farnborough ⁵
QinetiQ Pension Scheme Trustee Limited	England & Wales	Farnborough ⁵
QinetiQ Target Systems Limited	England & Wales	Farnborough ⁵

Name of company	Country of incorporation	Registered office
QinetiQ PFP Limited Partnership	Scotland	50 Lothian Road, Festival Square, Edinburgh, EH3 9WJ, Scotland
QinetiQ Philippines Company, Inc	Philippines	22 nd Floor Corporate Centre, 139 Valeri Street, Salcedo Village, Makati City, Philippines
QinetiQ Pty Ltd	Australia	Level 33, 101 Collins Street, Melbourne, VIC 3000, Australia
QinetiQ Services Holdings Pty Ltd	Australia	Level 33, 101 Collins Street, Melbourne, Victoria 3000, Australia
QinetiQ Space N.V.	Belgium	Hogenakkerhoekstraat, 9, 9150 Kruikebeke, Belgium
QinetiQ Sweden AB	Sweden	Advokatfirmaa Delphi, Box 1432, Stockholm, Sweden
QinetiQ US Holdings, Inc.	US	5885 Trinity Parkway, Suite 130, Centreville, Virginia 20120-1969, USA
Redu Operational Services NV	Belgium	Rue Devant les Hetres, 2B, 689 Transinne, Belgium
Rubikon Group Pty Limited	Australia	Level 33, 101 Collins Street, Melbourne, Victoria 3000, Australia
Sensoptics Limited	England & Wales	Farnborough ⁵
Tarsier Limited	England & Wales	Farnborough ⁵
Trusted Experts Limited	England & Wales	Farnborough ⁵
TSG International LLC	US	350 Second Avenue, Waltham, Massachusetts 02451, USA
QinetiQ Group Canada Inc.	Canada	199 Bay Street, Suite 4000, Commerce Court West, Toronto ON M5L 1A9, Canada ⁷
QinetiQ Holdings Canada Inc.	Canada	199 Bay Street, Suite 4000, Commerce Court West, Toronto ON M5L 1A9, Canada ⁷
QinetiQ Target Systems Canada Inc.	Canada	1 Place Ville Marie, Suite 3000, Montreal Quebec HB3 4N8, Canada ⁷
Associates⁴		
Redu Space Services NV	Belgium	Rue Devant les Hetres, 2B, 689 Transinne, Belgium
Trillium International – I, L.P.	Cayman Islands	179 Sully's Trail, Suite 305, Pittsford, NY, 14534, USA

¹ Accounting reference date is 31 March. All subsidiary undertakings listed above have financial year ends of 31 March except for QinetiQ Target Systems Limited, QinetiQ Target Systems Canada Inc. and QinetiQ Holdings Canada Inc. (31 December) and Rubikon Group Pty Limited (30 June).

² The Group owned 100% of the ordinary shares of the subsidiary undertakings except for Redu Operational Services S.A. (52%).

³ QinetiQ Group Holdings Limited is a direct subsidiary of QinetiQ Group plc. All other subsidiaries are held indirectly by other subsidiaries of QinetiQ Group plc.

⁴ The Group owned 48% of Redu Space Services S.A. and 25% of Trillium International – I, L.P.

⁵ Cody Technology Park, Ively Road, Farnborough, Hampshire, GU14 0LX.

⁶ The four companies were dissolved on 11 April 2017.

⁷ The four Canadian companies were amalgamated on 1 April 2017 to form a new company called QinetiQ Group Canada Inc.

Company balance sheet as at 31 March

all figures in £ million

	Note	2017	2016
Fixed assets			
Investments in subsidiary undertaking	2	466.2	462.9
		466.2	462.9
Current assets			
Debtors	3	190.0	185.0
		190.0	185.0
Current liabilities			
Creditors amounts falling due within one year	4	(380.3)	(291.0)
Net current liabilities		(190.3)	(106.0)
Total assets less current liabilities		275.9	356.9
Net assets		275.9	356.9
Capital and reserves			
Equity share capital	5	5.7	5.9
Capital redemption reserve	5	40.8	40.6
Share premium account	5	147.6	147.6
Profit and loss account	5	81.8	162.8
Capital and reserves attributable to shareholders		275.9	356.9

There are no other recognised gains and losses.

The financial statements of QinetiQ Group plc (company number 4586941) were approved by the Board of Directors and authorised for issue on 25 May 2017 and were signed on its behalf by:

Mark Elliott
Chairman

Steve Wadey
Chief Executive Officer

David Smith
Chief Financial Officer

Company statement of changes in equity

For the year ended 31 March

all figures in £ million	Issued share capital	Capital redemption reserve	Share premium	Profit and loss	Total equity
At 1 April 2016	5.9	40.6	147.6	162.8	356.9
Loss for the year	–	–	–	(1.6)	(1.6)
Purchase of own shares	–	–	–	(0.7)	(0.7)
Purchase and cancellation of shares	(0.2)	0.2	–	(47.4)	(47.4)
Dividend paid	–	–	–	(33.4)	(33.4)
Share-based payments	–	–	–	2.1	2.1
At 31 March 2017	5.7	40.8	147.6	81.8	275.9
At 1 April 2015	6.1	40.4	147.6	140.2	334.3
Profit for the year	–	–	–	97.8	97.8
Purchase of own shares	–	–	–	(0.7)	(0.7)
Purchase and cancellation of shares	(0.2)	0.2	–	(46.9)	(46.9)
Dividend paid	–	–	–	(32.3)	(32.3)
Share-based payments	–	–	–	4.7	4.7
At 31 March 2016	5.9	40.6	147.6	162.8	356.9

The capital redemption reserve is not distributable and was created following redemption of preference share capital.

Notes to the Company financial statements

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable UK Accounting Standards. As permitted by section 408(4) of the Companies Act 2006, a separate profit and loss account dealing with the results of the Company has not been presented.

These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework. In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ('Adopted IFRSs'), but makes amendments where necessary in order to comply with Companies Act 2006 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

- A cash flow statement and related notes;
- Disclosures in respect of transactions with wholly owned subsidiaries;
- Disclosures in respect of capital management;
- The effects of new but not yet effective IFRSs;
- Disclosures in respect of the compensation of key management personnel;
- Disclosures of transactions with a management entity that provides key management personnel services to the company;
- IFRS 2 Share Based Payments in respect of group settled share based payments; and
- Certain disclosures required by IFRS 13 Fair Value Measurement and the disclosures required by IFRS 7.

Investments

In the Company's financial statements, investments in subsidiary undertakings are stated at cost less any impairment in value.

Share-based payments

The fair value of equity-settled awards for share-based payments is determined on grant and expensed straight line over the period from grant to the date of earliest unconditional exercise. The fair value of cash-settled awards for share-based payments is determined at each period end until they are exercised or lapse. The value is expensed straight line over the period from grant to the date of earliest unconditional exercise. The charges for both equity and cash-settled share-based payments are updated annually for non-market-based vesting conditions. Further details of the Group's share-based payment charge are disclosed in note 29 to the Group financial statements. The cost of share-based payments is charged to subsidiary undertakings.

Notes to the Company financial statements continued

2. Investment in subsidiary undertaking

As at 31 March

all figures in £ million	2017	2016
Subsidiary undertaking – 100% of ordinary share capital of QinetiQ Group Holdings Limited	424.3	424.3
Capital contributions arising from share-based payments to employees of subsidiaries	41.9	38.6
	466.2	462.9

The increase in Investments in subsidiary undertakings in FY17 relates to £3.3m of equity-settled schemes during the year.

A list of all subsidiary undertakings of QinetiQ Group plc is disclosed in note 34 to the Group financial statements.

3. Debtors

As at 31 March

all figures in £ million	2017	2016
Amounts owed by Group undertakings	190.0	185.0

4. Creditors

As at 31 March

all figures in £ million	2017	2016
Amounts owed to Group undertakings	380.3	291.0

5. Share capital

The Company's share capital is disclosed in note 28 to the Group financial statements.

6. Share-based payments

The Company's share-based payment arrangements are set out in note 29 to the Group financial statements.

7. Other information

Directors' emoluments, excluding Company pension contributions, were £2.9m (2016: £3.6m). These emoluments were all in relation to services provided on behalf of the QinetiQ Group with no amount specifically relating to their work for the Company. Details of the Directors' emoluments, share schemes and entitlements under money purchase pension schemes are disclosed in the Remuneration Report.

The remuneration of the Company's auditor for the year to 31 March 2017 was £170,000 (2016: £170,000), which was for audit of the Group's annual accounts and audit related assurance services. No other services were provided by the auditor to the Company.

Five-year record

For the years ended 31 March (unaudited)

		2017	2016	2015	2014	2013 ²
EMEA Services (formerly UK Services)	£m	613.5	616.4	625.6	607.0	594.6
Global Products	£m	169.6	139.3	138.2	175.6	269.4
Revenue – continuing operations	£m	783.1	755.7	763.8	782.6	864.0
Discontinued operations (US Services)	£m	–	–	55.7	408.8	463.8
Revenue – total Group	£m	783.1	755.7	819.5	1,191.4	1,327.8
EMEA Services (formerly UK Services)	£m	92.7	93.8	93.0	86.7	84.8
Global Products	£m	23.6	15.1	18.3	27.0	60.2
Underlying operating profit¹ – continuing operations	£m	116.3	108.9	111.3	113.7	145.0
Discontinued operations (US Services)	£m	–	–	1.2	19.0	23.7
Underlying operating profit¹ – total Group	£m	116.3	108.9	112.5	132.7	168.7
Profit/(loss) before tax	£m	131.5	97.7	92.9	4.1	(137.0)
Profit/(loss) attributable to equity shareholders	£m	123.3	106.1	104.7	(12.7)	(133.2)
Underlying basic EPS ¹	Pence	18.1	16.3	15.3	16.0	18.9
Basic EPS	Pence	21.5	18.1	16.6	(1.9)	(20.5)
Diluted EPS	Pence	21.3	18.0	16.5	(1.9)	(20.5)
Dividend per share	Pence	6.0	5.7	5.4	4.6	3.8
Underlying net cash from operations (post-capex) ¹	£m	79.0	103.6	116.7	136.5	175.9
Net cash	£m	221.9	274.5	195.5	170.5	74.0
Average number of employees		6,114	6,266	6,454	9,134	9,772
Continuing operations³						
Orders excluding LTPA amendment	£m	675.3	659.8	613.6	596.9	626.1
Underlying operating margin ¹	%	14.9	14.4	14.6	14.5	16.8
Underlying profit before tax ¹	£m	116.1	108.7	107.8	101.2	128.4
Profit before tax	£m	131.5	90.2	105.4	84.0	103.7
Profit after tax	£m	123.3	98.6	117.4	68.0	89.9
Underlying basic EPS ¹	Pence	18.1	16.3	15.2	13.8	16.6
Basic EPS	Pence	21.5	16.8	18.6	10.4	13.9
Underlying net cash from operations (post-capex) ¹	£m	79.0	103.6	114.9	106.2	137.7

¹ Underlying measures are stated before specific adjusting items. Definitions of underlying measures of performance are in the glossary on page 151. Underlying financial measures are presented because the Board believes these provide a better representation of the Group's long-term performance trend. For details of specific adjusting items refer to Note 4 of the financial statements.

² The 2013 figures have been restated to reflect the reclassification of product sales from UK Services to Global Products and the reclassification of Cyveillance® from US Services to EMEA Services.

³ Continuing operations excludes the financial results of the US Services business disposed in 2015.

A European Space Agency image of a Galileo Full Operational Capability satellite. QinetiQ's next generation of satellite navigation receivers will use signals from Galileo, and other satellite navigation systems including GPS, to ensure users have unprecedented levels of availability, accuracy and assurance of positioning, navigation and timing.





Additional information

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Additional financial information

“

As a UK-listed company, the Group is required to adopt EU endorsed IFRSs and comply with the Companies Act 2006

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Foreign exchange

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

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

	12 months to 31 March 2017	12 months to 31 March 2016
£/US\$ – opening	1.44	1.49
£/US\$ – average	1.30	1.50
£/US\$ – closing	1.25	1.44
£/A\$ – opening	1.87	1.95
£/A\$ – average	1.74	2.05
£/A\$ – closing	1.64	1.87

Treasury policy

The Group treasury department works within a framework of policies and procedures approved by the Audit Committee. As part of these policies and procedures, there is strict control on the use of financial instruments. Speculative trading in financial instruments is not permitted. The policies are established to manage and control risk in the treasury environment and to align the treasury goals, objectives and philosophy of the Group.

Tax risk management

QinetiQ's tax strategy is to ensure compliance with all relevant tax legislation, wherever we do business, whilst managing our effective tax rates and tax cash flows. Tax is managed in alignment with our corporate responsibility strategy in that we strive to be responsible in all our business dealings. These principles are applied in a consistent and transparent manner in pursuing the tax strategy and in all dealings with tax authorities around the world.

- Tax planning – QinetiQ manages both effective tax rate (ETR) and cash tax impacts in line with the Board-endorsed tax strategy. External advice and consultation are sought on potential changes in tax legislation in the UK, the US and elsewhere as necessary, enabling the Group to plan for and mitigate potential changes. QinetiQ does not make use of 'off-shore' entities or tax structures to focus taxable profits in jurisdictions that legislate for low tax rates.

- Relationships with tax authorities – QinetiQ is committed to building constructive working relationships with tax authorities based on a policy of full disclosure in order to remove uncertainty in its business transactions and allow the authorities to review possible risks. In the UK, QinetiQ seeks to be open and transparent in its engagement with the tax authorities by sharing with HMRC the methodologies adopted in its tax returns.
- Transfer pricing – The Group does not have a significant level of cross-border activity but, where it does have such transactions controls are in place to ensure pricing reflects 'arm's length' principles in compliance with the OECD Transfer Pricing Guidelines and the laws of the relevant jurisdictions. The Group does not, therefore, have a significant exposure to transfer pricing legislation.
- Governance – The Board has approved this approach. The Audit Committee oversees the tax affairs and risks through periodic reviews. The governance framework is used to manage tax risks, establish controls and monitor their effectiveness. The Head of Tax is responsible for ensuring that appropriate policies, processes and systems are in place and that the tax team has the required skills and support to implement this approach.

QinetiQ's corporate tax contribution – QinetiQ is liable to pay tax in the countries in which it operates, principally the UK, the US, Australia, Canada and Belgium. Changes in tax legislation in these countries could have an adverse impact on the level of tax paid on profits generated by the Group. A significant majority of the Group's profit before tax is generated in the UK. This reflects the fact that the majority of the Group's business is undertaken, and employees are based, in the UK. Total corporation tax payments in the year to 31 March 2017 were £3.0m. The differential between the taxation expense and the tax paid in the year relates primarily to the timing of the recovery of research and development expenditure credits for which the cash is recovered in the year following the year of account. There is also an impact of deferred tax movements, whereby the income statement bears a charge (e.g. in respect of accelerated capital allowances) but for which there is no corporation tax paid in the year. Together, these result in the cash paid being £5.2m less than the total expense charged to the income statement.

Accounting standards

As a UK-listed company, the Group is required to adopt EU endorsed IFRSs and comply with the Companies Act 2006. The effect of changes to financial reporting standards in the year is disclosed in note 1 to the financial statements.

Glossary

AGM	Annual General Meeting	FCA	Financial Conduct Authority	NCSISS	Naval Combat System Integration Support Services
CAGR	Compound Annual Growth Rate	FMI	Foster-Miller, Inc. – the legal entity through which the US Products division operates	OHSAS	Occupational Health and Safety Advisory Services
C4ISR	Command, control, communications, computers, intelligence, surveillance and reconnaissance	Funded backlog	The expected future value of revenue from contractually committed and funded customer orders (excluding the £998m third-term re-pricing of the LTPA contract)	PDR	Performance development review
COTS	Commercial off the shelf			PBT	Profit before tax
CPI	Consumer Price Index			PSP	Performance Share Plan
CR	Corporate Responsibility			QLZ	QinetiQ Learning Zone
CRC	Carbon Reduction Commitment	GHG	Greenhouse gas	QNA	QinetiQ North America
CSR	Corporate Social Responsibility	IAS	International Accounting Standards	QSOS	QinetiQ Share Option Scheme
DAB	Deferred Annual Bonus	IFRS	International Financial Reporting Standards	R&D	Research and development
DE&S	MOD's Defence, Equipment and Support organisation	IRAD	Internal research and development	SEMAP	Systems Engineering Master Apprenticeship Programme
DHS	US Department of Homeland Security	KPI	Key Performance Indicator	SDSR	Strategic Defence and Security Review
DSP	Deferred Share Plan	LDP	Leadership development programme	SPA	Special protection area
DoD	US Department of Defense	LIBID	London inter-bank bid rate	SSRO	Single Source Regulations Office
EBITDA	Earnings before interest, tax, depreciation and amortisation	LIBOR	London inter-bank offered rate	SSSI	Site of Special Scientific Interest
ED&I	Equality, diversity and inclusion	LTI	Lost time incident	STEM	Science, Technology, Engineering and Maths
EEG	Employee Engagement Group	LTPA	Long Term Partnering Agreement – 25-year contract established in 2003 to manage the MOD's test and evaluation ranges	T&E	Test and Evaluation
EMEA	Europe, Middle East and Australasia	MDP	Management development programme	TSR	Total shareholder return
EPS	Earnings per share	MOD	UK Ministry of Defence	UAV	Unmanned aerial vehicle
ESA	European Space Agency	MSCA	Maritime Strategic Capability Agreement	UK Corporate Governance Code	Guidelines of the Financial Reporting Council to address the principal aspects of corporate governance in the UK
ESOS	Energy Savings Opportunity Scheme			UK GAAP	UK Generally Accepted Accounting Practice
EST	Engineering, Science and Technical				
FAR	Federal Acquisition Regulations				

Alternative performance measures (APMs)

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

Measure	Explanation	Note reference to calculation or reconciliation to statutory measure
Organic revenue growth	The level of year-on-year growth, expressed as a percentage, calculated at constant prior year foreign exchange rates, adjusting for business acquisitions and disposals to reflect equivalent composition of the Group	Note 3
Underlying operating profit	Operating profit as adjusted to exclude 'specific adjusting items' (see below)	Note 3
Underlying operating margin	Underlying operating profit expressed as a percentage of revenue	N/A
Underlying net finance costs	Net finance costs excluding net pension finance costs	Note 6
Underlying profit after tax	Profit after tax as adjusted to exclude 'specific adjusting items'	Note 4
Underlying effective tax rate	The tax charge for the year excluding the tax impact of 'specific adjusting items' expressed as a percentage of underlying profit before tax	Note 8
Underlying EPS	Basic earnings per share as adjusted to exclude 'specific adjusting items'	Note 12
Orders or order intake	The level of new orders (and amendments to existing orders) booked in the year.	N/A
Backlog, funded backlog or order book	The expected future value of revenue from contractually committed and funded customer orders	N/A
Book to bill ratio	Ratio of funded orders received in the year to revenue for the year, adjusted to exclude revenue from the 25-year LTPA contract	N/A
Net cash flow from operations (post-capex) or underlying operating cash flow	Net cash flow from operations before cash flows of specific adjusting items less cash outflow on purchase of intangible assets and plant and equipment, plus proceeds from sale of plant and equipment	Note 27
Underlying operating cash conversion	The ratio of underlying net cash from operations (post-capex) to underlying operating profit	Note 27
Specific adjusting items	Amortisation of intangible assets arising from acquisitions; impairment of goodwill and intangible assets; gains/losses on business divestments and disposal of property and investments; net pension finance expense; transaction costs in respect of business acquisitions; tax impact of the preceding items; and significant non-recurring deferred tax movements	Note 4

Shareholder information

Registrar:

Equiniti Limited
www.shareview.co.uk
Tel: 0371 384 2021

Shareholding enquiries

The Company's registrar is Equiniti. Enquiries regarding your shareholding, including the following administrative matters, should be addressed to Equiniti:

- Change of personal details such as change of name or address.
- Lost share certificates.
- Dividend payment enquiries.
- Direct dividend payments. You can have your dividends paid directly into a UK bank or building society account by completing a dividend mandate form. The associated dividend confirmation will still be sent to your registered address. If you live outside the UK, Equiniti offers a global payments service which is available in certain countries and could enable you to receive your dividends direct into your bank account in your local currency.

Contact details for registrar

By post:
Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

By telephone:

0371 384 2021* for UK calls
+44 (0)121 415 7576 for calls from outside the UK.

* Lines are open 8.30am to 5.30pm (UK time), Monday to Friday (excluding public holidays in England and Wales).

By email:

You can send an email enquiry securely from Equiniti's website, at <https://help.shareview.co.uk>.

Online:

Equiniti's website at <https://help.shareview.co.uk> (Shareview) includes answers to frequently asked questions and provides key forms for download. Shareview also offers online access to your shareholding where you can manage your account, register for electronic communications, see details of balance movements and complete certain amendments online, such as changes to dividend mandate instructions. You can register at www.shareview.co.uk, click on 'Register' and follow the steps.

Electronic communications

The company offers shareholders the option to receive documentation and communications electronically, via the Company's website. The wider use of electronic communications enables fast receipt of documents, reduces the Company's printing, paper and postal costs and reduces the Company's environmental impact. Shareholders can register for electronic communications at www.shareview.co.uk and may also cast their vote for the 2017 Annual General Meeting online quickly and easily using the Sharevote service by visiting www.sharevote.co.uk.

Dividend tax changes

In 2016 the dividend tax credit was replaced by an annual tax-free dividend allowance of £5,000. UK residents pay tax on dividends received over that amount at specified rates. Dividends paid on shares held within pensions and Individual Savings Accounts continue to be tax-free. Further information is available from HMRC at www.gov.uk/government/publications/dividend-allowance-factsheet.

Donating shares to charity – ShareGift

Small parcels of shares, which may be uneconomic to sell on their own, can be donated to ShareGift, the share donation charity (registered charity no. 1052686). ShareGift transfers these holdings into their name, aggregates them, and uses the proceeds to support a wide range of UK charities based on donor suggestion. If you would like further details about ShareGift, please visit www.sharegift.org, email help@sharegift.org or telephone them on 020 7930 3737.

Share price

Details of current and historical share prices can be found on the Company's website at www.QinetiQ.com/investors. The graph below shows the share price trend (in pence) during the year ended 31 March 2017:



The share prices used in the graph above are the mid-market prices as derived from the London Stock Exchange Daily Official List.

Analysis of Share Register at 31 March 2017

By type of holder	Number of holdings	% of total holdings	Shares held	% of share capital
Individuals	5,689	88.35%	5,676,431	0.99%
Institutions and others	750	11.65%	566,080,690	99.01%
Total	6,439	100.00%	571,757,121	100.00%
By size of holding				
1–500	4,247	65.96%	843,108	0.15%
501–1,000	551	8.56%	444,235	0.08%
1,001–5,000	995	15.45%	2,394,654	0.42%
5,001–10,000	170	2.64%	1,250,528	0.22%
10,001–100,000	227	3.52%	7,814,233	1.37%
Over 100,000	249	3.87%	559,010,363	97.77%
Total	6,439	100.00%	571,757,121	100.00%

Share fraud reporting:

www.fca.org.uk/scams

FCA Consumer**Helpline:**

0800 111 6768

Beware of share fraud

Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment. While high profits are promised, if you buy or sell shares in this way you will probably lose your money.

How to avoid share fraud

1. Keep in mind that firms authorised by the FCA are unlikely to contact you out of the blue with an offer to buy or sell shares.
2. Do not get into a conversation, note the name of the person and firm contacting you and then end the call.
3. Check the Financial Services Register from www.fca.org.uk to see if the person and firm contacting you is authorised by the FCA.
4. Beware of fraudsters claiming to be from an authorised firm, copying its website or giving you false contact details.
5. Use the firm's contact details listed on the Register if you want to call it back.
6. Call the FCA on 0800 111 6768 if the firm does not have contact details on the Register or you are told they are out of date.
7. Search the list of unauthorised firms to avoid at www.fca.org.uk/scams.
8. Consider that if you buy or sell shares from an unauthorised firm you will not have access to the Financial Ombudsman Service or Financial Services Compensation Scheme.
9. Think about getting independent financial and professional advice before you hand over any money.
10. Remember: if it sounds too good to be true, it probably is!

Report a scam

- If you are approached by fraudsters please tell the FCA using the share fraud reporting form at www.fca.org.uk/scams, where you can find out more about investment scams.
- You can also call the FCA Consumer Helpline on 0800 111 6768.
- If you have already paid money to share fraudsters you should contact Action Fraud on 0300 123 2040.

Key dates

19 July 2017	Trading update
19 July 2017	Annual General Meeting
3 August 2017	Ordinary shares marked ex-dividend
4 August 2017	Final 2017 dividend record date
1 September 2017	Final 2017 dividend payment date
30 September 2017	Half-year financial period end
16 November 2017	Half-year results announcement
February 2018	Trading update (provisional date)
31 March 2018	Financial year end
May 2018	Preliminary results announcement (provisional date)

Cautionary statement

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

This Annual Report is intended to provide information to shareholders and is not designed to be relied upon by any other party. The company and its Directors accept no liability to any other person other than under English law.

Company information**Registered office**

Cody Technology Park
Ively Road
Farnborough
Hampshire
GU14 0LX
Tel: +44 (0) 1252 392000
Company Registration
Number: 4586941

Auditor

KPMG LLP
Chartered Accountants
15 Canada Square
London
E14 5GL

Registrar

Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

Advisors**Corporate brokers**

J.P.Morgan
25 Bank Street
London
E14 5JP

Bank of America Merrill Lynch
2 King Edward Street
London
EC1A 1HQ

Principal legal advisor

Ashurst LLP
Broadwalk House
5 Appold Street
London
EC2A 2HA

Registered office

Cody Technology Park
Ively Road, Farnborough
Hampshire GU14 0LX
United Kingdom

Tel: +44 (0) 1252 392000
www.QinetiQ.com

Company Registration
Number
4586941
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